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Develop Business/Financial Planning

Last-Chance 2008 Tax Moves

By John P. Napolitano
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You might be amazed at your clients' eligibility for certain tax credits and deductions. Don't assume anything until you've talked to clients about the AMT, energy tax credits, retirement plan contributions, tax-loss harvesting, section 179 deductions, cost segregation studies, and even first-time home buyers' credits. But act quickly. Time is running out.

Clients who are upset and confused about recent market volatility may be wondering if you are the right person to help them navigate these difficult times. Add value by alerting them to a couple of tax-planning techniques that could make a difference in their tax bill. You'll demonstrate to them that your relationship is about more than just their portfolio's performance. Here are a few suggestions worth mentioning.

Alternative minimum tax

The alternative minimum tax, or AMT, can be the biggest surprise for many tax filers. It has way overstayed its welcome since its 1969 passage, and it has never been properly indexed for inflation like other tax provisions. Don't be lured by the [AMT limit adjustments](#) in the 2008 acts; they merely prevent the already-affected four million taxpayers from swelling to upwards of 25 million in 2008.

For AMT sufferers, this year's advice is the same as last year's. Do not accelerate the payment of itemized deduction items like property taxes and mortgage interest, and be very careful with the exercise of incentive stock options. Expect more changes to the AMT in 2009. Recent changes are merely a one-year patch to prevent an additional 21 million middle-class taxpayers from being subjected to this arcane provision.

Energy tax credits

Many energy tax credits were to end with the 2007 tax-filing year. Some have now been extended, and others are not available again until 2009. Your job is to alert clients about the broad categories of purchases that they can make in the energy-efficient area to generate tax credits, and to provide advice on the timing of when that purchase needs to take place to qualify for the credits.

The Solar Energy Credit allows individual taxpayers a credit up to \$2,000 for the installation of solar panels, solar water-heating equipment, or a fuel-cell power plant to their homes in the United States. Taxpayers are allowed one credit equal to 30% of the qualified investment in a solar panel up to a maximum credit of \$2,000, and another equivalent credit for investing in a solar water-heating system. No part of either system can be used to heat a pool or hot tub. The \$2,000 limit is lifted starting in 2009 and replaced by an unlimited credit.

Expenditures on energy-efficient home improvements such as furnaces and boilers, windows, insulation and sealing, or central air conditioning and heat pumps also qualify for credits against the tax for 2006, 2007, and 2009. In total, any of these expenditures will give you only up to a \$500 tax

credit, but nothing for 2008.

Qualified hybrid vehicles

Purchasers of qualified hybrid vehicles are also eligible for a tax credit as high as \$3,400. The IRS publishes a [list of pre-qualified vehicles](#). This credit is available only for the original purchasers of the hybrid vehicle. Used hybrid vehicles will not qualify.

I've heard all of the economic arguments about the cost-benefit analysis of hybrid vehicles, but that may not matter if your client feels strongly enough about energy conservation and wants to own this type of vehicle. Don't be a numbers nerd and vote against your client's decision without factoring in his or her strong desire to be energy efficient.

Retirement plan contributions

Take a proactive approach and examine your clients' retirement plans to see if an upgrade to a self-employed 401(k) plan, pension, or profit-sharing plan makes sense. The primary benefit: greater deductions.

If your client has a second income from consulting, director's fees, or whatever else, it may give rise to a Schedule C income filing. Consider setting up a [second plan](#) for that business. Most clients do not realize that they can set up a separate plan for their other income and shelter much or all of it with a new retirement plan. Keep in mind that some plans must be set up before the end of the calendar year. Some, such as the self-employed 401(k)-type plans, will allow setup as late as the due date of the tax return.

Is there an uncompensated spouse or any other family member working for the family business or second business? Be a hero by suggesting that the spouse or children actually get paid for that service, and then defer up to 100% of that income in a qualified retirement plan for that business. In fact, if you have someone in the family who could perform valuable services for your business, and defer up to 100% of those part-time earnings, why not get them to work and on the payroll so you can reap similar benefits?

Tax-loss harvesting

Unless your crystal ball works better than most planners, your clients are now sitting on a substantial amount of unrealized losses. Combine this with the mutual fund industry's warnings of a large distribution season, and your clients may get belted with the least expected and most unwanted of tax issues: paying taxes on [fund distributions](#) from mutual funds whose NAVs have been clobbered.

You should consider turning those unrealized losses into realized losses and [selling some of those losing positions](#) today. Of course, with the \$3,000 limit on capital losses currently in effect, there will not be great income tax reductions for your clients in 2008 unless you also harvest gains that can be used to eat up those losses. This is a great time to clean up low-basis holdings that are disproportionately present in client portfolios and to get the account in the desired balance or allocation that you have advocated. The worst case is that you have created a loss carryforward to be used in future tax years. This loss is carried forward indefinitely until it is eventually offset with future gains.

To avoid the [wash-sale rule](#), which would disallow the loss on the sale of that position, be sure not to repurchase the same security for 31 days. If you are an asset allocator, you know that you may have some exposure to sitting in cash for the 31 days, and you probably want to be fully invested in your

allocations anyway. To maintain the integrity of your allocations, you can purchase a substantially similar security immediately. That could mean selling the XYZ resources fund and purchasing the ABC resources fund or an exchange-traded fund in the resource space.

Also be very careful about any fund purchases for the rest of the year. You don't want to buy today and have your client get a 1099 for a distribution tomorrow.

First-time home buyer tax credit

While it is possible that your clients may not be first-time home buyers, it's important to remember that the criteria for a "first-time home buyer" is anyone who has not owned a primary residence for three years ending with the date of the new "first-time" home purchase. Did the client sell a home and begin renting three years ago until he or she could decide exactly where to settle? There are more people than you think in this category today.

This provision also creates a wonderful opportunity for clients who want to help their children take advantage of low prices to purchase their first home. In fact, one of the few advantages to the real estate meltdown is that college grads with good incomes and a solid down payment can purchase their first home sooner than expected and at rock-bottom prices.

This credit is subject to an AGI phaseout of between \$75,000 to \$95,000 for single or married-filing-separately taxpayers and \$150,000 to \$170,000 for married taxpayers filing a joint return. The credit is for up to 10% of the purchase price of the new home, with a maximum of \$7,500 for joint filers and \$3,750 for singles or married people filing separately. This credit applies for homes acquired between April 9, 2008 and July 1, 2009.

Unlike most credits, this one is really a 15-year interest-free loan, because the taxpayer will have to pay back the credit—without interest—over a 15-year period. Also unlike any other tax credit, this credit is allowable and will come to all first-time home buyers in this period, whether or not they actually paid tax in the given tax year. In fact, they could buy their home in April 2009 and amend their 2008 return and get the credit immediately.

For business taxpayers

"Business clients" can mean the owner of a \$50 million company or anyone who generates [side income](#) from a business activity. Business clients have lots of additional tax-planning strategies available to them.

My personal favorite is the Section 179 deduction. This is the code section that allows business taxpayers to write off the cost of property placed in service instead of depreciating it over a much longer period of time. Current law allows for the immediate write-off of up to \$250,000 in qualified tangible personal property. (Don't get bogged down by the use of the word "personal." That's a tax term that means something other than "real" property such as land and buildings.) Examples of tangible personal property include computers, machines, equipment, and furniture. Software does not count, and neither does real estate or any of the structural components within.

The 179 deduction includes business automobiles and other vehicles, but be aware that the luxury auto limits will prevent clients from deducting 100% of the purchase price. The property must also be used at least 50% of the time for business purposes, with the burden of proof placed on the taxpayer.

To qualify for the 2008 tax year, the property must have been placed in service by Dec. 31, 2008. That doesn't mean that it has to be paid for by then; it must simply arrive and be set up and used. So

if clients with schedule C income used a credit card or line of credit to acquire that new computer or other equipment for their business, they can take the deduction as long as the equipment was in place and being used by the end of the tax year in question.

A word of warning here: using the 179 deduction will drastically reduce the client's depreciation deduction in future years, so be careful using it if you believe that your client's income or tax bracket will be much higher in 2009. On the other hand, taxpayers can now go back and amend prior year tax returns from 2003 forward to change in either direction the use of their 179 deduction.

Bonus depreciation is another provision that allows taxpayers a 50% depreciation deduction for property placed in service by the end of the year. Depending on the client's situation, this may be helpful in 2008 or more valuable in future tax years. What is significant is that this bonus deduction of 50% is automatic, and clients must specifically opt out of using it to preserve larger depreciation deductions for later years.

Cost segregation studies

Cost segregation is something for purchasers of business real estate. In general, business real estate is depreciated over a 39-year useful life. While bricks and mortar may last that long, it is unlikely that the fixtures or ceiling panels will last that long. A cost segregation analysis is a study by engineers or other qualified professionals to estimate the amount of the purchase price for items in the building that can be depreciated over a much shorter time span than 39 years, therefore providing significantly larger depreciation deductions now.

Most forward-looking accountants are aware of this for their clients, but many are not. For your client who recently purchased a property, or who is about to close on a new building for his or her business, this could be huge. In most cases, the cost of the study is dwarfed by the tax savings offered with accelerated depreciation.

Of course, as with anything involved in taxes, consult your client's CPA or tax advisor before deciding on a course of action.

John P. Napolitano CFP, CPA, PFS, MST, RLP, a long-time financial advisor and CPA, is CEO of U.S. Wealth Management, parent of an independent broker/dealer and support network for RIAs. He is the author of The Complete Idiots Guide to Success as a Personal Financial Planner. Get free practice management ideas via Johns blog and/or newsletter by visiting www.theparagonadvisor.com.

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