# 2008 Year-end Tax Strategies – a legislative checklist

Getting a handle on 2008 year-end tax planning is especially challenging this year because of several areas of uncertainty.

Are traditional income/deduction timing techniques dwarfed by the current economic turmoil that dictates its own timetable? Will 2008 be the last year in which many existing tax breaks will be available, given any new administration's historic tendency to enact big tax bills during its first year in office? Will "must-pass" legislation pending actually pass and extend a handful of important tax breaks, including an Alternative Minimum Tax patch? Is another economic stimulus package waiting, or should 2008-only benefits be grabbed before they expire?

Are there new tax breaks starting in 2009 that are worth waiting for?

**PROVISIONS ENDING IN 2008**

Several enhanced tax breaks, designed to jump-start economic recovery in 2008, have a shelf life that is about expire. Using them before January. 1, 2009, is a decision that should be made soon. These expiring tax breaks include:

- **50-percent bonus depreciation.** Made available by the Economic Stimulus Act, qualification for bonus depreciation is based on property that is originally used, purchased and placed in service after March 31, 2008, and before January. 1, 2009 (Jan.1, 1010, for certain longer-lived and transportation property). "Placed in service" requires delivery and installation so that the equipment is operational. Businesses with customized equipment on order should be aware of this dual requirement.
- **Enhanced expensing.** Enhanced expensing, also made available by the Economic Stimulus Act, allows businesses to expense $250,000 of Code Sec. 179 property, reduced

by the value of the property over $800,000. But it is only available for 2008; with 2009 levels set to drop to $133,000 (together with the $530,000 phase-out limit).

Businesses not on a calendar year, however, should note that the higher expensing limits apply to tax years beginning in 2008. Their higher expensing under the new law does not start until their new fiscal tax year starts. For example, a small business on a June 1 – May 31 year would be limited for purchases for the year ending May 31, 2008, to a $125,000 deduction and a $500,000 threshold. The new $250,000/$800,000 amounts would kick in starting June 1, 2008, and continue through May 31, 2009.

- **Homesale exclusion for converted property.** The housing Act's new income exclusion for the $250,000 ($500,000) homesale exclusion for the non-qualified-use period of a property converted from a second home to a principal residence applies to conversions taking place after Dec. 31, 2008. This provision makes 2008 the last year for vacation-property conversions that avoid the new rule entirely.
- **Limited $500 property tax deduction for non-itemizer.** Made available in the Housing Act, this above-the-line deduction is for 2008 only. It expires for individual homeowners on Dec. 31, 2008.

**NEW PROVISIONS**

Certain tax provisions appear for the first time in 2008 and now need to be incorporated for the first time into year-end planning decisions. They include:

- **Discharge of principal residence mortgage debt.** The Mortgage Forgiveness Debt Relief Act of 2007 excludes from taxation under Section 108 discharges of up to $2 million of indebtedness that is secured by a principal residence and is incurred in the acquisition, construction or substantial improvement of the principal residence. While this special relief is available for three years beginning Jan. 1, 2007, and ending Dec. 31, 2009, its basic-reduction provision works on a calendar-year basis. Taxpayers who exclude indebtedness income under Section 108 are required to reduce the basis of their principal residence by the amount excluded from gross income. Unlike basis reductions required under Code Sec. 1017 for other Section 108 exclusions, the reduction for the principal residence exclusion is immediate, rather than postponed until the next tax year.

- **First-time homebuyer credit.** The housing Act gives first-time homebuyers nationwide a temporary refundable tax credit equal to 10 percent of the purchase price of a home, up to $7,500 ($3,750 for married individuals filing separately). The credit begins to phase out for taxpayers with adjusted gross income in excess of $75,000 ($150,000 in the case of a joint return). While new, it does not carry a year-end deadline. The credit is effective for home purchased on or after April 9, 2008, and before July 1, 2009.
- **Biofuel and racehorses.** Finally, some miscellaneous provisions kick in for 2009. A new nonrefundable credit applies to cellulosic biofuel produced after December. 31, 2012. And a uniform depreciation period of three years for all racehorses regardless of age generally applies to property placed in service after December. 31, 2008, and before Jan. 1, 2014.

**'EXTENDER'**

Unless Congress extends them, a long list of popular tax credits and deductions have already expired at the end of 2007. They include:

- The AMT "patch;"

- The state and local sales tax deduction;
- Energy tax incentives;
- The tuition and fees deduction;
- The educator deduction;
- The residential energy credit; and,
- The incremental research credit.

While an AMT patch for 2008 appears to be truly "must-pass" legislation, taxpayers and their advisors at press time should proceed at their own risk on assuming whether Congress will find the political stamina to beat the clock and pass an extenders measure before 2009. Meanwhile, an AMT patch has already been agreed upon in the Senate.

**TEMPORARY PROVISIONS**

Some practitioners predict only half-jokingly that soon the number of temporary provisions in the Internal Revenue Code will outnumber the permanent ones. While not scheduled to end in 2009, a large portion of these temporary provisions will do so in 2010 and, therefore, deserve some year-end attention now.

When the Bush tax cuts were first enacted in 2001, they seemed permanent, with their 10-year lifespan. Now, however, planning for the sunsetting of those tax cuts after 2010 principally, in connection with the lower income tax rates, capital gain rates, and the estate tax begins to fall into the category of short-term strategies.

The makeup of the next administration and Congress will have a lot to do with the outcome. Barack Obama is looking to tax high-income taxpayers to pay more of the tax burdens. With Obama having been elected, he will probably move quickly to propose tax legislation with the real possibility that the Bush tax cuts will end in 2009, rather than 2010.

## INFLATION ADJUSTMENTS

Some amounts that affect year-end planning are rising with inflation in 2009. The annual gift exclusion increases from $12,000 in 2008 to $13,000 in 2009 per donee (double those amounts if the donor splits the gift with a spouse for an amount of $26,000). Year-end gift-giving strategies should be adjusted accordingly for this increase.

While 2009 will be the first year that the annual individual retirement account contribution ceiling will be adjusted for inflation, the rounding convention for that adjustment leaves the ceiling amount at $5,000. Contributions continue to be allowed up until the normal filing date of a return when clearly designated as applying to the earlier year.

Long-term capital losses can be used to fully offset long-term capital gains. Losses taken in excess of gains can also be used to offset up to $3,000 in ordinary income (or $1,500 for a married couple filing separately). This $3,000 amount, unfortunately, is not adjusted for inflation. Excess losses, of course, may be carried forward.

## CONCLUSION

We do not pretend to be able to solve many of the uncertainties surrounding this year's year-end tax planning. If a lame-duck Congress is needed to consider an AMT patch and other possible extenders, we may not know until December how to react.

Our new president, too, likely won't begin to discuss tax plans until at least early December, making 2009 planning difficult, with longer-term planning requiring the knowledge to be gained from several months into 2009 before being effective.

Remaining nimble enough to react at the last possible moment this year may be the best advice we can give at this time.