TaxTips
Keeping you informed...
Summer 2008

Take Advantage of Tax Savings in a Down Market

Know when you have a deductible loss

Just because the stock market lost money, doesn't mean you have a deductible loss. As long as you hold on to an investment, you only have a loss on paper. It's only when you actually sell the investment that you have a transaction to report on your tax return.

Fortunately, the tax law allows you to offset your capital gains by your capital losses. You can avoid or minimize taxable gain by selling two investments, one at a gain and the other at a loss.

However, an investment sold at a loss is not gone forever. If you believe it was a good long-term investment, you can buy it back. This strategy works very well if the price of the investment either stays the same or goes down even further. For example, let's say you sold 100 shares of ACME stock, which you purchased for $3,000, and receive $2,500 in cash proceeds from the sale. You can use the $500 capital loss to offset capital gains or other income. Now, let's assume you want to buy back the ACME stock because it's a good long-term investment. If the price of 100 shares of ACME is $2,500 or less, you can use the proceeds from the first sale to buy the stock back without having to provide any additional money. Caution: You must wait at least 31 days after the sale to repurchase the stock, otherwise the loss is not allowed.

If you are an IRA owner over age 59½, you can take advantage of the down market by taking distributions (either voluntary or required) of actual investments from your IRA, instead of the cash. You'll also escape the additional ten-percent premature distribution penalty. If there are investments within your IRA account that you want to hold long-term, but the value is currently down, you may want to consider having them distributed to you. Be aware that this is a taxable event and the fair market value of the investment must be reported on your tax return. However, any appreciation earned after the distribution will not be taxable until you sell the investment. This provides several advantages:

- If you sell the investment, it will be taxed at the lower capital gains rate, which may be less than the rate for your IRA distribution;
- It reduces your IRA account so your required minimum distributions may be smaller in future years; and
- You can gift that investment to a person or a charity at a later date.

As always, consult your investment and tax advisor prior to taking any actions.

Refinancing Your Home Mortgage

What's deductible and what's not?

While there are benefits to refinancing your home mortgage, most refinancing costs are not deductible on your tax return. There is one exception, however. The amount you pay for points, or prepaid interest, may be amortized over the life of your new loan. Although this might not amount to much when you spread it out over 15, 20, or 30 years, don't file away your closing papers quite yet.

When the note is paid off, you may deduct the remaining interest attributed to the points you paid the first time you refinanced. However, according to the IRS, refinancing must be done at a different lender. In addition, the closing costs may reduce the taxable gain when you sell your home.

Do You Have Debt Forgiveness?

You may not have to include it in income

When you are liable for a loan but can't repay it, some lenders will forgive the debt. What many borrowers don't realize is that this cancellation of debt results in taxable income in the year of forgiveness. The lender usually will issue a Form 1099-C to report the cancelled debt. If you receive one, don't ignore it. Be sure to give it to your tax preparer and discuss the circumstances surrounding the loan.

If you have cancelled debt but are bankrupt or insolvent, you may exclude the income on your tax return. To prove insolvency, your liabilities must exceed the fair market value of your assets immediately before the debt discharge. The amount of forgiven debt that can be excluded cannot be more than the amount your liabilities exceed the value of your assets.

In light of the current mortgage crisis, Congress has provided more relief for borrowers who couldn't pay their mortgages. If you have forgiveness of debt on the mortgage of your qualified principal residence (usually due to foreclosure), you don't have to recognize cancelled debt. The maximum amount of debt forgiveness eligible for exclusion is $2 million. This relief is available for tax years 2007 through 2009.

Summer Day Care

What expenses qualify for the childcare credit?

Parents who have children under the age of 13 are allowed a tax credit for childcare expenses paid so they can work. In the summer, many parents send their children to a structured day camp or an overnight camp for a week or two at a time. In most cases, the cost of sending your child to a camp of this nature does not qualify as a childcare expense, even if one of the reasons for sending the child is for care. In order for the cost of a day camp to qualify for a tax credit, the organization that conducts the camp must adhere to the same rules as a dependent care center.

If you need childcare in the summer months and hire someone to come and watch your children in your home, the amount you pay for care qualifies for the credit. However, if you wish to take the credit, you must get the caregiver's social security number and address. Plus, you must issue that person a W-2 if you pay him or her more than $1,600.

Interest on Summer Recreation May Be Deductible

Your motor home or boat could yield a deduction

If you own a boat or motor home that is fully equipped with kitchen and sanitary facilities and you use it as a "second" home, the interest you pay on it is probably deductible on your tax return. Although a fishing boat without facilities won't qualify, most motor homes and campers do. If you're looking to buy a boat that doesn't qualify as a second home, you may want to consider paying for it with a home equity loan. That way, the interest is generally deductible. As with most tax rules, there are exceptions and limits so check with a tax expert before you sign on the dotted line.

Converting a Traditional IRA to a Roth?

You may want to wait

At some point, taxpayers who have a traditional IRA may wish to convert it to a Roth. Roth IRAs are more flexible in that there are no required minimum distributions when the owner reaches age 70½. In addition, qualified distributions from a Roth IRA are not taxable.

Under current tax law, in the year you convert a traditional IRA to a Roth IRA, you must recognize the amount converted as income on your tax return, with the exception of any basis that may be in the traditional IRA. Depending on the amount, this can significantly impact your tax return. It can even bump you up into a higher tax bracket!

New legislation may make it worthwhile to hold off converting your IRA. For conversions made in 2010 only, the income from these conversions will only be includible in income ratably over the two-year period beginning in 2011. For example, let's say you convert a traditional IRA worth $40,000 to a Roth during 2010. You won't need to report the conversion on your 2010 return, unless you elect to. Your 2011 and 2012 returns will each include $20,000 of income from the conversion.

Generally, if your income is more than $100,000, you currently are not eligible to make a conversion. However, beginning in 2010, this restriction will be eliminated and you'll be able to make conversions regardless of your income or filing status.

QUIK TIPS

1 Beginning January 1, 2008, the standard mileage rates for the use of a car (including vans, pickups, or panel trucks) are:

- 50.5 cents per mile for business miles driven;
- 19 cents per mile for all miles driven for medical or moving purposes; and
- 14 cents per mile for all miles driven for charitable purposes.

2 If your tax refund was too high or too low, adjust your withholding so it doesn't happen again next year. You can file a revised Form W-4 with your employer at any time to increase or decrease the number of exemptions you claim. The more exemptions you claim, the less tax your employer withholds from your wages, resulting in a smaller refund. Decreasing the number of exemptions results in more withholding and a larger refund.

3 It doesn't appear that a college education will get cheaper any time soon. Look into establishing a qualified tuition plan for your children. The earnings in the account grow tax-free. As long as the funds are spent on qualified education expenses, there are no tax consequences. Plus, there may be an added tax benefit at your state level.

4 Are you planning on making any substantial gifts? Talk to your tax preparer first. Gifts with values exceeding $12,000 must be reported to the IRS.

5 Not only will you save money at the pump if you buy a hybrid vehicle, you may be eligible for a credit on your income tax return.

6 If your child has earned income from a summer job, you may want to consider opening an IRA for him or her. There is no minimum age for contributing to an IRA. The only requirement is that the person making the contribution has earned income and has not reached age 70½.

Charitable Remainder Trusts

Reduce your estate by gifting property

There are many ways to contribute to a charitable organization. You can write a check, donate property, or give of your time. If you're planning for retirement, you might want to consider making a gift of a future interest in your property by establishing a charitable remainder unitrust or annuity trust. These trusts allow you to contribute the property and retain an income stream. You have an income interest in the property while the charity receives the actual property at some future date. At the time you contribute the property to the charitable remainder trust, you'll receive a charitable contribution deduction. This is a win-win situation for all. The charity can continue its work and you receive income and a charitable deduction while reducing your taxable estate.

HSA Funding Options

For a limited time only, there are more options

Health Savings Accounts (HSAs) are a great tax vehicle for making the most of your medical expenses. However, it's not always easy to come up with the money to fund an HSA. Well, now there are more options available to HSA owners. At any time before 2012, you can make a one-time only tax-free rollover from an IRA to an HSA. This rollover amount may not be more than your HSA maximum contribution for your type of coverage, whether individual or family. The transfer must be made via a direct trustee-to-trustee rollover. Because the rollover is tax-free, you won't receive a deduction for funding the HSA in this manner. Also, if you have a flex spending account (FSA) or a health reimbursement arrangement (HRA), you can make a one-time rollover into an HSA from one of these accounts. This tax-free rollover may not exceed the lesser of the balance in such an account on September 21, 2006, or on the date of the rollover distribution. Like the IRA rollover option, this rollover must also be completed via a trustee-to-trustee transfer. Talk to your tax preparer in deciding if one of these options is right for you.

Is an Inheritance Taxable?

In most cases, an inheritance is not taxable to you, but there are exceptions

At some point, you may inherit money or property that, in most cases, is not taxable to you. Life insurance proceeds are included in the deceased person's estate, but are not taxable to the beneficiaries. Bank accounts and other income-producing assets such as stocks are not taxable to you when received, but the income these assets generate is taxable to you. If you are not sure if something was included in the decedent's taxable income, you should check with the administrator or attorney handling the estate to advise you what portion of the income earned on these assets should be included on your personal return. You may get a Schedule K-1 for items that are allocated to you from the estate. Be sure to inform your tax preparer of any income you receive from an inheritance because, although in most cases there is no income tax liability, there are some exceptions. If you inherit a pension or IRA, you must pay tax on the amounts you receive just as the decedent would have been required to do during his life. Only the spouse of a decedent can roll over these types of funds tax free into a plan in her name and treat it as her own. If you inherit a pension plan or IRA, contact your tax professional as soon as possible to discuss your options regarding the withdrawal of the money. Savings bonds can also be treated in several different ways, so be sure to provide any information from the estate to your tax preparer.

Have you ever heard of the term "stepped-up basis"? This means that your investment in inherited property is considered to be the value as of the date of death. When you sell property that you inherit, you only pay tax on the difference between the amount you sold it for and the value of the property as of the date of death (or six months thereafter, as determined by the administrator of the estate). There can also be a loss if you sell the property for less than this date-of-death value. Your tax professional will need to know the date-of-death value to determine the gain or loss. The administrator or the attorney should be able to provide you with the value of the property so that you can correctly report the sale.