VESTPOINTEWEALTH MANAGEMENT

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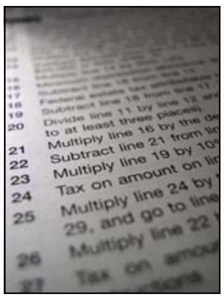
The Importance Of Year-Round Tax Planning

Chances are, you prefer to think about taxes as little as possible. But just avoiding the subject won't keep the Internal Revenue Service at bay. And paying attention long before tax season gives you time to implement strategies that could save you money. "You can't plan backwards," says Victoria Serles, partner and director of the Private Client Wealth Management Practice with the Seattle office of BDO Seidman, a national accounting firm. "But people who consider their taxes months ahead of time tend to be very satisfied with the results."



You could put these strategies into effect at any time (and sooner is almost always better than later):

Profit from tax losses. Call this the silver lining of a dark cloud. With markets struggling recently, you may be sitting on investment losses. But there could also be unrealized gains in your long-term holdings, and if you had planned to sell appreciated assets—but feared the tax bite—now could be the time to act.

You can offset gains with losses dollar for dollar. So a $50,000 loss will totally negate a $50,000 gain. If you sell a stock or fund at a loss, the loss is disallowed for tax purposes if you buy the same investment again 30 days before or after the date of sale; this "wash sale rule" is meant to discourage people from selling shares for tax purposes and then immediately repurchasing them.

However, you can jump right back into a similar investment—a stock in the same industry or another fund that tracks the same index, for example. If you sell, as a loss, a mutual fund of one investment objective, you could purchase a different fund with the same objective—therefore harvesting the tax loss without changing your overall allocation.

If your losses exceed your gains, you can use up to $3,000 in losses to offset ordinary income each year, and you can save leftover losses for future years.

Maximize retirement savings. In 2007 and 2008, annual contribution ceilings for retirement plans edged up to a maximum of $15,500 in pre-tax dollars going into a 401(k) and $5,000 for an individual retirement account. Catch-up contributions for savers 50 or older extend those limits by $5,000 a year for 401(k)s and $1,000 for IRAs. Any deductible contributions you divert into these accounts come off the top of your income, immediately reducing your taxes. So if you're saving less than the maximum, consider boosting your contributions now to spread the increase over the rest of the tax year. Wait until year-end and "you might not have the cash flow available to maximize that opportunity," says Serles.

Minimize the alternative minimum tax. The alternative minimum tax, or AMT, was originally designed to ensure that the very wealthy couldn't avoid taxes entirely by taking advantage of abundant tax

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It's Wise To Review Your Beneficiary Designations

You've probably had to name beneficiaries for several different kinds of assets. Your retirement plan at work, one or more life insurance policies, taxable investment accounts—in every case, you have been asked to designate the people you'd like to inherit that property. That may mean your spouse, your children, or another relative or friend, or you could select a charity or trust. But whatever your choices, it's important to review them periodically and make sure they're up to date, keeping accurate records including the date you named the beneficiaries.

In many cases, beneficiary designations trump what you've directed in your will. If you get married or divorced, you'll probably remember to change your will to reflect your new circumstances. But unless you also get the spouse's name on or off your 401(k), life insurance, and other financial accounts and instruments, there could be confusion when you die, and an ex-beneficiary might end up with some of your assets.

Because most workers today change employers and retirement plans more frequently than in the past, it's especially important to understand your present benefit policies and update your beneficiary designations. Also, realize that if someone other than your spouse inherits substantial assets, there could be tax implications.

Our annual review of your finances is a great time to check on all of your beneficiary designations. Please give us a call to set up an appointment.

Self-Employed Get Deductions For Long-Term Care

If you're self-employed, the good news is you can deduct some or even all of what you spend for long-term care (LTC) insurance. But complex rules make this a potential mine field.

Normally, qualified medical expenses—including premiums paid for regular health insurance and LTC coverage—are deductible only to the extent that they exceed 7.5% of your annual adjusted gross income (AGI). For example, if your AGI this year is $150,000 and your family incurs $12,000 in unreimbursed medical expenses, your deduction is limited to $12,000 – 0.075 ($150,000), or $750.

If you're self-employed, however, the situation improves. Thanks to recent tax law changes, you can deduct 100% of your qualified health insurance expenses, including premiums for long-term care insurance, on page 1 of Form 1040. The 7.5%-of-AGI floor doesn't apply. What's more, you can also deduct what you spend to cover your spouse and any dependents.

To qualify for this tax break, your business must establish the LTC insurance plan, and you can't deduct more than your earned income from the business. Moreover, you can't take a deduction for any month during which you're eligible to participate in a subsidized health plan maintained by your business or your spouse's employer. So if you can obtain LTC coverage through your spouse's job this year but choose to buy it through your business, you're out of luck on the tax deduction, though you might be able to claim a partial deduction if the spouse's job situation changes.

Even if you qualify for a deduction for LTC premiums, the IRS imposes limits on how much you can deduct. The ceiling varies according to the age of the person who's insured. (See "Your LTC Tax Break" for the latest figures, which are adjusted annually for inflation.)

To see how this might play out, suppose that you're self-employed and pay $3,000 in LTC premiums in 2008 to cover yourself and $2,000 for your spouse. You're age 55 and your spouse is 49 years old. The IRS stipulates that the most you can deduct this year is $1,110, and the maximum for your spouse is $580. Assuming your spouse can't get long-term care insurance at work, you're entitled to deduct total business expenses of $1,690. That partially offsets your out-of-pocket cost of $5,000.

Keep in mind that the cost of LTC premiums may vary widely, depending on the terms of the policy, your age, your health status, and other factors. It pays to shop carefully to get the coverage you need at the best price. And remember to keep detailed records to back up your deduction in case of an IRS challenge. ●

Your LTC Tax Break

Here's the maximum tax deduction for long-term care insurance premiums in 2008

Age on December 31, 2008	Deduction Limit
Age 40 or younger	$ 310
Age 41 through 50	$ 580
Age 51 through 60	$ 1,110
Age 61 through 70	$ 3,080
Age 71 or older	$ 3,850

Limits Of Family Limited Partnerships

In recent years family limited partnerships (FLPs) have become an increasingly popular way to give assets to children. You can discount the value of assets you transfer to an FLP by 20%, 30% or even 50%. The less a gift is worth in the eyes of the IRS, the more you can pass along with little or no tax liability. Thus, you can transfer an interest in a business, real estate, securities, or other holdings to your children and pay lower gift and estate taxes.

One of the key attractions to FLPs has been the ability to give away discounted interests in your assets while continuing to manage them. Now, however, a U.S. Tax Court decision has called into question the ability of those who establish FLPs to retain management control

Typically, parents establish an FLP to hold a particular asset. They serve as general partners and manage the FLP, while the children are limited partners. Because the children couldn't easily sell their interests in this private vehicle managed by their parents, the IRS considers interests in an FLP to be worth less than the actual market value of assets it holds. So, for example, a gift of a 99% limited partnership interest in an FLP owning property worth $1.5 million might be valued at just $1 million for tax purposes.

For wealthy families with many children and grandchildren, an FLP can be a good way to move assets out of parents' estates. Because anyone can make annual tax-free gifts of up to $12,000 to an unlimited number of recipients, parents can slowly transfer assets to their family's younger generations without paying gift tax. An FLP can also be an effective way to transfer real estate incrementally without having to file a new deed every year.

The Tax Court decision in May

New Economic Stimulus Law: A Break For Businesses

No one's complaining about the much-hyped tax rebates the IRS sent out this year. But the real boost in the Economic Stimulus Act of 2008 is for businesses, not individuals. Companies get double-barreled tax relief for buying equipment and other assets in 2008.

If you were a single filer on your 2007 federal income tax return (and you meet income requirements), you should have already received a one-time tax rebate this year of $600. A couple filing jointly received $1,200. In addition, families received rebates of $300 for each child under age 17, with no limit on the number of qualifying children.

But not everyone was eligible to receive these checks. The rebates began to be phased out for individuals whose adjusted gross income (AGI) exceeds $75,000 and couples who earn more than $150,000. Above those levels, you forfeit 5 cents for every dollar of income. So if you're single with no children, the rebate phases out completely at $87,000 of AGI (5 cents x 12,000 = $600). A married couple with two kids and a combined AGI of $175,000 receives $550 (5 cents x 25,000 = $1,250; $1,800 - $1,250 = $550). There are also $300 rebates for taxpayers who have no tax liability but earned at least $3,000 last year.

Though much less ballyhooed than the rebates for individuals, two key business tax breaks were also included in the stimulus legislation. Like the rebates, the business provisions are temporary, but for business owners who qualify, the deductions can be much larger.

The first business provision involves Section 179 deductions. Normally, equipment and other business purchases must be "depreciated" over several years, with a portion of the cost deducted each year. Under Section 179 of the Internal Revenue Code, however, you can treat the purchase of qualified assets as a business expense, deducting, up to a specified limit, the cost during the year the assets are placed in service. Before the new legislation, the ceiling for 2008 was $128,000. And if the value of new business assets exceeded $510,000 in 2008, your deduction would have been reduced by $1 for each additional dollar of equipment put into service.

The economic stimulus law has made the Section 179 rules much more generous, almost doubling the maximum deduction, just for 2008, to $250,000. The law also hiked the threshold for reducing deductions to $800,000. So, this year, if your company buys $850,000 of qualified assets, your maximum Section 179 deduction is $200,000 ($250,000 minus the $50,000 by which the purchases exceeded $800,000). Unless Congress acts to extend this tax break, it will expire after this year, and Section 179 deductions will again be governed by the old rules.

The second business break involves bonus depreciation. Like the Section 179 changes, this also speeds up the timetable for deducting business equipment expenses. For qualified assets placed in service in 2008, you can write off 50% of the cost. Keep in mind, though, that this bonus depreciation deduction is available only for purchasing new qualified assets in 2008. It doesn't apply to used equipment.

For the purposes of this rule, "qualified assets" include the following:

- Property with a cost recovery period of 20 years or less
- Depreciable software that is not amortizable over 15 years
- Certain leasehold improvements (for example, tenant upgrades in a commercial building)
- Water utility property

One great thing about bonus depreciation is that you can claim it in conjunction with the enhanced Section 179 deduction and regular depreciation deductions under the Modified Accelerated Cost Recovery System (MACRS). IRS rules call for computing deductions in this order: 1) Section 179 2) bonus depreciation 3) MACRS.

Suppose your business buys a new computer system in 2008 for $300,000. First, you can write off $250,000 under Section 179. Second, the 50% bonus depreciation deduction takes care of half of the remaining $50,000, or $25,000. Third, you can take a first-year MACRS deduction equal to 20% of the $25,000 balance. That's another $5,000, giving you a total write-off of $280,000.

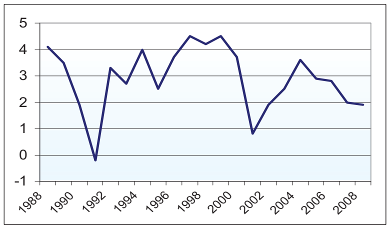
Other special rules, including limits on deductions for "luxury cars" used in your business, and the overall nature of most depreciation deductions as tax referral rather than elimination, may affect the size and benefit of your tax break. We can work with you to make sure your business takes full advantage of these temporary tax breaks. But remember, they are temporary, and go off the books after 2008. So you'll need to act quickly to reap the rewards. ●

2003 invalidated an FLP established by Albert Strangi. The problem, the court ruled, was that Strangi, through his attorney, still had use of the assets he was transferring, and as general partner retained the right to determine who could enjoy them. The court threw the full, undiscounted value of property contributed to the FLP back into Strangi's estate for tax purposes.

Subsequently, the decision against Strangi was affirmed by the Fifth Circuit Court.

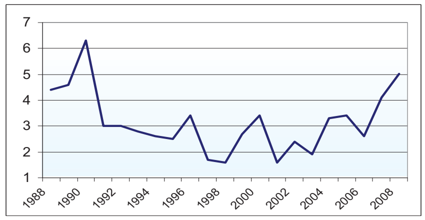
Despite this turn of events, FLPs are still very much alive, although some concessions may have to be made. For instance, parents transferring assets to children may have to give up management control of the FLP, say estate tax attorneys. One way to do that could be to name your spouse as general partner, says Gideon Rothschild, chairman of the American Bar Association International Estate Planning Committee. But you, and not your spouse, would have to transfer the assets, Rothschild says. Another approach would be to name a trust with an independent trustee as GP. Rothschild says that another recent court case confirmed the validity of FLPs when the transferring party didn't retain an interest in the assets. He maintains the Strangi case doesn't negate the benefits of FLPs; it just requires more careful crafting and a rethinking of the management structure. ●

Economy Watch: 2nd Quarter 2008



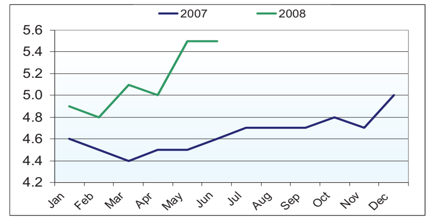
U.S. Economic Growth

Despite support from exports and stimulus checks, gross domestic product (GDP) only grew at a relatively anemic annualized rate of 1.9% in 2Q08, leaving economists debating whether recession or recovery was at hand.



Inflation

While the economy drifted, inflation surged. Retail prices were up 5.0% on an annualized basis by the end of 2Q08, and once again soaring energy costs were the prime culprit, followed by transportation and food.

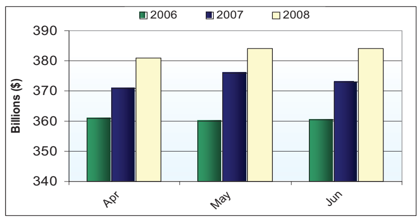


Jobs

Another 165,000 U.S. jobs disappeared over the quarter, driving the unemployment rate up to 5.5%. Construction, manufacturing, retail, and employment services were among the industries reporting the deepest layoffs.

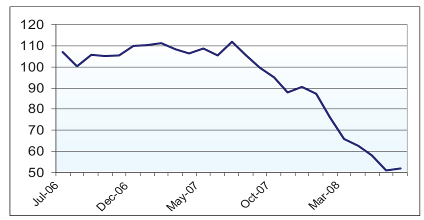
Manufacturing Growth

Rising costs and a cloudy economic outlook kept factory owners in wait-and-see mode. As a result, the pace of manufacturing activity continued to drift along almost unchanged from month to month throughout 2Q08.



Consumer Spending

Economic stimulus checks encouraged U.S. consumers to keep shopping in 2Q08, but the high price of gas meant that about 12% of all consumer dollars were spent at filling stations. Spending elsewhere was flat.



Consumer Confidence

Long-simmering worries about the job market, housing, and inflation kept the American public on the defensive and left expectations about the economy at their lowest level in history.

Data for the CPI, Unemployment Rate and Non-farm Payrolls are from the Bureau of Labor Statistics. Data for the GDP are from the Bureau of Economic Analysis. The Purchasing Managers Diffusion Index is a release of the Institute of Supply Management. Retail spending data are from the Bureau of the Census. Data for Consumer Confidence comes from the Conference Board.

Year-Round Tax Planning

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loopholes. These days, though, almost anyone can get snared by the AMT. For non-business owners, several things can trigger AMT liability: claiming personal exemptions, paying state and local taxes, taking miscellaneous itemized deductions, deducting medical expenses, or exercising incentive stock options. Any combination of these could push you into AMT territory.

Sitting down early with your tax professional to run an AMT projection could help you see whether you'll pay the AMT this year. It could also give you a chance to head off some of your liability. "If you are going to fall into the AMT area, you want to be thinking about the possibility of timing some of your deductions," Serles says.

For example, if it looks like you'll have to pay the AMT this year, but not next year, you might push some of your state and local tax deductions into next year, when you'll be able to use them to full effect. Or you could think about delaying the exercise of your incentive stock options until later, or bunching charitable deductions in years that you won't have to pay AMT and will receive the full benefit of the deduction.

Manage your business taxes. If you're self-employed or receive income from a side business, mid-year is a good time to make sure you're on track with your estimated taxes. Check with your tax specialist to see whether you're sending the government the correct amount each quarter. The longer you wait, the shorter the time you'll have to pay what you owe, and if you end up underpaying estimated taxes, you could be hit with a penalty. To reduce business taxes, you might consider employing your children. "That provides a deduction to you, and their income is taxed in a lower bracket," say Serles. Or you could increase the tax-deductible benefits you provide to your employees or yourself. Acting well before the end of the year will let you maximize the amount you deduct.

Other tax planning strategies include Roth IRA conversions and the use of charitable trusts. However, many of these strategies are complicated, so you should seek the guidance of your financial advisor and tax professional.●

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