# Limiting the Damage

## Steps Taken Now Can Lighten Your Tax Burden Later

By BRUCE M. FOGEL, Esq.

While year-end tax planning is always and in all ways important, it is especially crucial in 2008. The time is now to apply new tax rules to secure your best tax advantages for this year and beyond.

This is a very challenging time for individuals and businesses, a climate that demands that each of us takes a look at year-end tax planning, regardless of the level of our income, with an eye toward reducing our tax burden down the road. One or more of the following unprecedented events likely had an impact on you during 2008 and potentially for a number of years going forward: the stock-market collapse, the credit crisis, the recession, the bursting of the real-estate bubble, and/or the rise and fall of energy prices.

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What follows is a primer that will identify some of the ways in which you can take the lemons that may have been hurled at you and turn as many of them as possible into lemonade.

### Income and Deductions Shifting

Usually the most efficient planning opportunities will grow out of the time-tested strategy of maneuvering your income and/or expenses between tax years. The two primary benefits that grow out of the opportunities for doing this are the ability to control the tax rate at which you will be assessed and the ability to control *when* those taxes will be paid.

If you are in a position to control the timing and flow of income into your possession, it presents an opportunity for you to contemplate whether you are going to be in a higher marginal income tax bracket in the current tax year or the one to come. When you compare these tax brackets, you will then have the opportunity to determine in which year that income might generate the lower tax.

The corollary to the moving of income is the timing of the payment of your deductible expenses. Combining the two presents an opportunity to generate a larger tax benefit by making those swings of taxable dollars more substantial. For example, if you are able to put off $10,000 of income into the next tax year and can accelerate $5,000 of deductible expenses into the current tax year, you will effect a $15,000 swing in your reportable income, impacting your applicable tax bracket and potentially postponing the due date for those taxes by up to 15 months.

This particular strategy can be even more valuable in light of changes in the tax laws that have been made and those that experts anticipate coming down the pike. The importance of contemplating this strategy is significant for the tax years 2008 through 2010, inclusive, when you consider that those taxpayers who are in — or can put themselves in — the 10% or 15% tax brackets will potentially be able to take advantage of the 0% tax rate currently applicable to qualified dividend income and/or capital gains during those years.

A more challenging situation presents itself to those whose income is above the $200,000 to $250,000 threshold identified by President-elect Obama. Although it remains unclear when the tax increase on those taxpayers will actually go into effect, the question here, for those who can anticipate remaining at those income levels during the next few years, is whether to accelerate income into 2008 in order to potentially have it taxed at the lower brackets. This same group of taxpayers should also contemplate this issue while bearing in mind the president-elect's proposal to restore the limitations on the amount that can be claimed for either personal exemptions and/or itemized deductions.

### Bunching Deductions

The next concept impacted by the timing of payments is for those that qualify as itemized deductions, and is generally referred to as 'bunching.' The strategy of bunching deductions involves consideration of the timing of your various expenditures and/or deductions, including real-estate and excise taxes, state income taxes, charitable contributions, certain interest payments, medical expenses, and the like. The underlying concept of this strategy is that your itemized deductions are typically compared against a standard deduction that varies depending on your marital status and your age.

In some instances your itemized deductions may only be exceeding the otherwise available standard deduction by a small amount. In this case, a beneficial strategy might be to postpone some of those deductions until the next tax year and accelerate similar expenses from the following year. This will bunch all of your deductions into the middle of three years and create an amount that will substantially exceed the otherwise available standard deduction, potentially giving you better tax results over all three years.

This calculation needs to be considered in the context of the new tax provision enacted as part of the Housing Assistance Tax Act of 2008, which allows homeowners to claim an additional standard deduction for real property tax if the taxpayer does not itemize. The additional amount is limited to $500, or $1,000 for joint filers.

This bunching strategy also has applications in the context of higher earners who will have a reduction in their otherwise-available itemized deductions simply by virtue of their income level. Specific examples of this application include the fact that medical expenses are deductible only to the extent that they exceed 7.5% of one's adjusted gross income; and miscellaneous itemized deductions, including the fee that you pay to your tax professional, employee business expenses, and the like, are subject to a 2% threshold.

It is possible that some taxpayers will find that they are able to benefit from higher amounts of itemized deductions by applying this strategy of bunching.

### Loss Harvesting

Historically, the end of the year has been the time to take a look at your investments and see where you stand relative to capital gains realized during the course of the year. It was always prudent to look at your portfolio to determine which positions you held that might generate a loss, so that you could either match your gains to your losses and/or exceed your gains by an amount of up to $3,000. That is the amount that would be available as a deduction on your income-tax return to offset other ordinary income.

While there are sound tax reasons for considering this strategy, it is also important to remember that you need to consider the underlying investment wisdom and considerations associated with your having purchased the investment in the first place.

However, beyond that historical strategy, there is a very important planning opportunity that this year's stock-market collapse has presented relative to what is known as 'loss harvesting.' The application of the loss-harvesting concept this year extends more to the concept of stockpiling losses to be used in subsequent years, for several reasons, including the possibility of more short-term transactions or the prospect for capital-gains tax rates being increased.

The application of this strategy would be to sell those mutual funds, stocks, and/or bonds that are now in loss situations in order to realize the capital losses.

Assuming further that you do not wish to be out of the market altogether and would prefer not to be out of the market for any period of time during which a rebound might occur, the critical component of this strategy is to move the proceeds into comparable funds or investments in a way that will avoid the application of the 'wash sale rule.' Here, the IRS does not allow you to sell a stock or investment simply to generate a tax loss. For that reason you are not allowed to take a tax loss on an investment if you sell and repurchase the same within 30 days, before or after the sale.

If this strategy is being implemented with mutual funds, you could find a comparable fund within the same mutual-fund family — and thereby avoid sales charges. For example, if you had invested in the Vanguard fund based on the S&P 500 and you sold it and moved the proceeds into the Fidelity S&P 500 fund, the underlying investments would be substantially identical, and the wash sale rule would apply. But if you are able to select mutual funds that are comparable but not substantially identical, then you should be able to recognize the capital losses.

If the underlying investments are stocks or bonds, you must bear the wash sale rule in mind and avoid its application by not investing in 'substantially identical' securities. There are, however, strategies beyond the scope of this article that are available to allow you to get back into the identical security without being adversely affected by the rule. Another important component of this loss-harvesting strategy is the fact that the capital losses may be carried forward indefinitely.

The concepts and theories set forth here represent only a few of the tax-planning opportunities that are available. It is imperative for you to remember that, in all but a very few instances, those opportunities for the calendar year 2008 will expire at the stroke of midnight, New Year's Eve. It is important that you contact your tax professional in order to see which of these and the others might be applicable to helping you be the most efficient taxpayer you can be.❖

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