## Tax strategies for saving money when filing tax returns

As you get ready to file your 2008 tax return, take a quick look at the list that follows. It's a summary of little-known tax strategies that may save you money when you file your tax return. It pays to take a look. You may wind up owing Uncle Sam less than you thought, or get a bigger refund than you expected, even if only one of these strategies applies to you. Give our office a call to see exactly how a tax strategy applies to your personal situation.

**Back out of an IRA conversion.** If you converted a traditional IRA into a Roth IRA in 2008, you knew you'd have to report the taxable part of the traditional-IRA withdrawal on your 2008 return. But you may not have planned on a year-end surge in your income (for example, from a bonus or stock market gains). That extra income propelled you into a higher tax bracket, or will rob you of tax breaks (such as the education credit) that phase out at higher levels of adjusted gross income (AGI). You can't back out of your bonus or stock market gains (nor would you want to!), but you can back out of that taxable Roth IRA conversion. Through a mechanism known as “recharacterization,” you can undo the conversion and turn the Roth IRA back into a traditional IRA. Net result: Without the taxable income from the conversion, you may avoid being taxed in a higher bracket and/or may keep your AGI below the point where you would lose tax breaks.

**Turn a nondeductible Roth IRA contribution into a deductible IRA contribution.** Did you make a Roth IRA contribution in 2008? That may help you years down the road when you take tax-free payouts from the account (if you're eligible), but the contribution isn't deductible. If you realize you need the deduction that a contribution to a regular IRA yields, you can change your mind and turn that Roth IRA contribution into a traditional IRA contribution (again, via the “recharacterization” mechanism). The IRA deduction is yours if neither you nor your spouse is covered by an employer-provided retirement plan. If you or your spouse is covered, the deduction starts to phase out when AGI exceeds certain limits depending on filing status (for example, for 2008 the phaseout for joint filers starts at $85,000 of AGI).

**Make a deductible IRA contribution, even if you don't work.** As a general rule, you can't make a deductible IRA contribution unless you have wages or other earned income. However, an exception applies if your spouse is the breadwinner while you manage the home front. For 2008, you can make a deductible IRA contribution of up to $4,000 ($5,000 if you are 50 or over) even if you have no earned income. What's more, even if your spouse is covered by an

employer-provided retirement plan you can still make a fully deductible IRA contribution as long as your joint AGI as specially computed doesn't exceed $159,000. To be deductible for the 2008 tax year, the IRA contribution must be made no later than your tax return due date.

**Get tax-free gain from a home used as rental property.** Say a couple of years ago you left your condo in the city and moved into the country home you inherited from Mom. You've been renting the condo to others, but now you get an offer you can't pass up and you sell it. Up to $250,000 of gain from the sale is tax-free if you owned and used the condo as your principal residence for at least two of the five years preceding the sale. However, you will have to recognize gain attributable to depreciation allowable with respect to the rental of the residence after May 6, 1997. So most of your gain will be tax-free, even if you held the condo as rental property for the last couple of years. Up to $500,000 of gain is tax-free for joint filers meeting certain conditions.

**Claim a moving expense deduction because of your spouse's job.** Job-related moving expenses (the cost of moving household goods and personal effects plus transportation and lodging en-route) are above-the-line deductions, which can be claimed even by non-itemizers. This writeoff generally is available only if (1) you start a new job or business at the new location (or are transferred by your employer), and (2) the new job location is at least 50 miles farther from your old home than your old job was from your old home. Even if you don't qualify, however, you can claim the writeoff if your spouse does. The fact that your move was driven by your job-related needs, not your spouse's, doesn't matter.

For example, you're sick of a long, tough commute from distant suburbs to your city office. You sell your home and buy a condo that's a ten-minute walk from work. Your spouse decides to return to the job market after a long absence and lands a job in public relations. You can't qualify for moving expense deductions on the strength of your move, because you didn't change your job or your work location. But you can deduct moving expenses if the distance between your spouse's job and your old home is at least 50 miles (this is a special distance test for those returning to the job market). Your spouse must stay at the new job for certain minimum time periods, however.

**Partial swap of annuity contract is tax-free.** It is well known that it is possible to swap an entire annuity contract for another (for example, to get a better yield) without paying a current

tax. However, you might not be aware that it is also possible to make a tax-free direct transfer of *part* of the funds in an annuity contract to an annuity contract with another company. So if you made a direct transfer of part of your money in an annuity contract in 2008 to an annuity contract with another company, you don't owe tax on the switch.

**It may pay for you not to claim a dependency deduction for a child in college.** This can work to your family's benefit if you pay college tuition for your child, your income is too high for you to claim education credits, and your child has enough taxable income to make use of most or all of the credit. If you forego the dependency deduction, your child can claim the education credits on his or her return (even though you paid the education expenses). The tax-cutting value of the education credits that the child can claim may be greater than the value to you of the dependency exemption for the child. Note, however, that the child can't claim a personal exemption for himself or herself if you are eligible to, but don't, claim a dependency exemption for the child.

**Decide between an education credit and the higher education deduction.** If you paid college expenses in 2008, you may be able to choose between taking an education credit (Hope or Lifetime Learning) or the deduction for higher education expenses. In making this choice, note that the value of the deduction is greater if your marginal tax bracket is higher, while the value of the credit is the same regardless of your bracket. Another factor to bear in mind in making the choice is that different income cut-off points apply to the credits and the deduction. For 2008, the credits are phased out ratably for taxpayers with modified adjusted gross income of $48,000 to $58,000 ($96,000 to $116,000 in the case of a joint return).

**Write off the cost of a tutor as an education expense.** You can deduct the cost of education that maintains or improves the skills required in your business or employment, but not costs to meet the minimum requirements of your trade or profession, or to qualify you for a new job. “Education” doesn't have to be of the classroom variety. For example, suppose you're a sales executive who suddenly had to become an e-commerce expert. You hired a consultant to be your tutor and teach you everything you need to know. That cost is deductible as an education expense. But you can only claim it on Schedule A, Form 1040 as a miscellaneous itemized deduction. Such deductions can be claimed only to the extent their cumulative total exceeds 2% of your AGI.

**No current tax or lower tax on sales of small business stock.** Normally, gains on stock sales are taxed at a maximum rate of 15% (if held for more than one year) or at the same rate as your other income (if held for one year or less). And you can't avoid a tax on your gain by reinvesting in other stock. But special rules apply when you sell shares of qualified small business stock. A number of technical conditions have to be met. Two important ones: (1) The shares must have been originally issued after Aug. 10, 1993, and (2) you must have bought in when the shares were originally issued. There's no current tax on the sale if you held the shares for more than six months, and you reinvest the sales proceeds within sixty days in qualified small business stock issued by another qualifying corporation. And if you held the shares for more than five years, and don't reinvest in other qualified small business stock, then as a general rule half of your gain is tax-free, and the other half is taxed at a maximum rate of 28%. In effect, your maximum tax would be 14% of your total gain on the sale of qualified small business stock.

**Home improvements may be medical expense deductions.** Home improvements generally aren't deductible. But a medical expense deduction may be claimed if you make a medically necessary home improvement, such as a lift or elevator for a handicapped person, or a therapy spa for an arthritis sufferer. The cost of such an expense is deductible as a medical expense to the extent it exceeds any resulting increase in value of the property. For example, if a qualifying improvement costing $5,000 increases the value of your home by $2,000, the medical expense is $3,000. Note, however, that medical expenses can be claimed on Schedule A, Form 1040 only to the extent they exceed 7.5% of your AGI.

**Employee pay can help you write off business equipment.** A tax break for small businesses allows you annually to expense—that is, to currently deduct—the cost of machinery and equipment up to a certain amount ($250,000 for 2008). Assets that aren't expensed can only be written off over a period of years (usually five or seven) via depreciation deductions. However, among other conditions, the maximum annual expensing amount is limited to your taxable income from any active trade or business for the year in which you buy the equipment and place it in service. So, if there's no money coming in during your startup year, there's no expensing for that year. Fortunately, your salary as an employee counts as taxable income for expensing purposes. Therefore, if you start up a sideline business as a sole proprietorship and buy computers, printers, scanners, etc., you can write off their cost (up to the annual dollar limit—$250,000 for the 2008 tax year) even if there's no business income yet, as long as your salary in

that year at least equals what you spent on the equipment. The expensing deduction can offset your other income.

**Maximize deductions for automobiles used in business.** If, in 2008, you purchased and placed in service an automobile used in your business, you have two choices on how to deduct expenses related to the vehicle: (1) you can use a standard mileage rate (for 2008, 50.5 cents for each business mile driven Jan. 1—June 30 and 58.5 cents for each business mile driven July 1—Dec. 31), or (2) you can deduct actual expenses, including depreciation. The standard mileage deduction is relatively easy to compute. Simply multiply the number of miles the vehicle was driven for business by 50.5 cents (for miles driven during the first half of 2008) or 58.5 cents (for miles driven during the last half of 2008). Determining actual expenses requires more work. All of the expenses for the vehicle, for example, insurance, gas, repairs, garage rent, etc., must be added up. In addition, a depreciation deduction is allowable under the actual expense method (the standard mileage rate has an amount for depreciation built into it). For a vehicle purchased and placed in service in 2008 and used more than 50% for business, the depreciation deduction for 2008 is 20% of the car's cost, subject to a maximum deduction of $2,960 (under the so-called “luxury auto rules”). If the vehicle is used less than 100% for business, the portion of the expenses attributable to non-business use is not deductible.