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Executive Newsletter

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Capital Preservation

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Since the downturn of the stock market, there have been many inquiries about protecting cash deposits where one's deposit exceeds the new $250,000 limitation for FDIC insured accounts. Individuals can set up several accounts with the same banking institution including single accounts, retirement accounts, and trust accounts, and thus increase the amount of insured deposits if the accounts are properly titled. An individual can have even more insured accounts by holding deposits in other banking institutions following the same titling format.

For information about this, click on:
www.fdic.gov/deposit/deposits/index.html

Year-End Tax Planning

Alternative Minimum Tax

There's still time to consider implementing year-end planning strategies. With careful planning, taxpayers can significantly reduce their federal and state income taxes.

Alternative minimum tax (AMT) is the most effective way that the Internal Revenue Code neutralizes tax planning. Every year, the AMT confounds both taxpayers and advisors with hidden surprises when April 15 rolls around. The tax dates back to 1969 when Congress was determined to deprive wealthy taxpayers from benefiting from investment related deductions that could zero out their income tax. The final tax liability for an individual is the higher of the income tax or the AMT.

Income tax is calculated as follows:

Gross income
[wages, interest, dividends, capital gains, social security, miscellaneous income]

Less: deductions
[self employment taxes, IRA contributions, SEP IRA, moving expenses and other qualified deductions]

= Adjusted Gross Income

Less: itemized deductions
[Medical, taxes, interest, charitable, casualty or theft loss and miscellaneous itemized deductions]

Less: personal exemptions

= Net taxable income

Income tax rates apply at 10% - 35%

Less: allowable credits

= Net income tax

Alternative Minimum Taxable Income (AMTI) is calculated as follows:

Start at net taxable income above, and then add back several deductions and to arrive at AMTI. Adjustments or add backs include:

- Personal exemptions
- All state, local and personal property taxes
- All miscellaneous itemized deductions (legal, accounting, investment management) (See IRS Form 6251 for the complete list of adjustments)

Alternative Minimum Taxable Income is reduced by certain exemptions. The final amount is then subject to a flat rate of 26% for amounts up to $175,000 (joint returns), and 28% on any excess.

All individual taxpayers, including nonresident aliens, must pay the higher of the income tax or the alternative minimum tax (AMT). You'll likely be subject to the AMT if you have significant amounts of:

- Capital gains where the tax rate on the gains is limited to 15%
- Itemized deductions for state, local and personal property taxes
- Miscellaneous itemized deductions for investment advisory, legal, and accounting services
- Tax preferences related to the exercise of incentive stock options
- Litigation expenses: if you've won a legal settlement, the full recovery is taxable but the legal costs are usually disallowed under the AMT. In many instances where large settlements are awarded with contingent legal fees, the total award is taxed without any benefit for the offsetting legal costs. This can easily result in tax rates exceeding 50% on the net award.

While prepaying expenses that drive down your income tax is often a good year end strategy, if your income tax falls below the AMT, then paying such costs may be a waste of good deductions since your AMT will not be reduced. The following are still effective tax planning approaches when your AMT is higher than your income tax:

1. Focus on business income and deductions that make up Adjusted Gross Income since they impact the AMTI calculation, e.g.
   - Review any business or partnerships where you have control and have the ability to increase or decrease the pass through income or losses
   - Review whether active business income can be treated as passive, thus allowing you to utilize passive activity losses that are being carried forward
   - Change the status of investment activities into a trade or business so deductions are not miscellaneous itemized deductions that are disallowed under the AMT

2. If some of your miscellaneous itemized deductions relate to income from businesses (partnerships or S corporations), you may be able to claim them in calculating adjusted gross income, not as itemized deductions

3. Deferring income to the next year will reduce your AMT (however, the income may be taxed at the regular rates in the following year)
4. Certain itemized deductions are allowed for income tax and AMT including:
    - Investment interest expense
    - Charitable gifts

Both of these deductions are subject to several limitations outside the AMT calculations.

There's no silver bullet to planning around the AMT other than estimating your income, and then calculating your income tax and AMT and comparing the results. If you happen to have foreign source income, are subject to foreign taxes, and also have capital gains and itemized deductions, the mechanics of the actual calculation are mind numbing even to the experienced tax preparer. Only luck or a good tax software package can save you from the clutches of the AMT.

Other Year- End Tax Planning Strategies

Gains and Losses – This is a good time to consider selling stocks with losses so any gains realized during the year will not result in current tax. If you want to retain the shares in any given company, you need to avoid buying back the securities within thirty days or the loss will be disallowed under wash sale rules.

Charitable Giving – Charitable gifts allow individuals to deduct the fair market value of gifts donated to charitable organizations. Giving appreciated stock will result in a deduction equal to the fair market value of the gift, and the deduction is not an add-back for calculating alternative minimum tax. If your gifts are substantial and involve appreciated property, however, there are other limitations that need to be considered.

Executive Cars – If you purchased a high-end luxury car for business several years ago, the resale or trade-in value might not be very high, particularly if you have high mileage. Selling the car before year-end could result in a substantial tax deduction since the tax basis of the car may still be high as a result of restrictive depreciation deductions for luxury autos.

Bad Debts – With businesses and individuals struggling with the bad economy, this might be the year to write off a bad debt if the prospect of getting repaid is minimal. A personal loan that is worthless will yield a short term capital loss. If the loan qualifies as a business loan, there is an ordinary deduction. The loan must be worthless to claim the loss. To avoid problems in the event of an audit, you'll need to show attempts to collect the debt and proof that the loan was worthless as of December 31, 2008.

Stock Losses – A capital loss can be generated by claiming a worthless stock loss if the security can be shown to be worthless at the end of the year.

Year-End Tax Planning for Nonresidents and Part-year Residents

For incoming foreign nationals, there can be significant tax planning opportunities worth considering prior to the end of the year. For example, assume that you've recently immigrated, and have stock options with a low exercise price while the value of the shares is significantly high. You might consider exercising the options this year, assuming you're able to file your 2008 return as a nonresident. If the spread is all foreign source, there should be no US tax consequences. You'll now own the shares with a fair market value tax basis so the appreciation will escape future federal and state income tax. If you exercise the options in 2009 or later, when you are a full year resident, the spread will be taxed as ordinary income even though the appreciation occurred prior to your arrival in the US.

Incoming foreign nationals will need to consider the various tax filing options:

- Full year resident (worldwide taxation)
- Full year nonresident status (only US source income is taxed)
- Dual status filing where the year is divided into nonresident and resident status
- Joint income tax return with one's spouse
- Separate filing for each spouse

A simple example of the different outcomes is the deduction for home mortgage interest expense. One can deduct the interest expense if you file as a full year resident or for the resident period after arrival for a dual status resident. If you file as a nonresident for the full year, there is no deduction for interest expense.

If you're able to file as a nonresident in 2008 due to limited time in the US (generally less than 183 days), you may have a golden opportunity to save taxes by accelerating foreign source income into this year. As a nonresident, foreign source income is generally exempt from US tax. If you're no longer taxable in your country of origin, then this income may escape taxation in both countries. This might apply to bonuses, investment gains, and interest and dividend income from foreign sources that are received in 2008.

The comments above are for informational purposes only and should not be relied upon for making decisions without consultation with your tax or financial advisor.

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