

TAXOLUTIONS



►► *ideas on taxes*

CONGRESS APPROVES \$152 BILLION ECONOMIC STIMULUS PACKAGE

Reacting to mounting concerns that the U.S. economy is sliding into recession, House and Senate leaders announced on February 7 that they had approved by large bipartisan majorities a \$152 billion fiscal stimulus package that will provide tax rebates to most Americans and enhanced tax breaks for small businesses.

Designed to boost the economy at a time when the subprime mortgage lending crisis and falling house prices appear to be putting the brakes on growth, the Economic Stimulus Act of 2008 passed the Senate by a vote of 81 to 16, and the House by a vote of 380 to 34. Saying the measure provides “a booster shot for our economy,” President George W. Bush signed the bill on February 13.

Originally unveiled on January 24 by President Bush and House leaders, the law allocates more than \$100 billion to providing tax rebate checks to individuals and families. The IRS has said it will start sending out checks in May of this year to all qualifying taxpayers who filed a 2007 return. A version of the bill first approved by the House was modified slightly in the Senate to extend rebate checks to low-income seniors and to disabled veterans, while adding safeguards to ensure that no checks would go out to illegal immigrants.

Under the new law, individual taxpayers will be eligible to receive rebates of up to \$600, and married couples will receive checks for up to \$1,200, based on income tax paid in 2007. These rebates reflect the agreement that, for 2008, the 10% marginal rate will fall to 0% for the first \$6,000 in adjusted gross income (AGI) for single filers or \$12,000 in AGI for married filers.

The stimulus package also puts some extra cash in the pockets of many Americans who earn too little to owe federal income taxes: Americans with at least \$3,000 of earned income, defined as the sum of earned income, Social Security benefits, and veterans’ disability payments, will receive a minimum of \$300 per individual and \$600 per married

couple. All taxpayers eligible for this relief will also receive an extra \$300 per child.

These rebates are, however, phased out for taxpayers with AGIs of more than \$75,000 for single filers or \$150,000 for married couples filing jointly. Above these income levels, rebates will be reduced by \$50 for each additional \$1,000 in income.

A further \$50 billion of the package is devoted to offering incentives for business investment, including a 50% bonus deduction on most types of capital investments in the year the equipment is placed in service. The package also features an expansion of the Section 179 deduction, which allows small business owners to write off expenses immediately instead

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TAKING ADVANTAGE OF THE STUDENT LOAN INTEREST DEDUCTION

-paying for a college education can be very expensive, but the federal government makes it a little easier by allowing taxpayers to deduct the interest paid on student loans on their income tax returns. If you are considering claiming this deduction now or in the future, there are some restrictions that you should be aware of for tax planning purposes.

The maximum amount of student loan interest payments each taxpayer may deduct is currently set at the lesser amount of the actual interest paid on the loan in the course of the year or \$2,500. To qualify for the deduction, your modified adjusted gross income (MAGI) must be below \$70,000 if you are single or \$140,000 if you are married. The deduction is gradually phased out if your MAGI is above \$55,000 for single filers or \$110,000 for married filers. If you are married, you must file jointly in order to claim the student loan deduction; you are barred from claiming the deduction if you are married and filing separately.

You don't have to itemize your deductions to qualify for this tax break, but there are some restrictions on who is permitted to claim it. The loan must have been taken out to finance your own education or that of your spouse or dependent. You cannot claim the deduction if you have been claimed

as an exemption on the tax return of someone else, usually your parents. On the other hand, if your parents took out a loan to help pay for your education at a time when you were no longer their dependent, the interest they paid on the loan does not qualify for deduction.

The Internal Revenue Service (IRS) also stipulates that students for whom the deduction is claimed must have been enrolled at least half-time in an educational program that leads to a degree, certificate, or other educational qualification. The student must have been enrolled in an eligible educational institution, which includes any college or other postsecondary educational institution eligible to participate in the Department of Education's Federal Student Aid (FSA) programs. Generally, most accredited postsecondary institutions in the United States qualify, as do certain educational institutions located outside of the country, provided they participate in FSA programs.

The loan on which the interest is paid must have been taken out solely for the purposes of paying for educational expenses, which may include tuition, room and board, supplies, equipment, and other necessary expenses, such as transportation. These expenses must have been incurred within a "reasonable period of time" after the loan was dis-

bursed. If, however, you took out a personal loan that was used in part to pay for educational expenses, interest payments on the personal loan are not considered deductible. If you took out a home equity loan to help pay for college, you may be able to deduct the interest under the mortgage interest deduction, but the interest payments do not qualify for the student loan deduction.

Under IRS rules, you can deduct all the interest paid in the course of the year on a student loan, including voluntary payments, until the loan has been paid back. If you have been paying back a loan from a bank or government agency and have made interest payments of \$600 or more in the course of a given year, the loan servicer should automatically send you a Form 1098-E by January 31 of the following year. This form can be useful in helping you calculate the amount of interest paid, but the IRS does not require you to have a Form 1098-E to claim the deduction. In some cases, the information provided by Form 1098-E will not accurately reflect the full amount you are permitted to deduct. If, for example, loan origination fees are not reported on your Form 1098-E, the IRS allows you to use "any reasonable method" to allocate the loan origination fees over the term of the loan. ■

RETIREMENT SAVING AND YOUR TAXES

Contributing to tax-advantaged retirement plans can cut your tax bill, while helping you prepare for the future. Even if you are already contributing to a retirement plan, such as a 401(k), IRA, or Roth account, you should review your retirement savings strategy regularly to ensure that you are making the most of the tax breaks for which you qualify.

When you contribute money to a traditional individual retirement account (IRA) or an employer-sponsored defined contribution plan, such as a 401(k) or a

403(b), the adjusted gross income (AGI) figure that is used to calculate your income tax liability is lowered by the amount saved. Depending upon your income and the amount contributed, depositing funds in an IRA or 401(k) can substantially reduce your tax bill. While taxes must be paid on distributions from these accounts, most savers come out ahead because they are in a lower marginal tax bracket in retirement than they are while working. Investment growth within these retirement plans

is also tax deferred. Even savers whose marginal tax bracket is not lower in retirement usually benefit by allowing money they would otherwise have paid in taxes to grow over time.

The advantages of saving in tax-advantaged retirement plans are clear, but selecting the types of accounts that are best for your individual circumstances may be less straightforward. If your company offers a 401(k) plan with matching contributions, start by having your employer deduct from your paycheck

TAX BENEFITS OF DONATING USED VEHICLES TO CHARITY

Donating a used car or other vehicle to charity is a great way to support the nonprofit of your choice, while also allowing you to claim a deduction on your federal income tax return. But because the rules governing vehicle donations have tightened in recent years, it is important to be aware of the process involved in donating a car and the procedures that must be followed when claiming the tax deduction.

Many charities both large and small now accept vehicle donations. The types of vehicles that qualify for the tax deduction include all privately-owned automobiles manufactured primarily for use on public roads, as well as boats and airplanes. In order to claim a deduction, however, the charity that receives the gift must be recognized by the Internal Revenue Service (IRS) as a 501(c)(3) organization. Available online and at most public libraries, IRS Publication 78 includes an annually updated list of qualified charities.

Prior to a change in the rules in 2005, taxpayers were permitted to write off the fair market value of the donated vehicle. But under current law, you are only allowed to deduct automatically the good faith fair market value of the car if the estimated amount does not exceed \$500.

The IRS defines fair market value as the price a willing buyer would pay and a willing seller would accept for the vehicle when neither party is compelled to buy

or sell and both parties have reasonable knowledge of the relevant facts. When assessing the value of the vehicle, use a pricing guide that takes into account make, model, year, options, and accessories, as well as the condition of the car.

If the value of the vehicle is assessed at between \$500 and \$5,000, the size of the deduction depends upon what happens to the vehicle after the charity has received it. If the organization sells the car, your deduction is limited to the exact amount of the sale price. Different rules apply, however, if the charity makes what the IRS calls “significant intervening use” of the vehicle before it is sold or otherwise disposed of. If, for example, a donated car with a fair market value of \$1,500 is used by the charity for several months for pickups and deliveries before it is sold at auction for \$1,200, the donor would nonetheless be permitted to claim a deduction of \$1,500.

The donor may also claim the fair market value, rather than the sale price, if the charity sold the car to a “needy individual” at much lower price than the actual value, or if the organization makes a “material improvement”—generally, reconditioning work that is more than routine or cosmetic—before selling the vehicle. If, however, the vehicle is ultimately sold for less than \$500, the taxpayer may claim a deduction for the lesser of the vehicle’s fair market value on the date of the contribution or \$500.

Keep in mind that writing off your car donation is only possible if you itemize your deductions. To claim a vehicle deduction above \$500, the receiving charity must provide you with a written acknowledgement of receipt that includes detailed information about the intended use and sale of the vehicle. The charity is required to provide you with substantiation of the donation within 30 days of the date when you signed over the automobile or, if the car is sold, within 30 days of the sale. A copy of the receipt must be filed with the tax return, along with IRS Form 8283, “Noncash Charitable Contributions.” If the vehicle is worth more than \$5,000, you must also attach documentation from a qualified appraiser. If the donated car is worth between \$250 and \$500, you should obtain a written acknowledgement of the contribution from the charity for your records, but you are not required to attach the acknowledgement to your tax return.

When donating a vehicle, steer clear of for-profit intermediaries that advertise offers to help you manage your charitable donation, as these middlemen often keep the bulk of the proceeds from the sales of donated cars. If possible, give the vehicle to a charity with a car donation program that enables them to accept the vehicles directly. You should also consider avoiding charities that do not allow you to re-title the car when turning it over to them, as this opens you up to liability. ■

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of depreciating capital expenditures over many years. A temporary change in the tax code will allow small businesses that invest in new or used equipment in 2008 to fully expense \$250,000 in qualifying property purchases, up from \$125,000 in 2007, with an annual investment cap set at \$800,000.

President Bush said his administration struck a deal on the package follow-

ing intense negotiations with House Speaker Nancy Pelosi (D-CA) and House Minority Leader John Boehner (R-OH). “This package has the right set of policies and is the right size,” the President said. “The incentives in this package will lead to higher consumer spending and increased business investment this year. Importantly, this package recognized that lower taxes

is a powerful and efficient way to help consumers and businesses.”

Commenting on the bonus depreciation and Section 179 expensing enhancements contained in the stimulus package, Rep. Boehner said these provisions “will give employers—particularly small businesses—greater incentive to invest and create jobs for more Americans searching for work.” ■

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RETIREMENT SAVING AND YOUR TAXES

at least the amount necessary to take advantage of the full match. If the plan allows it, consider contributing beyond the matching limit, up to the maximum of \$15,500 (\$20,500 for people age 50 and older) in 2008. Depending upon your income, you may also have the option of contributing to an IRA in addition to your workplace retirement plan.

People who do not have access to a retirement plan at work, either because they are self-employed or because their company does not offer one, have a number of options when choosing a tax-advantaged savings account. If you have earned income, you and your spouse may be eligible to each make pre-tax contributions of up to \$5,000 (\$6,000 for those over age 50) to an IRA in 2008. There are also a number of tax-advantaged defined contribution plans designed specifically for the self-

employed or small business owners, including simplified employee pension (SEP) plans, SIMPLE IRAs, and owner-only 401(k) plans.

While they do not immediately reduce your taxable income, Roth IRAs and Roth 401(k)s can be useful tax planning tools over the long term. The contribution limits for Roth savings vehicles are the same as for traditional IRAs and 401(k)s, but the contributions made to Roth accounts must be in after-tax dollars. Investment growth within Roth accounts is tax free, and no taxes are owed on qualifying withdrawals. A Roth IRA can be an attractive option for people who earn too much to contribute to a traditional IRA but whose AGIs are still below the Roth IRA eligibility phase-out ranges of \$101,000–\$116,000 for single filers, and \$159,000–\$169,000 for married filers.

Roth retirement savings plans also offer greater flexibility than traditional IRAs and 401(k)s. Unlike retirement plans funded with pre-tax dollars, Roth accounts do not require savers to begin withdrawing funds after the age of 70½, making it easier to pass on a retirement nest egg to the next generation. A Roth savings plan may also be a good choice for people who do not expect to be in a lower marginal tax bracket in retirement and wish to maximize their retirement income.

The ideal financial plan may involve contributing to a variety of different tax-advantaged retirement accounts. Because changes in your income or in tax law can affect your eligibility for some plans, be prepared to regularly review and adjust your tax and retirement planning strategies. ■

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