Halcolm Bard
Certified Public Accountant & Consultants

TAX AND BUSINESS ADVISOR

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TAX AND BUSINESS *Alert*™

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Business Benefits of the Stimulus Act

As you have probably heard, the recently enacted Economic Stimulus Act of 2008 (Stimulus Act) provided tax rebates for millions of individuals. The Stimulus Act also provides some generous tax breaks for businesses, particularly small and medium size businesses. These business provisions are intended to encourage investment and generally provide for faster depreciation (expensing) of *qualified* business equipment.

Section 179 Deduction. Internal Revenue Code Section 179 provides for a large first-year write-off of newly acquired qualifying business equipment: the Section 179 deduction. However, equipment purchases are limited, and the deduction phases out on a dollar-for-dollar basis at a specific statutorily defined level. The Stimulus Act significantly enhances the Section 179 deduction for tax years beginning in 2008. For tax years beginning in 2009 and beyond, the normal Section 179 rules will apply.

For tax years beginning in 2008, the maximum Section 179 deduction is generally increased to $250,000, up from $128,000 before the Stimulus Act. For 2009–2010, the maximum deduction will revert back to $125,000 (the 2007 amount) with inflation adjustments. In addition, the Section 179 phase-out threshold is generally increased to $800,000, up from $510,000 before the Stimulus Act. So, the Section 179 deduction is completely phased out at $1,050,000 ($250,000 + $800,000). The increased phase-out threshold means more small and medium-sized businesses will be eligible for the Section 179 deduction in 2008. For 2009–2010, the phase-out threshold will revert back to $500,000 (the 2007 amount) with inflation adjustments.

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Example: New Section 179 deduction rule. Forrest Corp is a calendar-year taxpayer. In 2008, Forrest purchases and places in service $910,000 of qualifying Section 179 property. Forrest's maximum Section 179 deduction

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Planning for the "0%" Capital Gains Rate

Beginning in 2008 and extending through 2010, taxpayers in the 10% and 15% general tax brackets (e.g., joint filers with 2008 taxable income of $65,100 or less) are eligible for the new 0% long-term capital gains rate through 2010. For these taxpayers, long-term capital gains recognized this year are generally free of taxation for individuals in tax brackets under 25% (10% and 15%). So, if you are eligible for the 0% bracket and have the discretion to recognize long-term capital gains in 2008, it may make sense to do so on a tax-free basis.

What about long-term capital losses? Due to the 0% net long-term capital gains rate, taxpayers in a regular tax bracket under 25% (10% and 15%) for 2008 will receive no benefit for long-term capital losses until these losses exceed long-term capital gains. These taxpayers should consider holding these *loss assets* until after 2010 when the 0% rate is scheduled to be repealed. Alternatively, long-term capital loss assets should be sold in a year with no long-term capital gains. These losses can then be used to offset either net short-term capital gains (which are taxable at the ordinary tax rate) or up to $3,000 ($1,500 for married filing separate) of ordinary income.

Use Your Vacation Home for Retirement Savings

Many taxpayers own vacation homes in the area where they eventually plan to retire. In this situation, a vacation home can prove to be a tax-advantaged retirement fund. After retirement, the primary residence can be sold, and up to $500,000 of gain is generally tax-free for married couples filing a joint return. Any additional capital gain is taxed at a maximum rate of 15%. The taxpayers would then move to their former vacation home and make it their permanent residence. The tax-free home sale gain proceeds can be used as retirement funds versus withdrawals from a retirement account that are currently taxed at up to 35%.


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Once the taxpayers occupy their former vacation home for at least two years, they become eligible for an additional $500,000 exclusion on the sale of that home. Once again, the tax free sale proceeds can be used as retirement funds. Alternatively, the home can be passed on to the couple's children or other beneficiaries.

Swapping Bonds to Claim Losses

Taxpayers holding bonds that have decreased in value may benefit from a technique known as a bond swap. To facilitate a bond swap, the taxpayer sells currently owned bonds at a loss and immediately reinvests the proceeds in different bonds. A bond swap enables a taxpayer to currently benefit from the decline in a bond's value and either increase or keep the same cash flow generated by the current bond. This technique is beneficial if the taxpayer has current capital gains, particularly short-term, that can be offset by the bond's capital loss, or if the taxpayer's overall net capital loss following the bond disposition is $3,000 or less (which the taxpayer can offset with other ordinary income).

Taxpayers entering into bond swaps must avoid the wash sale rules to avoid having the loss from the disposition disallowed. Also, the transaction charges (e.g., brokerage commissions) associated with buying and selling bonds will reduce the economic benefit of a bond swap.

for 2008 is $140,000 [$250,000 maximum minus $110,000 ($910,000 – $800,000) excess over the $800,000 phase-out threshold]. Before the favorable changes made by the Stimulus Act, Forrest would not have been entitled to any Section 179 deduction for 2008 because the phase-out threshold was so much lower at $638,000 ($128,000 + $510,000).

Warning: Taxpayers with fiscal tax years should note that the enhanced Section 179 deduction rules don't take effect until the beginning of the fiscal year that starts in 2008. The maximum Section 179 deduction for tax years beginning in 2007 is generally $125,000, and the phase-out threshold is generally $500,000.

First-year Bonus Depreciation. The Stimulus Act revives the 50% additional first-year bonus depreciation under essentially the same rules as before for *qualifying* assets that are both acquired and placed in service during calendar year 2008. To be eligible for 50% first-year bonus depreciation, an asset must pass all three of the following tests: (1) it must be qualified property, (2) it must be purchased during calendar year 2008, and (3) the original use of the asset generally must commence with the taxpayer during calendar year 2008. However, the placed-in-service deadline is extended through 12/31/09 for certain longer-lived assets.

Qualified property generally encompasses most tangible personal property, but most real estate assets will generally fail to meet the definition. Certain leasehold improvements also qualify. An asset is eligible for 50% first-year bonus depreciation only if its original use commences with the taxpayer after 12/31/07. In other words, the asset must be new. A special exception applies to assets that are sold and leased back.

The 50% first-year bonus depreciation break is also available for the cost of "qualified leasehold improvement property." To meet this definition, the building must be

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nonresidential real property, and the improvement must be (a) to the interior portion of a building, (b) made pursuant to or under a lease by either the lessee (or sublessee) or the lessor to property that will be occupied exclusively by the lessee (or sublessee), and (c) placed in service more than three years after the date the building was first placed in service. Certain improvements are ineligible by definition. These include expenditures to enlarge a building, costs for any elevator or escalator, any structural component benefiting a common area, and any internal structural framework of a building.

For a new passenger auto or light truck that is used for business and subject to the luxury auto depreciation limitations, the 50% bonus depreciation break increases the maximum first-year depreciation deduction by $8,000. For new passenger autos acquired and placed in service in 2008, the maximum first-year depreciation deduction is $10,960 ($8,000 + $2,960). For new light trucks acquired and placed in service in 2008, the maximum first-year depreciation deduction is $11,160 ($8,000 + $3,160). Of course, the full $10,960 or $11,160 amount is available only when the new passenger auto or light truck is used 100% for business. For instance, if a new passenger auto is used 80% for business, the maximum first-year depreciation deduction would be $8,768 (.80 × $10,960).

The depreciation rules are the same for both regular tax and AMT purposes with respect to assets for which the 50% first-year bonus depreciation is claimed.

Please call us if you have questions concerning the Stimulus Act or any other business or personal tax compliance or planning issue.

Claiming Head of Household Status in Divorce Situations

In some divorce situations, parents are awarded joint custody of their children.


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Claiming head of household (HOH) status by either parent depends on where the child resides for more than half the year, along with whether that parent meets the remaining head of household tests. It does not matter which parent claims the dependency exemptions or which parent is awarded custody by the court.

Example: Joint custody of children—who is head of household? Kevin and Janet have one child, Aaron, age 9. They were legally divorced in 2007. Under the divorce decree, they were awarded joint custody of Aaron, whose time is to be spent equally with each parent. Only one parent can claim HOH status. To do so, that parent must pay more than half the cost of maintaining a household and must maintain the household occupied by the child for more than half the year. If Kevin and Janet each pay more than half the cost of maintaining a household (their separate households) for Aaron, the one whose household is Aaron's principal home for more than half the year is eligible to file as HOH.

Variation 1: If Kevin and Janet had two children (Aaron and Sally) and each parent was awarded custody of a different child, both could claim HOH status if the other rules for eligibility were met.

Variation 2: If Kevin and Janet had two children and shared joint custody of both, it appears both parents could claim HOH status as long as they each met the requirement to maintain a household that is the principal place of abode of one qualifying child. This requires that one child live with one parent more than half the year and the other child live with the other parent more than half the year, and that each parent provide more than half the cost of maintaining the household in which each child lives.

The ability to claim HOH status for a child often centers on the amount of time spent with each parent. Thus, maintaining records of the amount of time a child spends in each household is critical in joint custody situations. Please call us if you have questions concerning head of household status or any other tax matter.

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Halcolm Bard CPA • 38 Fraley Street • Kane, Pennsylvania 16735 • (814) 837-9150 • Tax and Business Advisor