

2008-2009

Tax Planning Guide

Sophisticated strategies for high-net-worth individuals



How much will you get to keep?

As a successful individual, you know that building your net worth takes more than simply increasing your income. It requires minimizing your taxes, so you get to keep more of what you earn. But as tax law becomes more complex, tax planning becomes more difficult. You need to think farther ahead, employ more sophisticated strategies and take advantage of every tax break you can.

To help you save as much as possible, this guide discusses recent tax law changes and presents a broad range of strategies for reducing your income tax liability. It also shows how to tie together your business and personal financial goals, how to tax-efficiently build up funds for education or retirement and how to transfer wealth to loved ones. But it simply can't cover all possible tax planning strategies. So be sure to contact a tax advisor to find out which would work best for you.

Contents

Tax Rates	2
Chart 1: 2008 individual income tax rate schedules	
Chart 2: Employment taxes	
Timing & AMT	4
Chart 3: 2008 individual AMT rate schedule and exemptions	
Executive Compensation	7
Investing	10
Chart 4: 2008 capital gains tax rates	
Business Ownership	16
Chart 5: 2008 corporate income tax rate schedule	
Chart 6: Tax differences based on business structure	
Charitable Giving	18
Chart 7: AGI limitations on charitable contribution deductions	
Education & Children	21
Retirement	24
Chart 8: 2008 retirement plan contribution limits	
Estate Planning	28
Chart 9: The changing impact of the federal estate tax on a \$10 million taxable estate	
Tax Strategies Checklist	32



Your tax rate may be higher than you think

TAX RATES

Probably the first thing that comes to mind when you think of your income tax rate is your regular tax bracket. (See Chart 1.) This shows your marginal rate — the rate that applies to your next dollar of ordinary income. Ordinary income includes salary and bonuses, self-employment and business income, interest, taxable retirement plan distributions, and more.

The top regular income tax rate on ordinary income for 2008 is 35%. But that's not the only rate you have to worry about:

- ▼ If you're subject to the alternative minimum tax (AMT), the maximum rate your ordinary income will be taxed at is 28%. Although this rate is lower than the maximum regular tax rate, it typically applies to a higher taxable income base and thus can result in unpleasant tax surprises. Unfortunately, the AMT continues to be a significant threat to many taxpayers. (See page 4.)
- ▼ For both regular tax and AMT purposes, some types of income — such as certain capital gains and dividends — are subject to lower rates. And even these rates can vary. (See Chart 4 on page 13.)

In other cases, the actual rate you pay on an item of your income may be higher after other factors are accounted for, such as whether employment taxes, AGI-based provisions or any penalties apply.

Know the impact of employment taxes

In addition to income tax, you must pay Social Security and Medicare taxes on earned

income, such as salary and bonuses. The amount of income subject to Social Security tax is limited, but all earned income is subject to the 2.9% Medicare tax. (See Chart 2.)

If you're self-employed, your employment tax liability doubles, because you also have to pay the employer portion of these taxes. As a result, self-employment income can be taxed at an effective federal rate as high as 48% compared to about 43% for income from wages. Why isn't the difference greater? Because you receive a deduction for 50% of the self-employment tax you pay.

There are also special employment tax considerations if you're a business owner who also works in the business. (See page 16.)

Be aware of AGI-based provisions

If your adjusted gross income (AGI) exceeds certain levels, your ability to benefit from many tax breaks is reduced. For example:

Personal exemptions. You begin to lose the \$3,500 per exemption (for 2008) deduction from your taxable income if your AGI exceeds:

- ▼ \$159,950 if single,
- ▼ \$199,950 if head of household,
- ▼ \$239,950 if married filing jointly, or
- ▼ \$119,975 if married filing separately.

The good news is that in 2008 and 2009 only one-third (down from two-thirds

Case Study 1

AGI-based provisions can boost your tax liability

Say you're married filing jointly, have four dependent children, have an adjusted gross income (AGI) of \$1 million, and are in the top tax bracket (35%). Without the AGI-based exemption phaseout, your \$21,000 of personal exemptions ($\$3,500 \times 6$) would save you \$7,350 in taxes ($\$21,000 \times 35\%$). But because your personal exemptions are subject to the maximum 2008 phaseout — that is, you lose one-third of your personal exemptions — you won't see about \$2,450 ($\$7,000 \times 35\%$) of that tax benefit.

The AGI-based itemized deduction reduction can be more expensive. In this scenario, you could lose the benefit of as much as \$8,401 [$1\% \times (\$1 \text{ million} - \$159,950)$] of your itemized deductions that are subject to the reduction — at a tax cost as high as \$2,940 ($\$8,401 \times 35\%$).

The combined AGI-based provisions could increase your tax by nearly \$5,400.

Chart 1

2008 individual income tax rate schedules

Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	\$ 0 – \$ 8,025	\$ 0 – \$ 11,450	\$ 0 – \$ 16,050	\$ 0 – \$ 8,025
15%	\$ 8,026 – \$ 32,550	\$ 11,451 – \$ 43,650	\$ 16,051 – \$ 65,100	\$ 8,026 – \$ 32,550
25%	\$ 32,551 – \$ 78,850	\$ 43,651 – \$112,650	\$ 65,101 – \$131,450	\$ 32,551 – \$ 65,725
28%	\$ 78,851 – \$164,550	\$112,651 – \$182,400	\$131,451 – \$200,300	\$ 65,726 – \$100,150
33%	\$164,551 – \$357,700	\$182,401 – \$357,700	\$200,301 – \$357,700	\$100,151 – \$178,850
35%	Over \$357,700	Over \$357,700	Over \$357,700	Over \$178,850

Source: U.S. Internal Revenue Code

in 2007) of this reduction applies. For example, if based on your AGI the reduction amount is \$1,800, your exemption deduction will actually be reduced by only \$600 ($\$1,800 \times \frac{1}{3}$).

Itemized deductions. For 2008, most itemized deductions are reduced if AGI is over \$159,950 (\$79,975 for married filing separately). But only one-third of the reduction, which originally was 3%, applies in 2008 and 2009. Itemized deductions for medical expenses, investment interest, casualty losses and gambling losses aren't subject to the reduction.

You may be able to time income and above-the-line deductions to reduce your AGI enough to minimize the impact of these phaseouts and reductions. If that's not possible, keep them in mind in your tax planning — especially when timing expenses subject to the itemized deduction reduction. (See Case Study 1.)

Pay enough tax throughout the year

You can be subject to significant penalties if you don't pay the appropriate amount of tax during the year through estimated tax payments or withholding. To avoid such penalties, make sure your estimated payments or withholding equals at least 90% of your tax liability for the current year or 110% of the prior year's tax (100% of the prior year's tax if your 2007

AGI was \$150,000 or less). Here are two strategies that can help you avoid underpayment penalties:

- 1. Use the annualized income installment method.** This method often benefits taxpayers who have considerable variability in income due to bonuses, investment gains and losses, or seasonal income, if it's skewed toward the latter part of the year. Annualizing computes the tax due based on income, gains, losses and deductions through each estimated tax period.
- 2. Estimate your tax liability and increase withholding.** If you determine you've underpaid, consider having the tax shortfall withheld from your salary or year end bonus by Dec. 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters.

Avoid early retirement plan withdrawals

Taking distributions from your tax-deferred retirement plan, such as a traditional 401(k) or IRA, before age 59½ also can boost your effective tax rate. That's because, unless an exception applies (see page 27), you'll pay a 10% penalty on the premature withdrawal. This can raise your effective federal tax rate to as high as 45% (the maximum marginal rate plus the penalty).

Also keep in mind that, regardless of when they're taken, distributions from these plans are taxed at your ordinary-income tax rate, rather than the more beneficial long-term capital gains rate that applies to many other investments. ▲

Chart 2

Employment taxes

	Social Security	Medicare	Total tax
2008 income limit	\$102,000	no limit	NA
Employee rate	6.2%	1.45%	7.65%
Employer rate	6.2%	1.45%	7.65%
Self-employed rate	12.4%	2.90%	15.30%

Source: U.S. Internal Revenue Code



Watch out for the AMT threat

TIMING & AMT

It's important to review your income and deductible expenses for the year to date well before Dec. 31 so that you can take action before Jan. 1 to ensure the most favorable tax result. This may include timing both income and deductible expenses where possible.

But you also must consider the alternative minimum tax (AMT) — a separate income tax system that calculates tax differently. You must pay this tax if your AMT liability exceeds your regular income tax liability.

The Emergency Economic Stabilization Act of 2008 (EESA) provides temporary AMT relief by raising the AMT exemptions for 2008. (See Chart 3 on page 5.) But more taxpayers will be subject to the AMT for 2009 if Congress doesn't take additional action. Even with the 2008 "patch," many higher-income taxpayers could still find themselves subject to this tax.

Be aware of AMT triggers

Many deductions you can use to calculate your regular income tax aren't allowed under the AMT and thus can trigger AMT liability. Some income differences also might trigger or increase AMT liability. Common triggers include:

- ▼ State and local income taxes, especially if you live in a high-income-tax state,
- ▼ Real estate and personal property taxes,
- ▼ Interest on a home equity loan or line of credit not used to buy, build, or improve your principal residence,

- ▼ Accelerated depreciation adjustments and related gain or loss differences when assets are sold,
 - ▼ Tax-exempt interest on certain private-activity municipal bonds, and
 - ▼ Incentive stock option (ISO) exercises when the stock isn't sold within one year, because the difference between the ISO exercise price and the acquired shares' fair market value (the "bargain element") creates a tax "preference" that's included in AMT income but not regular income. (See page 8.)
- ▼ Miscellaneous itemized deductions subject to the 2% of adjusted gross income (AGI) floor, including investment advisory fees and employee business expenses,
 - ▼ Long-term capital gains and dividend income, which are taxed at 15% for both regular tax and the AMT but can still trigger the AMT,



Chart 3

2008 individual AMT rate schedule and exemptions

	AMT brackets		AMT exemption	
	26% tax rate	28% tax rate	Exemption	Phaseout ¹
Single or head of household	\$0 – \$175,000	Over \$175,000	\$46,200	\$112,500 – \$297,300
Married filing jointly or surviving spouse	\$0 – \$175,000	Over \$175,000	\$69,950	\$150,000 – \$429,800
Married filing separately	\$0 – \$87,500	Over \$87,500	\$34,975	\$75,000 – \$214,900

¹ The alternative minimum tax (AMT) income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Note: Consult your tax advisor for AMT rates and exemptions for children subject to the kiddie tax.

Source: U.S. Internal Revenue Code



Implement AMT strategies

With proper planning, you may be able to avoid the AMT, or at least reduce its impact — and perhaps take advantage of its lower maximum rate. The first step is to work with your tax advisor to determine whether you could be subject to the AMT this year or next:

1. If you expect to be subject to the AMT this year. Where possible:

- ▼ Defer expenses you can't deduct for AMT purposes until 2009, to potentially preserve those deductions,
- ▼ Defer expenses you *can* deduct for AMT purposes to next year if the deductions will be more valuable because of the higher maximum regular tax rate,
- ▼ Accelerate ordinary income and short-term capital gain income to this year if you'll benefit from the lower maximum AMT rate, and
- ▼ Defer exercising some or all of your ISOs to avoid AMT on the bargain element or consider exercising and selling within one year.

2. If you don't expect to be subject to the AMT this year, but probably will be next year. Take the opposite approach. For instance, defer income to next year, because you'll probably pay a relatively lower AMT rate. And prepay your state income tax this year because that

deduction won't help you next year.

Also, sell any private activity municipal bonds before year end. But be aware that tax law changes are possible for next year.

See if you qualify for the AMT credit

If you pay AMT in one year on deferral items, such as depreciation adjustments, passive activity adjustments or the tax preference on ISO exercises, you may be entitled to a credit that offsets regular tax in a subsequent year.

In effect, this takes into account timing differences that reverse in later years. But the credit might provide only partial relief or take many years before it can be used in full. Fortunately, the new refundable feature of the AMT credit may reduce the time it will take to recoup AMT paid.

Certain taxpayers who have unused AMT credits are now allowed to claim a refundable credit for a portion of the so-called long-term AMT credit carryovers. Any minimum tax credit that was generated three or more years ago is considered a long-term AMT credit.

For calendar years 2008 through 2012, the refundable credit amount is equal to the greater of 50% (up from 20% before EESA) of the unused long-term AMT credit for the tax year or the amount of the refundable credit for the preceding tax year. For

example, if the unused long-term AMT credit for 2008 is \$500,000 and the refundable credit for 2007 was \$100,000, the refund for 2008 will be 50% of \$500,000, or \$250,000. EESA also eliminates the AGI limitation on the refundable credit.

Time income and expenses

Smart timing of income and expenses can reduce your tax liability, and poor timing can unnecessarily increase it. Examples of timing strategies when AMT is a possibility were discussed earlier. If you don't expect to be subject to the AMT this year or next, consider deferring income to next year and accelerating deductible expenses into this year, because this will defer tax, which is usually beneficial. But if you expect to be in a higher tax bracket next year, the opposite approach may be beneficial.

Whatever the reason you'd like to time income and expenses, here are some items whose timing you may be able to control:

Income:

- ▼ Bonuses,
- ▼ Consulting or other self-employment income,
- ▼ U.S. Treasury bill income,
- ▼ Real estate or other nonpublicly traded property sales, and
- ▼ Retirement plan distributions, if not required.

Expenses:

- ▼ State and local income taxes,
- ▼ Real estate taxes,
- ▼ Mortgage interest,
- ▼ Margin interest, and
- ▼ Charitable contributions.

Important: Prepaid expenses can be deducted only in the year to which they apply. For example, you can prepay (by Dec. 31, 2008) real estate taxes for the year 2008 that are due in 2009, and deduct the payment on your 2008 return. But you can't prepay real estate taxes for 2009 and deduct the payment on your 2008 return.

Bunch deductions

Expenses that may qualify as miscellaneous itemized deductions are deductible for regular tax purposes only to the extent they exceed, in aggregate, 2% of your AGI. Bunching these expenses into a single year may allow you to exceed this floor.

Carefully record your potential deductions to date. If they are close to or already exceed the 2% floor — and you don't expect to be subject to the AMT this year — where possible, pay accrued expenses and incur and pay additional expenses by Dec. 31, such as:

- ▼ Deductible investment expenses, including investment advisory fees, custodial fees, safe deposit box rentals and investment publications,
- ▼ Professional fees, such as tax planning and preparation, accounting, and certain legal fees (to the extent deductible), and
- ▼ Unreimbursed employee business expenses, including travel, meals, entertainment, vehicle costs and publications — all exclusive of personal use.

Similarly, medical expenses are generally deductible only to the extent they exceed

7.5% of your AGI. (For AMT purposes, however, only medical expenses in excess of 10% of your AGI are deductible.) To take advantage of the deduction, consider bunching your nonurgent medical procedures and other controllable expenses into one year. Bunching medical expenses is often easier to do than bunching miscellaneous itemized deductions.

Deductible medical expenses include:

- ▼ Health insurance premiums,
- ▼ Prescription drugs, and
- ▼ Medical and dental costs and services.

Keep in mind that expenses that are reimbursed (or reimbursable) by insurance or paid through a pretax Health Savings Account (HSA) or Flexible Spending Account (FSA) aren't deductible.

If one spouse has high medical expenses and a relatively lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn't be deductible if you filed jointly. But beware of an AMT trap: The AMT exemption for separate returns is considerably lower than the exemption for joint returns.

Consider the sales tax deduction

EESA has extended through 2009 the provision that allows you to deduct state and local *sales* taxes in lieu of state and local *income* taxes. You may benefit if you live in a state with no or low income tax or if you've purchased major items, such as cars or boats. ▲

Case Study 2

Bad timing can mean more taxes

Say you and your spouse are subject to the maximum ordinary-income rate of 35% and take these steps by Dec. 31, 2008, to maximize tax deferral:

Defer billing of consulting fees earned in 2008 to Jan. 1, 2009	\$ 25,000
Pay 2008 real estate tax bill due in early 2009 and fourth quarter 2008 state estimated tax payment due in 2009	29,000
Make charitable contributions in 2008 that would otherwise be made in 2009	10,000
Total reduction of 2008 taxable income	\$ 64,000
Federal tax rate	35%

Tax deferred to next year \$22,400

But, if you have to pay the alternative minimum tax (AMT) in 2008 (and not in 2009), these year end strategies can cost you:

The deferred consulting fees will be subject to your regular tax rate of 35%, rather than the lower 28% AMT rate if collected in 2008	\$ 1,750
The prepaid real estate taxes and fourth quarter 2008 state estimated tax payment aren't deductible for AMT purposes, so they'll generate no tax benefit	10,150
The charitable contributions will generate a tax benefit of only 28%, rather than 35% if made in 2009	700
Total additional 2008 taxes	\$12,600



Rewards may come with tax perils

EXECUTIVE COMPENSATION

Executives (and other key employees) often are compensated with more than just salary, fringe benefits and bonuses. They also may be rewarded through more sophisticated methods with more complicated tax consequences, such as nonqualified deferred compensation (NQDC), stock options and restricted stock. But tax perils can come with these valuable rewards. To avoid them, awareness is key.

Understand your NQDC plan

NQDC plans pay executives some time in the future for services to be currently performed. They differ from qualified plans, such as 401(k)s (see page 24), in that:

- ▼ NQDC plans can favor certain highly compensated employees,
- ▼ Although the executive's tax liability on the deferred income also may be deferred, the employer can't deduct the NQDC until the executive recognizes it as income, and
- ▼ Any NQDC plan funding isn't protected from the employer's creditors.

Over the past few years, Internal Revenue Code (IRC) Section 409A and related IRS guidance have tightened and clarified the rules for NQDC plans, and the compliance deadline is looming. (See the Tax Law Change Alert at right.) Some of the most significant changes affect:

Timing of initial deferral elections.

Executives must make the initial deferral

election before the year in which they perform the services for which the compensation is earned. So, for instance, an executive who wishes to defer part of his or her 2009 compensation to 2010 or beyond generally must make the election by the end of 2008.

Timing of distributions. Benefits must be paid on a specified date, according

to a fixed payment schedule or after the occurrence of a specified event — such as death, disability, separation from service, change in ownership or control of the employer, or an unforeseeable emergency.

Elections to change timing or form. The timing of benefits can be delayed but not accelerated. Elections to change the timing or form of a payment must be made at least 12 months in advance. Also, new payment dates must be at least five years after the date the payment would otherwise have been made.

Another important NQDC tax issue is that employment taxes are generally due when services are performed or when there's no longer a substantial risk of forfeiture, whichever is later. This is true even though

Tax Law Change Alert

Nonqualified deferred compensation plan compliance date looms

Employers have until Dec. 31, 2008, to bring their nonqualified deferred compensation (NQDC) plans into compliance with the final regulations under Section 409A of the Internal Revenue Code.

Employers should identify all plans that may be subject to Sec. 409A and have them reviewed to determine whether they're operationally and administratively compliant. If a plan isn't compliant, the employer must bring the plan and plan documents into conformity by Dec. 31, 2008. (Employers must also have operated their plans in "good faith" compliance with Sec. 409A retroactive to 2005, when the requirements first went into effect.)

The penalties for noncompliance can be severe: Plan participants will be taxed on plan benefits at the time of vesting, and a 20% penalty tax and potential interest charges also will apply. So executives receiving NQDC should also check with their employers to make sure they're addressing any compliance issues.

ISO exercises require careful planning

Let's say you're granted an incentive stock option (ISO) to buy 40,000 shares of your company stock at \$15 a share, exercisable over four years. When eligible one year later, you begin annually exercising 10,000 shares at the trading price of \$25 each year. Within four years, you exercise all 40,000 shares. Assuming you hold the stock for an additional year and then sell it for \$30 per share, your tax consequences are as follows:

- ▼ No regular tax cost when the options are granted or exercised,
- ▼ An alternative minimum tax (AMT) preference item of \$100,000 each year (10,000 shares selling at \$25 per share, reduced by your cost of \$15 per share), potentially creating an AMT liability of as much as \$28,000 per year,
- ▼ A long-term capital gain of \$600,000 when you sell the shares (40,000 shares at \$30 per share less your basis of \$15 per share), resulting in a maximum federal tax cost of \$90,000 (at the long-term capital gains rate of 15%), and
- ▼ An AMT credit, which may help ameliorate the initial AMT effect by offsetting regular taxes in future years.

Your net cash benefit of the exercise and sale is:

Proceeds from the sale	\$1,200,000
AMT (maximum amount)	(112,000)
Capital gains tax	(90,000)
AMT credit ¹	112,000
<hr/>	
Net proceeds after taxes	1,110,000
Cost to purchase the shares	(600,000)
<hr/>	
Net cash benefit	\$ 510,000

A falling stock price, however, can result in costly tax consequences: If, for example, the price per share falls back to \$15 after your initial exercise of 10,000 shares, you may be subject to an AMT liability as high as \$28,000. This is because the exercise results in the \$100,000 tax preference item. So if the AMT applies, you'll pay tax even though the selling price of your shares is equal to the price you paid for them. You'll be able to claim a credit for the AMT paid, but you may not fully recoup the tax. Nevertheless, the net tax paid may still be less than selling the shares in a disqualifying disposition in the year of exercise.

¹You'll realize the AMT credit only to the extent your regular tax exceeds your tentative AMT liability in any year. All or part of the credit can also be refundable if certain conditions are met. A negative AMT adjustment in the year of sale for the difference between the gain for AMT purposes and the regular tax gain allows the AMT paid to be recouped faster.

the compensation isn't actually paid or recognized for income tax purposes until later years. So employers may:

- ▼ Withhold the executive's portion of the tax from his or her salary or ask the executive to write a check for the liability, or
- ▼ Pay the executive's portion, in which case the executive will have additional taxable income.

Avoid the tax pitfalls of ISOs

Incentive stock options (ISOs) deserve special attention. If properly structured, they aren't subject to the complex NQDC rules, but they must comply with other rules to receive tax-favored treatment.

If you're an executive who's received ISOs, you must carefully decide when to exercise them and whether to immediately sell or hold shares received from an exercise.

Although the rules are complex, they also offer opportunities to minimize your taxes. Here are some key considerations:

How ISOs work. ISOs allow you to buy company stock in the future at a fixed price determined when the options are granted. This price must be equal to or greater than the stock's fair market value at the date of the grant. Therefore, the stock must appreciate before the ISOs will have any value. When they do — and once you've satisfied the applicable holding periods — you can buy shares at a price below what they're trading for. To qualify as an ISO, an option must have an expiration date no later than 10 years after the date on which it's granted.

ISO tax consequences. The key tax consequences related to granting and exercising ISOs include:

- ▼ No tax cost when the options are granted,
- ▼ No regular tax cost when the options are exercised — though a tax "preference" item is created on the difference between the fair market value of the stock and the exercise price (the "bargain element"), which is included in income for alternative minimum tax (AMT) purposes but not regular tax purposes and thus can trigger the AMT (see page 4),
- ▼ Long-term capital gains treatment if the shares are held one year from the date of the exercise or two years from the date the options were granted, whichever is later,
- ▼ A disqualifying disposition with any gain taxed as compensation at ordinary-income rates — and no AMT preference item — if the stock is sold before long-term capital gains treatment applies, and
- ▼ No compensation deduction for the employer unless the executive makes a disqualifying disposition.

AMT ALERT: *The AMT preference item for the bargain element when ISOs are exercised is particularly a problem because exercising the option doesn't generate any cash with which to pay the tax — and the problem is magnified if the stock price then drops by the time the shares are sold. You can be left with a large AMT bill in the year of exercise, though it will create an AMT credit for future years. (See Case Study 3.)*

ISO timing considerations. Waiting until immediately before the expiration date to exercise options (when the stock value may be the highest, assuming the stock is appreciating) and holding on to the stock long enough to garner long-term capital gains treatment often is beneficial. But in several situations, acting earlier can be advantageous:

- ▼ Exercise early to start your holding period so you can receive long-term capital gains treatment sooner.
- ▼ Exercise when the bargain element is small or when the market price is close to bottoming out to reduce or eliminate your AMT liability.
- ▼ Exercise annually so you can buy only the number of shares that will achieve a break-even point between the AMT and regular tax and thereby incur no additional tax.
- ▼ Sell early in a disqualifying disposition and pay the higher ordinary-income rate to avoid the AMT on potentially disappearing appreciation.

On the negative side, exercising early:

- ▼ Accelerates the need for funds to buy the stock,
- ▼ Exposes you to a loss if the value of the shares drops below your exercise cost, and
- ▼ May create a tax cost if the preference item from the exercise generates an AMT liability.

Tax planning for ISOs is truly a numbers game. With the help of your tax advisor, you'll need to evaluate the risks and crunch the numbers using various assumptions.

Take into account NQSO differences

The tax treatment of nonqualified stock options (NQSOs) is considerably different from that of ISOs:

- ▼ NQSOs create compensation income (taxed at ordinary-income rates) on the bargain element when exercised but don't create an AMT preference item.
- ▼ The employer gets a compensation deduction when the executive exercises the NQSO.

One benefit of NQSOs is that how they are taxed doesn't depend on whether the stock is held or sold immediately. Federal income tax and employment taxes are withheld from proceeds if the stock is sold in a cashless exercise. You may need to make estimated tax payments or increase other withholding to fully cover the tax. State tax estimates should also be considered.

Consider the 83(b) election for restricted stock

Restricted stock is stock that's granted subject to a substantial risk of forfeiture.

Income recognition is normally deferred until the restricted stock is no longer subject to that risk or you sell the stock. You then pay taxes on the fair market value of the stock at the ordinary-income rate.

But, under IRC Section 83(b), you can elect to instead recognize ordinary income when you receive the stock. This election, which you must make within 30 days after receiving the stock, can be beneficial if the income at the grant date is negligible or the stock is likely to appreciate significantly before income would otherwise be recognized. Why? Because the election allows you to convert future appreciation from ordinary income to long-term capital gains income, and defer it until the stock is sold.

There are some disadvantages of a Sec. 83(b) election:

- ▼ You prepay tax in the current year. But if a company is in the earlier stages of development, this may be a small liability.
- ▼ Any taxes you pay because of the election can't be refunded if you eventually forfeit the stock or the stock's value decreases. But you'll have a capital loss when you sell the stock.

Work with your tax advisor to map out compensation strategies best suited for your situation. ▲





Making tax-smart investment decisions

INVESTING

Investments come in a variety of types and tax treatments, and investment income can include both earnings while you own an asset (interest or dividends) and gain upon its sale. Understanding the tax cost can help you compare investment choices and make tax-smart investment decisions, which is especially important with the market as volatile as it's been.

Here are some important factors to consider:

- ▼ Long-term capital gains and qualified dividend income generally are taxed at 15% for both regular tax and alternative minimum tax (AMT) purposes. Keep in mind, though: You have only through 2010 to take advantage of the 15% rate, unless Congress extends it. (See the Tax Law Change Alert below for when a 0% rate applies.)
- ▼ To benefit from long-term capital gains treatment, you must have held a capital asset for more than 12 months.
- ▼ Net short-term capital gains, nonqualified dividends, and interest are subject to ordinary-income rates and therefore could be taxed at a rate as high as 35%.
- ▼ Special rates, exclusions or rules apply to certain types of investments, such as mutual funds, qualified small business stock (see page 12), passive activities and personal residences.
- ▼ You may reap benefits from tax-deferred sale strategies or investment interest deductions.

Nevertheless, when buying or disposing of investments, remember that tax goals are just one part of the equation. Also consider

your risk tolerance, desired asset allocation and whether an investment makes sense for your financial and personal situation.

Time gains and losses

Appreciating investments that don't generate current income aren't taxed until sold, deferring tax and perhaps allowing you to time the sale to your tax advantage — such as in a year when you're in a lower tax bracket or have capital losses to offset.

Capital losses are netted with capital gains to determine your capital gains tax liability (or loss). You can even offset net short-term gains with net long-term losses and net long-term gains with net short-term losses. By determining your year-to-date gains and losses now, you can time sales of other investments before year end to maximize your tax savings:

If you have a net capital gain. Tax is computed at the long-term capital gains rate or your ordinary-income rate, depending on whether the net gain is long-term or short-term. Higher long-term gains rates apply to certain types of assets. (See Chart 4 on page 13.) Also consider the following:

- ▼ Look for unrealized losses in your portfolio and sell the assets, thus offsetting

Tax Law Change Alert

No capital gains tax in 2008 — for some

From 2008 through 2010, the long-term capital gains rate drops to zero — but only for capital gain that would be taxed at 10% or 15% based on the taxpayer's regular income tax rate. If you have adult children in one of these brackets, there may be ways you can help them benefit from the lower capital gains rate, which also applies to qualified dividends.

For example, suppose you want to help out your 22-year-old daughter, who recently graduated from college and now is in a promising but low-paying job. You can give her qualified-dividend-producing stock that can provide her with tax-free income, at least through 2010.

Or perhaps you wish to give your 30-year-old son money toward a down payment to buy his first home. Instead of giving him cash, give long-term appreciated stock, which he can then sell without owing any tax on the gains.

But before implementing one of these strategies, make sure your child won't be subject to the kiddie tax. (See the Tax Law Change Alert on page 21.) Also, consider any gift tax consequences. (See page 28.)

the gains. But first evaluate whether it pays to do so. For example, it may be wiser to pay 15% tax on a net long-term capital gain and to defer realizing losses until they can offset gains that would be subject to higher rates.

- ▼ If you decide to offset a net gain, remember your tax savings will be based on the type of gain you reduced or eliminated, not on whether you used a net short-term or long-term loss.
- ▼ If you're trying to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from using a loss on a security if you buy the same — or substantially identical — security within 30 days before or after you sell the security that created the loss.
- ▼ There are ways to avoid the wash sale rule. For example, you may buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. You also can do a bond swap, where you sell a bond at a loss and then immediately buy another bond of similar quality from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical.

AMT ALERT: Substantial net long-term capital gains can trigger the AMT. (See page 4.)

If you have a net capital loss. You can claim up to \$3,000 (\$1,500 for married taxpayers filing separately) of the loss against ordinary income this year and carry forward any excess to future years. Also consider the following:

- ▼ You may want to realize gains before year end to use any excess loss. But first evaluate whether it may be more beneficial to carry forward the loss. For instance, if you can use the loss next year to offset short-term gains, rather than using it this year to offset a long-term gain, the deferral may be worthwhile.

- ▼ Remember that capital gains distributions from mutual funds can also be offset with capital losses.

Sweat the details. If you don't keep in mind the following rules, the tax consequences of a sale may be different from what you expect:

- ▼ Investors usually want to sell high-tax-basis shares when possible to reduce gain or increase the loss and offset other gains. But if you bought the same security at different times and prices, you should specifically identify in writing which shares are to be sold by the broker before the sale.
- ▼ For tax purposes, the trade date, not the settlement date, of publicly traded securities determines the year in which you recognize the gain or loss.

Watch out for two mutual fund pitfalls

Investing in mutual funds is an easy way to diversify your portfolio. But keep these two tax pitfalls in mind:

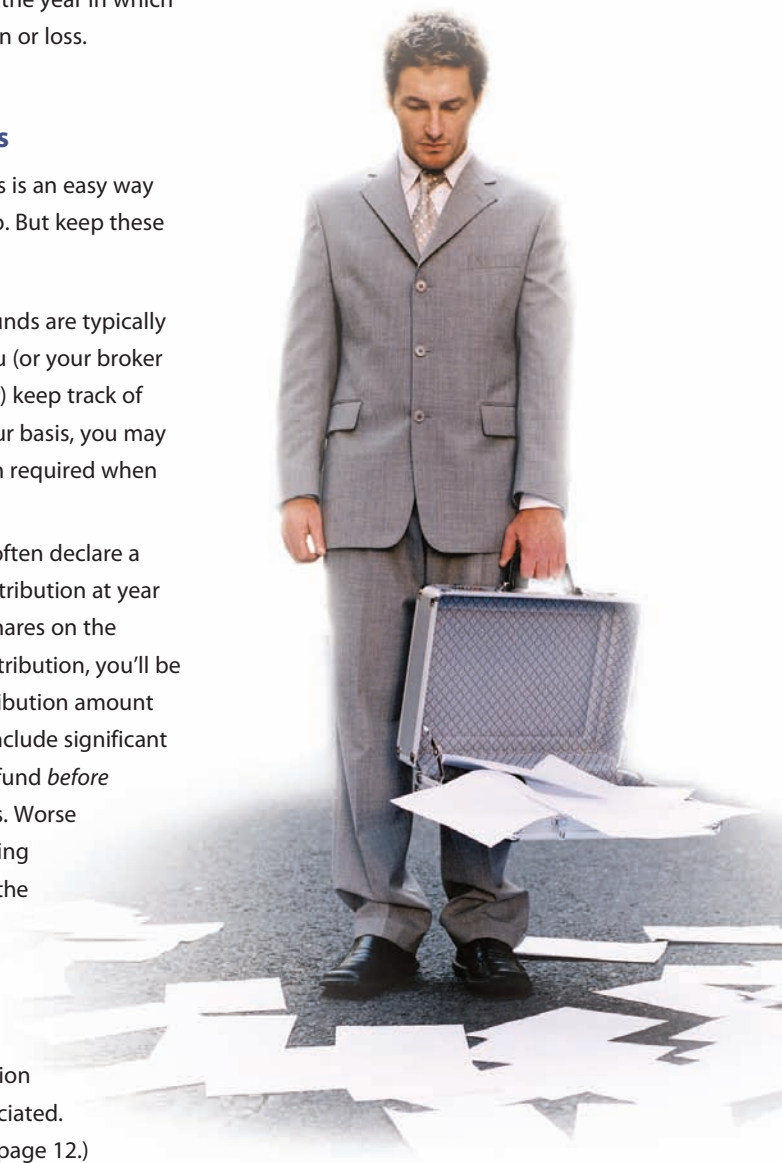
1. Earnings on mutual funds are typically reinvested. Unless you (or your broker or investment advisor) keep track of these additions to your basis, you may report more gain than required when you sell the fund.
2. Equity mutual funds often declare a large capital gains distribution at year end. If you own the shares on the record date of the distribution, you'll be taxed on the full distribution amount even though it may include significant gains realized by the fund *before* you owned the shares. Worse yet, you'll end up paying tax on those gains in the current year — even if you reinvest the distribution in the fund and regardless of whether your position in the fund has appreciated. (See Case Study 4 on page 12.)

Choose income investments wisely

While qualifying dividends generally are taxed at the reduced rate of 15%, interest income is taxed at ordinary-income rates up to a maximum of 35%. So, dividend-paying stocks may be more attractive from a tax perspective than other income investments, such as CDs and bonds. But there are many exceptions:

Some dividends are subject to ordinary-income rates. These may include certain dividends from:

- ▼ Money market mutual funds,
- ▼ Real estate investment trusts (REITs),
- ▼ Foreign investments,



Mutual fund distributions have a taxing effect

Typically, distributions from mutual funds are reinvested in the fund. But the distribution itself, in most instances, doesn't change your value in the fund. It simply increases the number of shares you own, yet now at a lower per-share value. Unfortunately, the distribution can cost you taxes.

For example, let's say you purchased 2,500 shares of an equity mutual fund on Dec. 1, 2008, at \$50 per share. The next week, the fund makes a capital gains distribution of \$8 per share. You end up with capital gains income of \$20,000 (2,500 shares at \$8 per share), reportable on your 2008 return. It doesn't matter whether the actual value of the shares has increased or even decreased since you purchased them.

- ▼ Regulated investment companies (RICs), and
- ▼ Stocks, to the extent the dividends are offset by margin debt.

Some bond interest is exempt from income tax. For example:

- ▼ Interest on U.S. government bonds is taxable on your federal return, but it's generally exempt on your state and local returns.
- ▼ Interest on state and local government bonds is excludible on your federal return. If the state or local bonds were issued in your home state, interest also may be excludible on your state return.

Although state and municipal bonds usually pay a lower interest rate, their rate of return may be higher than the after-tax rate of return for a taxable investment.

AMT ALERT: *Private activity municipal bonds may subject you to the AMT.*

Review your retirement plans

Consider which investments you should hold inside and outside your retirement accounts. For instance:

- ▼ If you hold taxable bonds to generate income and diversify your overall portfolio, consider holding them in a retirement account where there won't be a current tax cost.

- ▼ Bonds with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay you this interest annually — and you must pay tax on it. So, they also may be best suited for retirement accounts.
- ▼ Try to own dividend-paying stocks that qualify for the 15% tax rate outside of retirement plans so you'll benefit from the lower rate.

It's also important to periodically reallocate your retirement plan assets. For example, the allocation you set up for your 401(k) plan 10 years ago may not be appropriate now that you're closer to retirement. (See page 24 for more on retirement planning.)

Reap the rewards of small business stock

If you, as an individual, buy stock in a qualified small business (QSB), you may qualify for preferential tax treatment. Here are the three main tax benefits QSB stock offers:

1. **Conversion of capital loss to ordinary loss.** If you sell QSB stock at a loss, you can treat up to \$50,000 (\$100,000, if married filing jointly) as an ordinary, rather than a capital, loss — regardless of your holding period. This means you

can use it to offset ordinary income, such as salary and interest, reducing your taxes by as much as 35% of the loss.

2. **Tax-free gain rollovers.** If within 60 days of selling QSB stock you buy other QSB stock with the proceeds, you can defer the tax on your gain until you dispose of the new stock. The rolled over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold.

3. **Exclusion of gains.** You may be eligible to exclude 50% of the gain from the sale of QSB stock. However, the actual tax benefit you'll receive will equal only 1% of the gain — the difference between the 15% maximum long-term capital gains rate and the effective tax rate on the sale of 14%. Why 14%? Because the taxable portion of the gain is subject to tax at 28%, and thus the 50% exclusion results in a tax rate of 14%.

Keep in mind that each of the tax benefits listed above is subject to specific requirements and limitations, such as those related to the date purchased and holding period. Be sure to consult your tax or financial advisor to be sure an investment in QSB stock is right for you.

Plan for passive losses

If you've invested in a trade or business in which you don't materially participate, you need to remember that passive activity losses generally are deductible only against income from other passive activities. You can carry forward disallowed losses to the following year, subject to the same limitations.

To avoid passive activity treatment, typically you must participate in a trade or business more than 500 hours during the year or demonstrate that your involvement constitutes substantially

all of the participation in the activity. If you don't pass this test, there are steps you may be able to take to turn passive losses into tax-saving opportunities:

- ▼ Increase your involvement in the activity to more than 500 hours, so it's no longer subject to passive loss limits.
- ▼ Dispose of the activity. You're then allowed to deduct all the losses — including any loss on disposition (subject to basis and capital loss limitations). But the rules about recognizing losses on the disposition of a passive activity can be complex, so it's important to consult with your tax advisor.
- ▼ If you own a limited partnership interest in a business, limit your participation in an activity that's generating income to less than 500 hours or invest in another income-producing trade or business that will be passive to you. Under both strategies, you'll have passive income that can offset your passive losses.

Warning: A rental activity won't produce passive income (though any losses will still be passive) if the taxpayer provides property for use in an activity that's conducted by a flow-through entity in which the taxpayer owns an interest. Thus, you can't generate passive income by, for example, renting a building to your professional corporation at an inflated rent.

Keep in mind that losses from real estate activities are passive by definition — unless you're a real estate professional. Then you can deduct rental real estate losses in full. To qualify, you must annually perform:

1. More than 50% of your personal services in real property trades or businesses, and
2. More than 750 hours of "significant and bona fide" service in these businesses during the year.

If you fail either test and you have passive losses, try to increase your hours to



meet the test and convert current-year passive losses into deductible losses. If you actively participate in a rental real estate activity but you aren't a real estate professional, you may be able to deduct up to \$25,000 of real estate losses each year. This deduction is subject to a phaseout beginning when adjusted gross income (AGI) reaches \$100,000 (\$50,000 for married taxpayers filing separately).

Use tax-deferred sale strategies when appropriate

Would you like to divest yourself of an appreciated asset but defer the tax liability? With proper planning, it's possible. Here are two strategies to consider:

1. Like-kind exchange. If you're thinking of selling rental property or investment real estate, consider a like-kind exchange (also known as a Section 1031 exchange). You

Installment sales provide tax deferral, with some risk

In 2008, you sell a building you own by agreeing to give the buyer a 10-year mortgage for 75% of the net selling price of \$1.2 million. The first mortgage payment is due in January 2009. You initially paid \$600,000 for the building but \$240,000 of accumulated depreciation has reduced your tax basis to \$360,000, resulting in a capital gain of \$840,000.

You elect installment sale reporting. Your taxable gain for 2008 is \$210,000 (\$300,000 down payment at the gross profit ratio of 70%, which is the ratio of the total gain of \$840,000 compared to the selling price of \$1.2 million). Because the gain on the sale up to the amount of certain prior depreciation claimed is “recaptured” first and taxed at 25%, your tax for 2008 is \$52,500 (\$210,000 x 25%).

The remaining tax of \$97,500 gets deferred, payable only as additional principal payments are received. The remaining \$30,000 of gain related to depreciation is taxed at 25%. The rest of the capital gain is taxed at 15%. But, if the 15% long-term capital gains rate isn’t extended, you could ultimately end up paying more tax overall.

may be able to defer paying tax on the gain until you sell the replacement property.

2. Installment sale. An installment sale allows you to defer capital gains on most assets other than publicly traded securities by spreading the gain over several years as you receive the proceeds. **Warning:** Ordinary gain, including certain depreciation recapture, is recognized in the year of sale, even if no cash is received. (See Case Study 5 above.)

Keep in mind, however, that tax deferral may be somewhat risky because of the scheduled return of the long-term capital gains rate to 20% in 2011.

Consider investment interest expense

Investment interest — interest on debt used to buy assets held for investment, such as margin debt used to buy securities — is deductible, but special rules apply:

- ▼ Your investment interest deduction is limited to your net investment income, which generally includes taxable interest, dividends and short-term capital gains (but not long-term capital gains), reduced by other investment expenses.

- ▼ Any disallowed interest is carried forward, and you can deduct it in a later year if you have excess net investment income.
- ▼ You may elect to treat net long-term capital gain or qualified dividends as investment income in order to deduct more of your investment interest. But if you do, that portion of the long-term capital gain or dividend is taxed at ordinary-income rates.

- ▼ Payments a short seller makes to the stock lender in lieu of dividends may be deductible as an investment interest expense.
- ▼ Interest on debt used to buy securities that pay tax-exempt income, such as municipal bonds, isn’t deductible.

Also keep in mind that passive interest expense — interest on debt incurred to fund passive activity expenditures — becomes part of your overall passive activity income or loss, subject to limitations.

Take advantage of home-related tax breaks

Whether you own one home or several, it’s important to maximize your deductions and plan for any gains or rental income:

Property tax. If you’re looking to accelerate or defer deductions (see page 5), property tax is one expense you may be able to time. You can choose to pay your 2008 bill that is due in early 2009 by Dec. 31, 2008, and deduct it this year. Or you can wait until the due date and deduct it in 2009.

AMT ALERT: *Property tax isn’t deductible for AMT purposes. If you end up subject to the AMT this year, a prepayment will be for naught because you’ll lose the deduction.*

Tax Law Change Alert

Housing act may increase taxes for certain homeowners

Although the Housing and Economic Recovery Act of 2008 provides tax breaks for first-time homebuyers and nonitemizing homeowners (which your children or parents may benefit from — contact your tax advisor for details), it may increase taxes for those who convert a vacation home or rental property to a primary residence before selling it.

Under the act, the home sale gain exclusion (see “Gains and losses on your principal residence,” at right) won’t apply to the extent that it relates to the “nonqualified use period” of a residence. Generally, this is any period beginning on or after Jan. 1, 2009, that the property is not used as the taxpayer’s principal residence. So if you convert a vacation home or rental property to your principal residence and sell it after 2008, part of any gain may be taxable even if you’ve used it as a principal residence for the required time (two of the last five years) under the gain exclusion’s use test.

There is an exception for homes that are first used as a principal residence and later converted to nonqualified use, which could protect those unable to sell their homes. So, even if you don’t live in the home while trying to sell it, you still may be eligible for the full gain exclusion, provided you meet the other requirements for the exclusion.



Acquisition debt. You can deduct interest on up to a combined total of \$1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. And you can deduct points related to a loan for purchasing or improving your *principal* residence.

Home equity debt interest. Interest on home equity debt used to improve your principal residence — plus interest on up to \$100,000 of home equity debt used for any purpose — is deductible. So consider using home equity debt to pay off credit cards or auto loans, whose interest isn't deductible.

AMT ALERT: *If home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes and could trigger the AMT.*

Gains and losses on your principal residence. When you sell your principal residence, you can exclude up to \$250,000 (\$500,000 for joint filers) of gain if you meet certain tests. To support an accurate tax basis, maintain thorough records, including information on your original cost and subsequent improvements, reduced by casualty losses and any depreciation that may have been claimed based on business use. Losses aren't deductible. But if part of your home is rented or used exclusively for your business, the loss attributable to that portion will be deductible, subject to various limitations.

Gains and losses on second homes.

Because a second home is ineligible for the gains exclusion, consider converting it to rental use before selling. It will then be considered a business asset, and you

may be able to defer tax on any gains by doing a like-kind exchange. (See page 13.) Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion. (Also see the Tax Law Change Alert at left.)

Rental income. The rules are complicated, but here are the basics:

- ▼ If you rent out all or a portion of your primary residence or second home for less than 15 days, you don't have to report the income. But expenses associated with the rental aren't deductible.

- ▼ If you rent out your primary residence for 15 days or more, you'll have to report the income, but you also may be entitled to deduct some or all of your rental expenses — such as utilities, repairs, insurance and depreciation. However, you can deduct expenses only to the extent of your rental income. Any excess can be carried forward to offset rental income in future years.
- ▼ If the home is classified as a rental property for tax purposes, you can't deduct any interest that's attributable to your personal use of the home. But you can take the personal portion of property tax as an itemized deduction and deduct rental expenses, including losses (subject to the passive activity rules).

In some situations, it may be beneficial to reduce personal use of a residence so it will be classified as a rental property. (See Case Study 6.) ▲

Case Study 6

Converting a personal residence to a rental property may save taxes

Let's say you own a vacation home that, during the year, you use a few times and rent out several weeks, collecting a total of \$20,000 in rent. Your mortgage interest is \$10,000, your property taxes are \$8,000, and your other expenses related to the home are \$12,000, for a total of \$30,000 of expenses in 2008. You also own another property that you rent out, but you don't use it personally. It generates net income of \$10,000 for the year.

Assuming your personal use of the vacation home is enough that it's considered a residence for tax purposes (used more than the greater of 14 days or 10% of the days the home is rented to others), your rental expense deduction is limited to the \$20,000 in rental income. If, based on your use of the home, your expenses are 20% personal and 80% rental, you can deduct 20% of your interest and taxes, or \$3,600, as itemized deductions. Your rental expenses are \$24,000 (80% of \$30,000). You can use \$20,000 of those expenses to offset your rental income, but you can't deduct the rental loss of \$4,000 — you can only carry it forward. So, your 2008 total deductions related to the home are \$23,600.

If you reduce your personal use to the point where the home is classified as a rental property, you may be able to enjoy some tax savings. Let's say your expenses are now approximately 10% personal and 90% rental. The rental portion of interest, taxes and other expenses is \$27,000 (90% of \$30,000), resulting in a \$7,000 loss, which, because your rental income from your other rental property is sufficient to absorb it, is fully deductible. Although you can't deduct your personal portion of interest, you can take your 10% personal portion of property taxes, or \$800, as an itemized deduction. By converting the property from personal to rental, you increase your total current deductions related to the home to \$27,800.

Tie together your business and personal financial goals

BUSINESS OWNERSHIP

The ultimate goal of a business isn't just to be profitable; it's to build wealth for its owners. So if you're an owner, you must make an effort to tie your business strategies to your personal tax and estate planning goals.

Evaluate business structure

The structure of your business has major tax consequences, but taxes shouldn't be the only consideration when evaluating structure. Business structures fall into three categories:

1. Entities that "pass through" taxation to the individual owners but don't provide liability protection, such as sole proprietorships and general partnerships,
2. Entities that pass through taxation and provide liability protection, such as limited partnerships, limited liability partnerships (LLPs), limited liability companies (LLCs) and S corporations, and

3. Entities that are taxed as a separate entity and provide liability protection for shareholders, such as C corporations.

See Chart 5 for the corporate tax rates and Chart 6 for a summary of pass-through vs. C corporation taxation.

You also must consider the impact of state income taxes in the states where your company does business.

Employment tax consequences for owner-employees should also be considered. For example:

Partnerships and LLCs. Generally all trade or business income that flows through to you for income tax purposes

is subject to self-employment tax — even if the income isn't actually distributed to you. (See page 2.)

S corporations. Only income you receive as salary is subject to employment tax. So to reduce your employment tax, you may want to keep your salary relatively low and increase your distributions of company income. But to avoid potential back taxes and penalties, you must take a reasonable salary — generally what would be paid to an outside individual performing the same services for your company.

C corporations. Only income you receive as salary is subject to employment tax. You may prefer to take more income as salary (which is deductible at the corporate level) because the overall tax paid by both the corporation and you may be less.

Note that the IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

Don't wait to develop an exit strategy

Many business owners don't have company-sponsored pension plans and most of their money is tied up in their business, making retirement a challenge. Others want to make sure their business — or at least the bulk of its value — will be passed to their loved ones without a significant loss to estate taxes. If you're facing either situation, now is the time to start developing an exit strategy that will maximize the value you or your heirs

Chart 5

2008 corporate income tax rate schedule

Tax rate	Tax bracket
15%	\$ 0 – \$ 50,000
25%	\$ 50,001 – \$ 75,000
34%	\$ 75,001 – \$ 100,000
39%	\$ 100,001 – \$ 335,000
34%	\$ 335,001 – \$ 10,000,000
35%	\$ 10,000,001 – \$ 15,000,000
38%	\$ 15,000,001 – \$ 18,333,333
35%	Over \$ 18,333,333

*Note: Personal service corporations are taxed at a flat 35% rate.
Source: U.S. Internal Revenue Code*



receive from the business while minimizing the tax bite.

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money. Because a stable business is worth more than an unstable one, creating a seamless transition is essential to maximize the value of your investment. This requires planning while the company is in good economic health. Here are the most common exit options:

Buy-sell agreements. When a business has more than one owner, a buy-sell agreement can be a powerful tool. The agreement controls what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. Among other benefits, a well-drafted agreement:

- ▼ Provides a ready market for the departing owner's shares,
- ▼ Sets a price for the shares, and
- ▼ Allows business continuity by preventing unnecessary disagreements caused by new, unwanted owners.

A key issue with any buy-sell agreement is providing the buyer with a means of funding the purchase. Life or disability insurance often helps fulfill this need and can give rise to several tax and nontax issues and opportunities.

One of the biggest advantages of life insurance as a funding method is that proceeds generally are excluded from the beneficiary's taxable income. There are exceptions to this, however, so be sure to consult your tax advisor.

Succession within the family. You can pass your business on to family members or close relatives by:

- ▼ Giving interests,
- ▼ Selling interests, or
- ▼ Doing some of each.

Be sure to consider your income needs, how family members will feel about

Chart 6

Tax differences based on business structure

Pass-through entity	C corporation
One level of taxation: The business's income flows through to the owners.	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owners. Owners may realize current tax savings by taking any losses individually. However, there may be limitations due to basis.	Losses remain at the corporate level and are carried forward to offset future corporate-level income.
Top individual tax rate is 35%.	Top corporate tax rate is generally 35% ¹ . Income distributed as dividends is taxed a second time, generally at 15%.

¹ See Chart 5 for exceptions.

your choice, and the gift and estate tax consequences. (See page 28.)

Nonfamily succession. Here are three nonfamily options:

- ▼ **Management buyout.** This may provide for a smooth transition because there may be little learning curve for the new owners. Plus you avoid the time and expense of finding an outside buyer.
- ▼ **Employee stock ownership plan (ESOP).** An ESOP is a qualified retirement plan created primarily to purchase your company's stock. Whether you're planning for liquidity, looking for a tax-favored loan or supplementing an employee benefit program, an ESOP can offer you many advantages.
- ▼ **Selling to an outsider.** If you can find the right buyer, you may even be able to sell the business at a premium.

Assess tax consequences when buying or selling

Whether you're selling your business or acquiring another business, the tax consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

Asset vs. stock sale. With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. Buyers generally want

an asset sale to maximize future depreciation write-offs.

Taxable sale vs. tax-deferred transfer.

A transfer of ownership of a corporation can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying reorganization, but the transaction must comply with strict rules. Although it's generally better to postpone tax, there are some advantages to a taxable sale:

- ▼ The seller doesn't have to worry about the quality of buyer stock or other business risks that might come with a tax-deferred sale.
- ▼ The buyer benefits by receiving a stepped-up basis in its acquisition's assets and not having to deal with the seller as a continuing equity owner, as it would in a tax-deferred transfer.
- ▼ The parties don't have to meet the technical requirements of a tax-deferred transaction.

Installment sale. A taxable sale may be structured as an installment sale, due to the buyer's lack of sufficient cash or the seller's desire to spread the gain over a number of years. Installment sales are also useful when the buyer pays a contingent amount based on the business's performance. (See page 14 for more information on installment sales.) ▲



Do well by doing good: Create a win-win donation strategy

CHARITABLE GIVING

Giving to charity is one of the best tax planning opportunities available because you can enjoy not only a sizable tax deduction, but also the satisfaction of doing good. Plus you can control the timing to best meet your needs. Well-planned gifts also can save estate tax while allowing you to take care of your heirs in the manner you choose.

Pick the right giving strategy

In determining your charitable giving strategy, you need to consider what to give, as well as how to give it. Outright gifts of cash (which include gifts made via check, credit card and payroll deduction) are the easiest. The key is to make sure you substantiate them. To be deductible:

- ▼ Cash donations under \$250 must be supported by a canceled check, credit card receipt or written communication from the charity, and
- ▼ Those of \$250 or more must be substantiated by the charity.

Deductions for cash gifts can't exceed 50% of your adjusted gross income (AGI). This is a higher limit than applies to some other types of donations. (See Chart 7.) Contributions disallowed due to the AGI limit can be carried forward for up to five years.

Despite the simplicity and high AGI limits for outright cash gifts, making outright gifts of other types of assets or using the right charitable giving vehicle may prove more beneficial.

AMT ALERT: *Although charitable contribution deductions are allowed in figuring your alternative minimum tax (AMT) liability, the tax savings may be reduced if you're subject to the AMT.*

Plan gifts of property carefully

Gifts of property are a little more complicated. But, when properly planned, they may provide more tax benefits. Your deduction depends in part on the type of property donated:

Long-term capital gains property. This includes stocks and other securities you've held more than one year. It's one of the best charitable gifts:

- ▼ You can take a charitable deduction equal to its current fair market value.
- ▼ You avoid paying tax on the long-term capital gain you'd incur if you sold the property.

But beware: Gifts of appreciated assets are subject to tighter deduction limits than other contributions. (See Chart 7.) In limited circumstances it may be better to elect to deduct the basis rather than the fair market value, allowing you to

take advantage of the higher AGI limits. Whether this is beneficial will depend on your AGI and the likelihood of using — within the next five years — the carryover you'd have if you deducted the fair market value and the 30% limit applied.

Ordinary-income property. Examples include stock held less than a year, inventory and property subject to depreciation recapture. You can receive a deduction equal to only the lesser of fair market value or your tax basis. But the higher AGI limits apply.

Tangible personal property. Your deduction depends on the type of property and the charity:

- ▼ If the property isn't related to the charity's tax-exempt function (such as a painting donated for a charity auction), your deduction is limited to your basis in the property.
- ▼ If the property is related to the charity's tax-exempt function (such as a painting donated to a *museum*), you can deduct the property's fair market value.

Property donations also have detailed reporting requirements. For example, those valued at more than \$5,000 (other than publicly traded securities) must be supported by a qualified appraisal.

Donate from your IRA

If you're 70½ or older, you can distribute tax free up to \$100,000 annually from your

IRA (Roth or traditional) to your favorite charity through Dec. 31, 2009. Keep in mind: No charitable deduction is allowed for any amount that would have been otherwise taxable, but you save the tax you would have otherwise owed.

Benefit yourself and then charity with a CRT

To benefit a charity while helping ensure your own financial future, consider funding a charitable remainder trust (CRT). If properly structured, it offers several benefits:

- ▼ For a given term, the trust pays income to you. (The income is distributed in a specific order — first, any ordinary income, then any short-term capital gains, then any long-term capital gains, then any tax-exempt income and, finally, tax-free return of principal.)
- ▼ At the term's end, the trust's remaining assets pass to one or more charities.
- ▼ When you fund the trust, you receive an income tax deduction for the present value of the amount that will go to charity (the remainder interest).
- ▼ The property is removed from your estate.
- ▼ If you contribute appreciated assets, you can avoid paying capital gains tax on their sale.

You can name someone other than yourself as income beneficiary, but there may be gift tax consequences. You also can fund the trust at your death, but your estate won't receive an income tax deduction, only an estate tax deduction.

A CRT can work particularly well to diversify your investment portfolio if you own non-income-producing assets that would generate a large capital gain if sold. Because a CRT is a tax-exempt entity, it can sell the property without having to pay tax on the gain. The trust can then invest the proceeds in a variety of stocks and bonds. (See Case Study 7 on page 20.)

Chart 7

AGI limitations on charitable contribution deductions

The deduction for your total charitable contributions for the year is subject to a limitation based on your adjusted gross income (AGI) and the type of charity.

Public charity or operating foundation

Cash, ordinary-income property and unappreciated property

50%

Long-term capital gains property deducted at fair market value

30%

Long-term capital gains property deducted at basis

50%

Private nonoperating foundation

Cash, ordinary-income property and unappreciated property

30%

Long-term capital gains property deducted at fair market value

20%

Long-term capital gains property deducted at basis

30%

Source: U.S. Internal Revenue Code

Do the reverse with a CLT

A grantor charitable lead trust (CLT) is basically the opposite of the CRT:

- ▼ For a given term, the trust pays income to one or more charities.
- ▼ At the term's end, the trust's remaining assets pass to you.
- ▼ When you fund the trust, you receive an income tax deduction for the present value of the annual income expected to be paid to the charity. (You also pay tax on the trust income.)
- ▼ The trust assets remain in your estate.

With a nongrantor CLT, you name someone other than yourself as remainder beneficiary. You won't have to pay tax on trust income, but you also won't receive an income tax deduction. The trust assets will be removed from your estate, but there also may be gift tax consequences. Alternatively, the trust can be funded at your death, and your estate will receive an estate tax deduction (but not an income tax deduction).

A CLT can work well if you don't need the current income but want to keep an asset

in the family. As with other strategies, consider contributing income-producing stocks or other highly appreciated assets held long-term.

Keep control with a private foundation

If you wish to make large donations but also want a degree of control over how that money will be used, consider forming a private foundation. A foundation is particularly useful if you haven't determined what specific charities you want to benefit.

Be aware, though, that increased control comes at a price: You must follow a number of rules designed to ensure that the private foundation serves charitable interests and not private interests. For example, there are:

- ▼ Requirements on the minimum percentage of annual payouts to charity, and
- ▼ Restrictions on most transactions between the foundation and its donors or managers.

Violations can result in substantial penalties. Ensuring compliance with the rules

can also make a foundation expensive to run. In addition, the AGI limitations for deductibility of contributions to nonoperating foundations are lower. (See Chart 7 on page 19.)

Provide influence with a donor-advised fund

If you'd like to influence how your donations are spent but you want to avoid the tight rules and high expenses of a private foundation, consider a donor-advised fund. Many larger public charities offer them.

The fund is simply an agreement between you and the charity: The charity agrees to consider your wishes regarding use of your donations. This agreement is nonbinding, and the charity must exercise final control over the funds, consistent with the charitable purposes of the organization. To deduct your contribution, you must obtain a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

Remember other important donation rules

Consider the following:

- ▼ If you contribute your services to charity, you may deduct only your out-of-pocket expenses, not the fair market value of your services.
- ▼ If you donate use of property, you receive no deduction because it isn't considered a completed gift to the charity.
- ▼ If you donate a vehicle, unless it's being used by the charity, you generally can deduct only the amount the charity receives when it sells the vehicle.
- ▼ If you donate clothing or household goods, they must be in at least "good used condition" to be deductible.

Work with your tax advisor to determine the best charitable giving strategy for you. ▲

Case Study 7

A CRT can reduce single-stock exposure risk

Your portfolio consists of \$1.5 million in a single publicly traded stock (from when your company went public) with a low tax basis and other securities valued at \$500,000. You feel the time is right to diversify your portfolio, but you've been reluctant to do so because of the tax you'd have to pay on the gain.

One solution is to contribute some of the stock — say, \$1 million that has only a \$100,000 basis — to a charitable remainder trust (CRT). The trust can sell the stock without paying any current capital gains tax on the \$900,000 gain. It can use the sale proceeds for other investments, which in turn helps diversify your portfolio because of your income interest in the trust. You can also use your trust payouts to make investments to further diversify your portfolio, but you won't have access to trust assets other than the scheduled payouts.

Assuming the CRT comes with a 5% payout rate, you'll receive \$50,000 each year for the trust's term, which may be taxable depending on the trust's net income and provisions for reserving long-term capital gains. You'll also receive a current-year charitable deduction for the present value of the remainder amount going to charity. Remember, though, that the family loses the remainder value because it will pass to the designated charities at the end of the trust's term.



Don't miss out on these tax-saving opportunities

EDUCATION & CHILDREN

Whether you have concerns about the escalating costs of a quality education or you simply like to make the most of tax-advantaged savings vehicles where available, you'll appreciate the benefits Section 529 plans and Coverdell Education Savings Accounts (ESAs) offer. And whether you're a parent or a grandparent, you'll want to consider other strategies that can get the children in your life on the road to tax-advantaged saving.

Maximize tax-free savings with 529 plans

529 plans offer parents (or anyone else, such as grandparents) a tax-advantaged way to fund education expenses:

- ▼ Plan assets grow tax-deferred.
- ▼ Distributions used to pay qualified higher education expenses are income tax free for federal purposes and may be tax free for state purposes.
- ▼ Contributions aren't deductible for federal purposes, but you may be eligible for a state tax break, though some states offer tax benefits only to residents who invest in that state's 529 plan.

529 plans also offer a degree of control and flexibility:

- ▼ You maintain control of the account and can withdraw funds — even after the child is of legal age (unlike an UGMA or UTMA account — see page 23).
- ▼ You can make rollovers to another qualifying family member at any time.

the school. Moreover, your state may offer tax benefits to residents who invest in the state's qualified tuition program.

2. College savings plans. These plans, which only states can offer, can be used to pay a student's qualifying expenses at any eligible educational institution. You may find a savings plan better meets your needs than a prepaid tuition plan because:

- ▼ It allows more flexibility in choosing schools, with more certainty in how benefits will be applied based on school selection,
- ▼ If the student doesn't use all of his or her account funds, the excess can be rolled over to a college

The plans come in two forms:

1. Prepaid tuition plans. Both states and private education institutions can provide these plans that allow you to "buy" tuition at current levels on behalf of a designated child. If your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the child actually attends

Tax Law Change Alert "Kiddie tax" expands its reach

Beginning in 2008 the "kiddie tax" applies to children age 18 and younger, as well as to full-time students under age 24 (unless the students provide over half of their own support from their earned income). In 2007, the kiddie tax applied only to those *under 18*.

These age changes dramatically affect a popular tax-saving strategy: shifting income to children. Under this strategy, parents give their children income-producing assets so the family can benefit from the child's lower marginal tax rate. But for those subject to the kiddie tax, unearned income beyond \$1,800 (for 2008) is taxed at their parents' marginal rate. Now a lot more children will be subject to the kiddie tax. So consider how this may alter your current tax and estate planning strategies.

Shifting income to an adult child who isn't subject to the kiddie tax but is in a lower tax bracket can still save your family tax dollars — especially if the child qualifies for the 0% long-term capital gains tax rate that goes into effect this year. (See the Tax Law Change Alert on page 10.)

Grandparents can leverage 529 plans as an estate planning tool

Because contributions to 529 plans are eligible for the \$12,000 per beneficiary annual gift tax exclusion in 2008, you also can avoid any generation-skipping transfer (GST) tax liability that may otherwise be incurred when you fund a 529 plan for a grandchild — without using up any of your \$2 million GST tax exemption.

Plus, a special break for 529 plans allows you to front-load five years' worth of annual exclusion gifts (\$60,000) in one year, and married couples splitting gifts can double this amount to \$120,000. And that's *per beneficiary*.

So a 529 plan can be a powerful estate planning tool for grandparents. For instance, let's suppose you have six grandchildren and want to set up plans for each of them. You and your spouse can transfer as much as \$720,000 this year and not use any of your lifetime gift tax exemptions or your GST tax exemptions.

But if either of you dies before 2013, that spouse's estate will include a portion of the gift made in 2008. That amount will also use up part of the spouse's GST tax exemption or be subject to GST tax, because it no longer will be considered an annual exclusion gift.

savings plan for another family member, and

- ▼ Funds can be used to pay for equipment, supplies, books, fees, tuition and, generally, room and board.

In many situations, 529 plans are better than ESAs for these reasons:

- ▼ There are no income limits for contributing.
- ▼ Typically 529 plans offer much higher contribution limits (determined by the sponsoring state or private institution).
- ▼ There generally is no beneficiary age limit for contributions or distributions.

There are, however, some disadvantages:

- ▼ You don't have direct control over investment decisions.
- ▼ The investments may not earn as high a return as you could earn elsewhere. But you're allowed to make a tax-free rollover of funds to a different 529 plan for the same child every 12 months, so you can make a change if you're unhappy with one plan's performance.

- ▼ There is a risk that the child may not attend college and there may not be another qualifying beneficiary in the family — which is especially problematic if the account balance is high.

It's also important to consider the gift tax consequences. To avoid gift taxes, you need to either limit your contributions to annual exclusion gifts or use up part of your \$1 million lifetime gift tax exemption. (See page 28 for more on gift taxes.) There also may be gift tax consequences if you roll a plan over to a new beneficiary. Fortunately, a special break for 529 plans allows you to jump start a plan without negative gift tax consequences. (See Case Study 8.)

Cover more types of expenses, enjoy more control with ESAs

An ESA is similar to a 529 college savings plan in that:

- ▼ Plan assets grow tax-deferred,
- ▼ Distributions used to pay qualified higher education expenses (equipment,

supplies, books, fees, tuition and, generally, room and board) are income tax free for federal tax purposes and may be tax free for state purposes, and

- ▼ Contributions aren't deductible for federal purposes.

But ESAs have two advantages over 529 plans:

1. Tax-free ESA distributions also can help pay for a child's qualified elementary and secondary school expenses, including tuition, room and board, tutoring, computer costs, Internet access, and certain other costs.
2. You can control how the account is invested.

ESAs also have their disadvantages:

- ▼ The ability to make ESA contributions begins phasing out at adjusted gross income (AGI) levels of \$190,000 for married couples filing jointly and is fully phased out at \$220,000 (\$95,000/\$110,000 for single taxpayers and heads of households).
- ▼ The annual ESA contribution limit *per beneficiary* is only \$2,000.
- ▼ Generally, no contributions can be made after the beneficiary reaches age 18.
- ▼ Generally, any amounts left in the ESA when the beneficiary turns 30 must be distributed within 30 days and any



earnings will be subject to tax, though a new beneficiary who is under age 30 and a member of the family or extended family can be named to maintain the ESA's tax-advantaged status.

- ▼ There is a risk that the child may not attend college and there may not be another qualifying beneficiary in the family, though the balance would generally be lower than that of a 529 plan.

If your AGI prevents you from contributing to your child's ESA, others (such as grandparents) whose AGIs fall within the limits may make contributions on his or her behalf.

Transfer assets to minors while still retaining control

If you'd like to help your grandchildren (or other minors) fund their college education but you don't want to be subject to the limitations of a 529 plan or an ESA, you can transfer cash, stocks and bonds to a Uniform Gifts (or Transfers) to Minors Act (UGMA/UTMA) account:

- ▼ Although the transfer is irrevocable, you maintain control over the assets, but only until the age at which the UGMA or UTMA terminates (age 18 or 21 in most states).
- ▼ The transfer qualifies for the annual gift tax exclusion. (See page 28.)

But keep in mind that UGMAs and UTMA's are much less attractive from an income tax perspective than they were a few years ago, because the "kiddie tax" has been expanded. (See the Tax Law Change Alert on page 21.)

Get kids started on tax-free saving with a Roth IRA

The children in your life may be able to benefit from another tax-advantaged savings vehicle: the Roth IRA. While this may seem premature considering their

retirement is likely half a century or more away, it's that lengthy period of time that can allow them to maximize the leverage of tax-free compounding. Putting away what seems like a small amount now can really multiply. (See Case Study 9.)

Roth IRA contributions may be withdrawn tax and penalty free at any time and for any reason. If withdrawals before age 59½ exceed contributions, the earnings portion generally is subject to tax and a 10% early withdrawal penalty. But there are some exceptions, two of which younger IRA owners may find useful:

1. Withdrawals in excess of contributions used to pay qualified higher education expenses are penalty free, but they're subject to income tax.
2. Withdrawals up to \$10,000 in excess of contributions used for a first-time home purchase are both tax and penalty free.

Note that the Roth IRA must have been open for five years for these exceptions to apply. Of course, leaving the account untouched until retirement will maximize tax-free growth.

To make contributions, children must have earned income. The 2008 contribution limit is the lesser of \$5,000 or 100% of earned income from a legitimate job reported on their tax returns. Contributions aren't deductible, but:

- ▼ If a child earns no more than \$5,450 (the 2008 standard deduction amount for singles) and has no

unearned income, he or she will pay zero federal income tax anyway. So the lack of a contribution deduction may not result in any loss of current tax savings.

- ▼ If a child earns more than \$5,450, the income likely will be taxed at only 10% or 15%. So the tax-free treatment of future qualified distributions will likely be well worth the loss of any current deduction. But if current taxes are a concern, the child can contribute to a traditional IRA instead and deduct the contribution. Distributions from traditional IRAs are taxed at ordinary-income rates, and there are other differences. Consult your tax advisor for details.

If your children or grandchildren don't want to invest their hard-earned money, consider giving them the amount they're eligible to contribute — but keep the gift tax in mind. (See page 28.)

If they don't have earned income but you own a business, consider hiring them so they have sufficient earned income to contribute. As the business owner, you can deduct their pay. And if your business is unincorporated and has no owners other than you and certain family members — and your children are under age 18 — you won't owe any payroll or unemployment taxes on their wages.

But remember: They must perform actual work for wages and be paid in line with what you would pay nonfamily employees. ▲

Case Study 9

Early contributions can really multiply in a Roth IRA

Let's say your son makes Roth IRA contributions of \$5,000 each year for 10 years starting at age 16. Assuming an 8% rate of return and that he lets the account build up until he's 68, he'll have over \$2 million, which can be distributed tax free. Think how much more this could be if he made contributions each year until he retired.



Managing your portfolio for a truly golden retirement

RETIREMENT

A variety of tax-advantaged retirement plans are available to help you build the wealth you need to live the retirement lifestyle you desire. Even if you're already there, these plans can be an important part of your investment portfolio. And everyone with retirement plan assets needs to watch out for the tax pitfalls that may accompany their tax benefits.

Contribute to your employer-sponsored plan

Today the most common type of employer-sponsored retirement plan is the defined contribution plan, such as a 401(k), 403(b), 457, SIMPLE or SARSEP. It tells you how much can be put into the plan each year (see Chart 8 at right), but not what you'll have at retirement. That depends on the contributions that have been made and the growth in the account.

Because of an employer-sponsored plan's tax advantages, contributing the maximum you're allowed is likely a smart move. Plans generally fall into one of two types:

Tax-deferred. Plan assets grow tax-deferred — meaning that you pay no income tax until you take distributions. In addition:

- ▼ Contributions are usually pretax, so they reduce your current-year taxable income.
- ▼ Your employer may match some or all of your contributions — also on a pretax basis.

Tax-free. If you participate in a 401(k) or 403(b) plan, it may offer an alternative "Roth" version that allows both tax-free growth and tax-free distributions. But:

- ▼ Contributions are *not* pretax, so they don't reduce your current-year taxable income.
- ▼ Employer matches aren't eligible to be treated as Roth contributions.

There are no income limits on designating Roth 401(k) or Roth 403(b) contributions, so these plans may be especially beneficial for higher-income earners who are ineligible to contribute to Roth IRAs.

Set up your own plan

If you're a business owner or self-employed, you have more flexibility because you can



set up the plan that allows you to maximize your contributions. Keep in mind that, if you have employees, they generally must be allowed to participate in the plan, provided they work enough hours. Here are a few options:

Profit-sharing plan. This is a defined contribution plan that allows discretionary employer contributions and offers increased flexibility in plan design. In addition:

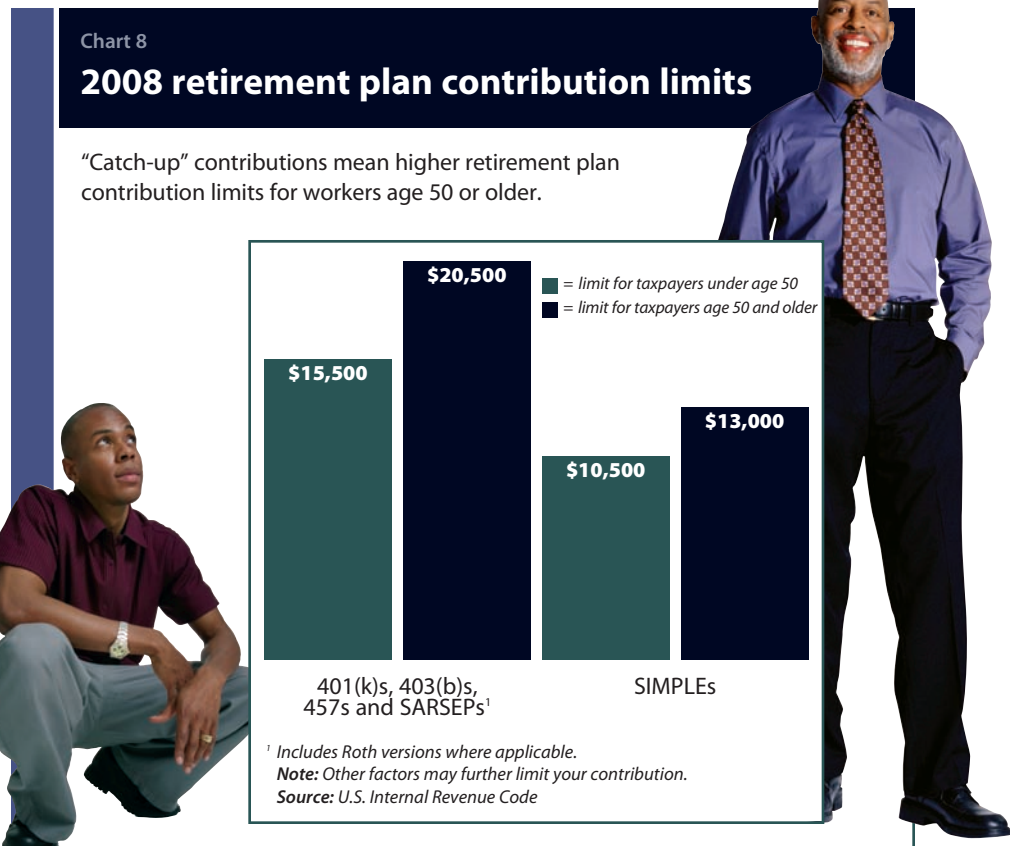
- ▼ The maximum 2008 contribution is \$46,000 or, for those who include a 401(k) arrangement in the plan and are eligible to make catch-up contributions, \$51,000. Your specific contribution limit is a function of your income.
- ▼ You can make deductible 2008 contributions as late as the due date of your 2008 income tax return, including extensions — provided your plan exists on Dec. 31, 2008.

SEP. A Simplified Employee Pension (SEP) is a defined contribution plan that provides benefits similar to those of a profit-sharing plan. In addition:

- ▼ The maximum 2008 contribution is the lesser of \$46,000 or 25% of your eligible compensation (net of the deduction for the contributions), which means you can contribute \$46,000 if your eligible compensation exceeds \$230,000. Catch-up contributions aren't available with SEPs.
- ▼ You can establish the SEP in 2009 and still make deductible 2008 contributions as late as the due date of your 2008 income tax return, including extensions.

Another benefit of a SEP is that it's much easier to administer than a profit-sharing plan. So if you have eligible compensation in excess of \$230,000 and would be ineligible to make catch-up contributions to a profit-sharing plan, setting up a SEP may be a better option.

Defined benefit plan. This plan sets a future pension benefit and then actuarially



calculates the contributions needed to attain that benefit. The maximum annual benefit for 2008 is generally \$185,000 or 100% of average earned income for the highest three consecutive years, if less. In addition:

- ▼ Because it's actuarially driven, the 2008 contribution necessary to attain the projected future annual benefit may exceed \$46,000 based on your age and either your annual desired benefit or the maximum allowable benefit. Employer contributions are generally *required* and must be paid quarterly if there was a shortfall in funding for the prior year.
- ▼ You can make deductible 2008 contributions until Sept. 15, 2009, provided your plan exists on Dec. 31, 2008.

Take advantage of IRAs

If you participate in an employer-sponsored plan (or a plan for the self-employed), your income likely is too high for you to make deductible traditional IRA contributions. It's also

probably too high for you to contribute to a Roth IRA. But that doesn't mean you can't benefit from IRAs.

In fact, many high-income taxpayers already have IRAs because they opened them either when they were earning less and still eligible to contribute, or they received the balance from an employer-sponsored plan when they changed jobs. (See page 26.)

If you have a traditional IRA, start thinking about the potential benefit of converting it to a Roth IRA once the income restriction on conversions is waived beginning in 2010:

- ▼ The long-term tax benefit is that you convert tax-deferred future growth into tax-free growth.
- ▼ The disadvantage is that the rolled over amount is taxable in the year of the rollover. (For Roth conversions made in 2010, the income can be deferred in equal installments to 2011 and 2012. Thus, you can defer the tax on that income as well.)



So, evaluate the potential benefit of the tax-deferred growth compared to the lost earnings on the tax you pay because of the rollover.

Also remember that a Roth IRA is a great estate planning vehicle:

- ▼ No distributions are required during your life.
- ▼ After your death your beneficiary can withdraw the money tax free over his or her lifetime, while funds remaining in the account continue to grow tax free.

You'll need to consider the impact of estate taxes, however, because the value of the Roth IRA will be included in your taxable estate upon your death. (See page 28.)

Be careful when you leave a job

When you change jobs or retire, you'll need to decide what to do with your employer-sponsored plan. You may have several options:

Take a lump-sum withdrawal. This is generally not a good idea: You'll have to pay taxes on the withdrawal, and your employer is required to withhold 20% for federal income taxes. If you're under age 59½, you may also face a 10% early withdrawal penalty. (See page 27.)

Stay put. If you have more than \$5,000 in your account, you can leave the money

there. You'll avoid current income tax and any penalties, and the plan assets can continue to grow tax-deferred. This may seem like the simplest solution, but it may not be the best. Keeping track of both the old plan and the plan sponsored by your new employer can make managing your retirement assets more difficult. Plus, you'll have to be mindful of any rules specific to the old plan, such as minimum balance requirements.

Roll over to your new employer's plan.

You can still avoid any penalties and continue to defer taxes. And this may leave you with only one retirement plan to keep track of. It can be a good solution, but be sure to first compare the new plan's investment options to the old plan's options.

Roll over to an IRA. This option allows you to avoid any penalties and continue to defer taxes. In most cases this is the best alternative because IRAs offer nearly

unlimited investment choices. Plus, if you change jobs again, you can roll over retirement plan assets into the same IRA. Such consolidation can make managing your retirement assets easier. Finally, you'll have the option (at least in 2010 or later) to convert to a Roth IRA, if appropriate.

Important: If you choose a rollover, request a *direct* rollover from your old plan to your new employer's plan or IRA. If the funds from the old plan are instead paid to you, you'll need to make an *indirect* rollover to your new plan or IRA within 60 days to avoid the tax and potential penalty on those funds. Keep in mind:

- ▼ The check you receive from your old plan may be *net* of federal income tax withholding, but
- ▼ If you don't roll over the *gross* amount (which will require making up for the withheld amount with other funds), you'll likely be subject to income tax and, if applicable, the 10% penalty on the difference.

Case Study 10

Roth 401(k) is a powerful saving tool

Let's say you're deciding whether to make contributions of \$15,500 — the current limit for individuals under age 50 — to a Roth 401(k) or to a traditional 401(k) for 20 years. Adding the catch-up contributions that would be available starting at age 50 would simply augment the benefits.

	Roth 401(k)	Traditional 401(k) if tax savings are	
		Invested	Not invested
Value after 20 years	\$ 766,055	\$ 766,055	\$ 766,055
Federal taxes on withdrawal	0	(268,119)	(268,119)
Value of invested tax savings	—	192,749	—
Net amount available in 20 years	\$766,055	\$690,685	\$497,936

If it's unlikely you'd invest the tax savings from a traditional 401(k), the Roth 401(k) provides a significant advantage. Of course, this is a simplified example. You'd also have to consider factors such as when you'll take distributions, how large those distributions will be, whether you'll be in a different tax bracket, whether tax rates will go up or down and the income tax and estate planning opportunities provided by Roth vs. traditional accounts.

This example is for illustrative purposes only and isn't a guarantee of future results. It assumes an annual rate of return of 8%, deposits at the beginning of the year, a federal tax rate of 35%, earnings on the invested tax savings taxed in the year earned and that a lump-sum withdrawal is made, without penalty, at the end of the 20th year.

Avoid early distribution penalties

Most distributions from tax-deferred retirement plans before age 59½ will be subject to a 10% penalty in addition to the applicable income tax. You can escape the early withdrawal penalty for the following reasons:

- ▼ You become disabled.
- ▼ The distributions are a result of your inheriting the plan account.
- ▼ You take distributions as substantially equal periodic payments for at least five years, with the last payment received on or after age 59½.
- ▼ Distributions begin because of early retirement or other job separation *and* the separation occurs during or after the year you reach age 55 (except IRAs).
- ▼ The distribution is used for deductible medical expenses (that is, expenses exceeding 7.5% of adjusted gross income).
- ▼ You get divorced and the distributions (except from IRAs) are made pursuant to a qualified domestic relations order (QDRO).

401(k) plans have their own “hardship” distribution rules based on “immediate and heavy financial need.” But those rules merely allow a participant to get funds out, not to escape the income tax or the 10% penalty (unless one of the penalty exceptions applies).

Follow the minimum distribution rules

You’re generally required to take distributions from retirement plans after age 70½:

- ▼ There’s a prescribed method and table for determining annual required minimum distributions (RMDs).
- ▼ You must take the RMD each year by Dec. 31.

Case Study 11

Make withdrawals wisely

Suppose you’ve got a \$1 million traditional IRA and are trying to decide whether it’s smarter to:

1. Take 5% withdrawals starting the year you turn age 65½ and then take the greater of 5% of the balance or your required minimum distribution (RMD) starting the year you turn 70½, or
2. Wait to take distributions until the year you turn 70½ and then take the greater of 5% or your RMD.

Assuming an 8% return on your IRA funds, here’s what you could expect under the two scenarios:

Age at year end	Scenario 1: Starting at age 65½		Scenario 2: Starting at age 70½	
	Total received	Year end IRA balance	Total received	Year end IRA balance
Age 70½	\$ 210,223	\$1,194,052	\$ 47,753	\$1,513,408
Age 80½	\$ 659,812	\$1,597,300	\$ 617,586	\$2,024,507
Age 90½	\$1,448,453	\$1,758,077	\$1,617,154	\$2,228,284

By waiting until age 70½, you’d not only maintain a much larger balance in the account, but, if you lived long enough, you’d also receive more total distributions. So if you could afford to leave the funds in the plan until that age, you might want to do so — even if it means depleting other investment accounts. Of course, additional factors may impact your specific situation, so consult your tax and financial advisors to determine the best strategy for you.

This example is for illustrative purposes only and isn’t a guarantee of future results. The figures presume a balance of \$1 million at the beginning of the year you turn 65½, withdrawals at the end of the year in which you reach the stated age, and your birthday falling in the first half of the year. The amounts presume federal income taxes of 35% that would be due on the distributions, but don’t reflect any other potential tax consequences that would be unique to your circumstances.

- ▼ If you don’t take the RMD, you’ll be subject to a 50% penalty on the amount you should have taken out but didn’t.
- ▼ Your initial RMD can be deferred until April 1 of the following year, but that will mean you’ll have to take two distributions that year.
- ▼ Regardless of age, distributions from your current employer’s plan may not be required if you’re still employed and don’t own more than 5% of the business.
- ▼ There are no required distributions from your Roth IRA during your lifetime.
- ▼ A Roth 401(k) does require distributions, but you can avoid the rule by rolling the funds into a Roth IRA.

Should you take any distributions between ages 59½ and 70½, or more than the RMD after age 70½, if you don’t need the money? Distributions in any year that your tax bracket is low may be beneficial. But first:

- ▼ Compare the benefit of the reduced tax rate against the tax-deferred growth if the funds are left in the retirement account.
- ▼ If you’re receiving Social Security, consider the income thresholds requiring 85% of the payments to become taxable.

If you’ve inherited a retirement plan, consult your tax advisor regarding the distribution rules that apply to you. ▲



Preserve your wealth for your loved ones

ESTATE PLANNING

You've spent a lifetime building your wealth, and you'd like to provide for your family and perhaps even future generations after you're gone. With proper planning, you can do just that — regardless of whether the estate tax repeal scheduled for 2010 is extended or made permanent.

Maximize exemptions, deductions and exclusions

The top gift and estate tax rates and the generation-skipping transfer (GST) tax rate are currently 45%. The GST tax is scheduled to be repealed along with the estate tax for 2010, and the gift tax will remain in place that year, albeit at a lower rate (equal to the top income tax rate at the time, scheduled to be 35%). So taking steps to minimize these taxes is as important as ever. Fortunately, some exemptions, deductions and exclusions are available to help:

Gift and estate tax exemptions. During your lifetime, the gift tax exemption allows you to transfer up to \$1 million without paying gift tax. At death, transfers up to the estate tax exemption amount minus any gift tax exemption used can be made free of estate tax. For 2008, the estate tax exemption is \$2 million.

Keep in mind that many states impose estate tax at a lower threshold than does the federal government. Check the laws of the states where you reside or own property and make sure your estate plan takes state transfer taxes into account.

Annual gift tax exclusion. In 2008, you can exclude most gifts of up to \$12,000 per

recipient (\$24,000 per recipient if your spouse elects to split the gift with you, or you're giving community property) without using up any of your gift tax exemption. (The annual gift tax exclusion will increase to \$13,000 for 2009.) If you gift more than the annual exclusion during the year to one person, you must file a gift tax return, even if no tax is due.

Unlimited marital deduction. Your estate generally can deduct the value of all assets that pass from you to your spouse at your death, provided your spouse is a U.S. citizen.

GST tax exemption. The GST tax applies to transfers (both during life and at death) made to people two generations or more below you, such as grandchildren or nonrelatives more than 37½ years younger than you. For 2008, the GST tax exemption is \$2 million. Note that, to make the transfers completely tax free, you'll also need to use your gift or estate tax exemption.

Case Study 12

Exhausting your gift tax exemption provides future savings

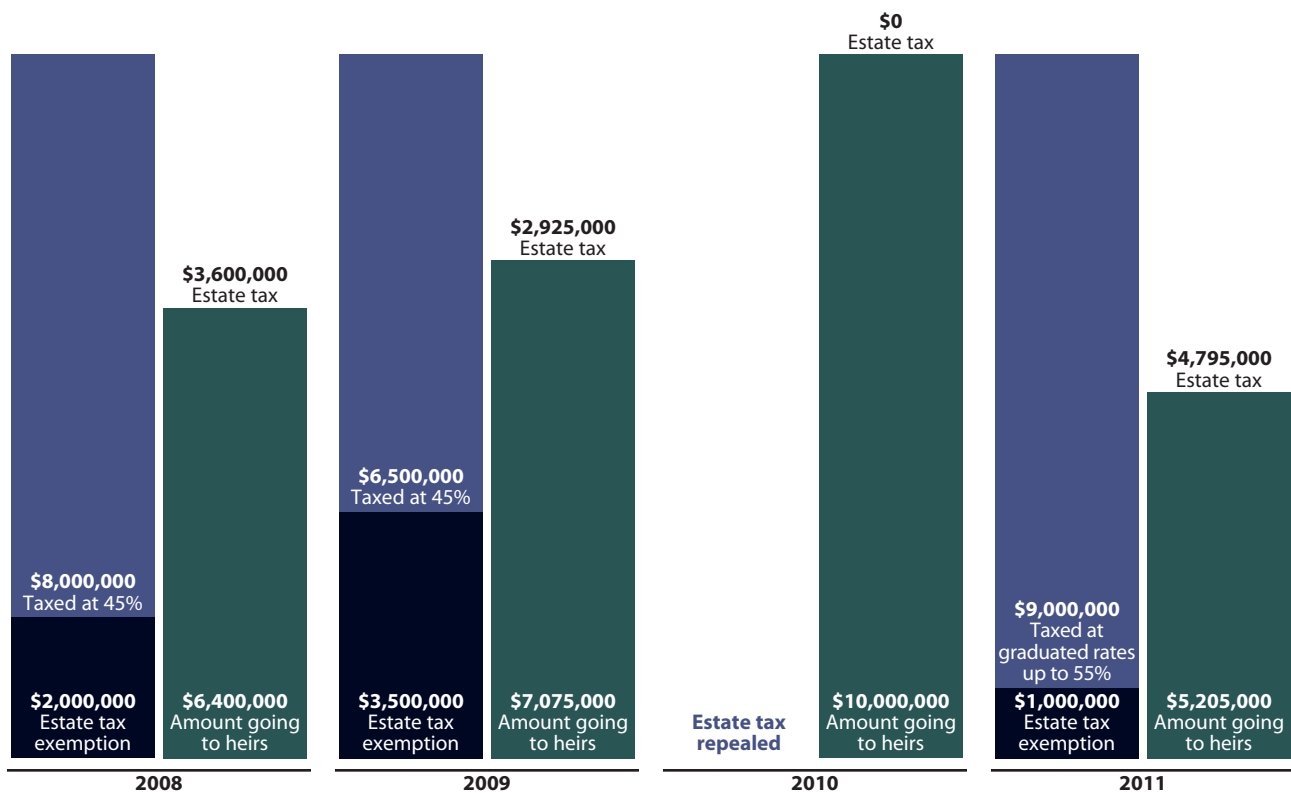
Let's look at the difference between using up both your and your spouse's \$1 million lifetime gift tax exemptions by gifting \$2 million of assets in 2008 (and, thus, removing any future appreciation on those assets from your taxable estates) vs. transferring these assets — including any appreciation on them — at death in, say, 2028. Assuming a 6% after-tax growth rate, in 20 years the \$2 million will have grown to \$6,414,271.

If the \$4,414,271 of appreciation is subject to a flat estate tax rate of 45% (the lowest maximum rate scheduled other than in the year of estate tax repeal), the tax will be \$1,986,422 — tax that would be avoided if you gifted the \$2 million now instead.

It's possible that in 20 years the \$1,986,422 tax might be reduced or eliminated depending on the actual growth of the assets, the total size of your taxable estate and the actual estate tax exemption and rate at the time — or if the estate tax repeal is made permanent. You also need to consider that using your \$2 million of gift tax exemptions now will reduce the estate tax exemptions available at your deaths by \$2 million. But if you haven't already used any of your gift tax exemptions and can afford to gift the \$2 million of assets today, you'll be no worse off even if the estate tax is repealed — and if it isn't, you may ultimately save substantial estate taxes.

Chart 9

The changing impact of the federal estate tax on a \$10 million taxable estate



Note: The chart assumes no gift tax exemption was used during life, and it doesn't include state estate tax, which could reduce the amount going to heirs.

Charitable deduction. There's no limit on this deduction. If you bequeath your entire estate to charity, no estate tax will be due. (For more on charitable giving, see page 18.)

Make gifts today

Lifetime giving remains one of the best estate planning strategies. Giving away an asset not only removes it from your estate, but also removes future appreciation and any annual earnings, lowering future estate tax. In addition, future income from the asset may be taxed at a lower rate if the recipient is in a lower income tax bracket — netting an overall family tax reduction.

So consider maximizing your annual exclusion gifts and perhaps also using part or all of your \$1 million gift tax exemption. (See Case Study 12.) Here are some additional strategies for tax-smart giving:

Choose gifts wisely. Take into account both estate and income tax consequences

and the economic aspects of any gifts you'd like to make:

- ▼ To minimize *your estate tax*, gift property with the greatest future appreciation potential.
- ▼ To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it.
- ▼ To minimize *your own income tax*, don't gift property that has declined in value; instead sell the property so you can take the tax loss and then gift the sale proceeds.
- ▼ Be aware that giving assets to children and certain young adults may have unexpected income tax consequences because of the "kiddie tax" — see the Tax Law Change Alert on page 21.

Keep in mind the step-up in basis at death. If it's likely that loved ones to whom you gift property won't sell it before you

die, think twice about gifting it to them. If it stays in your estate, the property gets an automatic step-up in basis to fair market value at the time of death. This could result in a significant income tax saving for your heirs upon later sale. Note, however, that the rules regarding step-up in basis are more complex for 2010, the year of the scheduled estate tax repeal.

Make annual exclusion gifts to grandchildren. Such gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers.

Gift interests in your business. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the discounts total 30%, you can gift an ownership interest equal to as much as \$17,143 tax free in 2008 because the discounted value doesn't exceed the \$12,000 annual exclusion. But, the IRS may challenge the

Tax Law Change Alert

IRS tries to keep FLP assets in donors' estates

The IRS has attacked family limited partnerships (FLPs) in a number of cases and has had some success in having FLP assets included in the donor's estate in two situations:

1. When the donor retains the actual or implied right to enjoy the FLP assets. Examples include transferring a home to the FLP and continuing to live there rent free or transferring most personal assets to the FLP, thus leaving the donor dependent upon distributions from the FLP to meet living expenses. Therefore, you shouldn't transfer personal-use assets to an FLP, transfer so much of your assets as to leave insufficient means to pay for living expenses, or have unfettered access to FLP assets for your own use.

2. When the donor retains simply the right to manage the FLP. It's much less certain that the IRS will prevail under this argument. Nevertheless, if you wish to create an FLP while retaining some control, you should discuss the risks with your professional advisor and determine the best way to proceed. For many donors, giving up the right to manage the FLP, at least indirectly, is unacceptable.

value; a professional appraisal is required to substantiate it. (For more on transferring interests in your business, see page 16.)

Gift FLP interests. If you don't own a business but you'd like to benefit from valuation discounts, you can set up a family limited partnership (FLP). You transfer assets, such as rental property or investments, to the FLP. You then gift FLP interests to family members. The valuation discount, combined with careful timing of the gifts, may enable you to transfer substantial interests free from gift tax. The FLP can work especially well for transfers of rapidly appreciating property. But the IRS is scrutinizing FLPs, so make sure you set up and operate yours properly. (See the Tax Law Change Alert above.)

Pay tuition and medical expenses. You may pay these expenses for a loved one gift-tax free, without using up your annual exclusion for the loved one or even any of your gift tax exemption, as long as you make the payment directly to the provider. (For other ways to combine educational funding with gifting, see page 22.)

Achieve your goals with trusts

Trusts can provide significant tax savings while preserving some control over what

happens to the transferred assets. Here are some trusts you may want to consider:

Marital trust. This trust is created to benefit the surviving spouse and is often funded with just enough assets to ensure that no estate tax will be due upon the first spouse's death. The remainder of the estate, which would equal the estate tax exemption amount, is used to fund a credit shelter trust.

Credit shelter trust. Also referred to as a bypass trust, this is funded at the first spouse's death to take advantage of his or her full estate tax exemption. The trust primarily benefits the children, but the surviving spouse can receive income, and perhaps a portion of principal, during his or her lifetime. If you already have a credit shelter trust in place, ask your financial advisor or attorney to review it. Because the estate tax exemption has been increasing, a trust allocation that made sense a number of years ago may no longer accomplish your goals.

A qualified domestic trust (QDOT). This marital trust can allow you and your non-U.S.-citizen spouse to take advantage of the unlimited marital deduction.

Qualified terminable interest property (QTIP) trust. This type of trust passes

trust income to your spouse for life, with the remainder of the trust assets passing as you've designated. A QTIP trust gives you (not your surviving spouse) control over the final disposition of your property and is often used to protect the interests of children from a previous marriage.

Irrevocable life insurance trust (ILIT). The ILIT owns one or more insurance policies on your life, and it manages and distributes policy proceeds according to your wishes. An ILIT keeps insurance proceeds, which would otherwise be subject to estate tax, out of your estate (and possibly your spouse's). You aren't allowed to retain any powers over the policy, such as the right to change the beneficiary. The trust can be designed so that it can make a loan to your estate for liquidity needs, such as paying estate tax.

Crummey trust. This trust allows you to enjoy both the control of a trust that will transfer assets at a later date and the tax-savings of an outright gift. ILITs are often structured as Crummey trusts so annual exclusion gifts can fund the ILIT's payment of insurance premiums.

Grantor-retained annuity trust (GRAT) and grantor-retained unitrust (GRUT). GRATs and GRUTs allow you to give assets to your children today — removing them from your taxable estate at a reduced value for gift tax purposes (provided you survive the trust's term) — while you receive payments from the trust for a specified term. At the end of the term, the principal may pass to the beneficiaries or remain in the trust. It's possible to plan the trust term and payouts to minimize — or even avoid — a taxable gift. (See Case Study 13.) In a GRAT, the income you receive is an annuity based on the assets' value on the date the trust is formed. In a GRUT, the payments are a set percentage of the assets' value as redetermined each year.

Qualified personal residence trust (QPRT). This trust is similar to a GRAT except that,

instead of holding assets, the trust holds your home — and, instead of receiving annuity payments, you enjoy the right to live in your home for a set number of years. At the end of the term, your beneficiaries own the home. You may continue to live there if the trustees or owners agree and you pay fair market rent.

Dynasty trust. The dynasty trust allows assets to skip several generations of taxation. You can fund the trust either during your lifetime by making gifts or at death in the form of bequests. The trust remains in existence from generation to generation. Because the heirs have restrictions on their access to the trust funds, the trust is excluded from their estates. If any of the heirs have a real need for funds, the trust can make distributions to them. If you live in a state that hasn't abolished the rule against perpetuities, special planning is required.

Take advantage of special breaks for business owners

Current tax law has provided two types of tax relief specifically for business owners:

1. Section 303 redemptions. Your company can buy back stock from your estate without the risk of the payment to the estate being treated as a dividend for income tax purposes. Such a distribution generally must not exceed the tax, funeral and administration expenses of the estate, and the value of your business must exceed 35% of the value of your adjusted gross estate.

2. Estate tax deferral. Normally, estate taxes are due within nine months of death. But if closely held business interests exceed 35% of your adjusted gross estate, the estate may qualify for a deferral. No payment (other than interest) for taxes owed on the value of the business is due until five years after the normal due date. The tax then can be paid over as many as 10 equal annual installments. Thus, a portion of your tax can be deferred for as long as 14 years from the original due date.

Leverage life insurance

Life insurance can replace income, provide cash to pay estate taxes, offer a way to equalize assets among children active and inactive in a family business, or be a vehicle for passing leveraged funds free of estate tax.

Life insurance proceeds generally aren't subject to income tax, but, if you own the policy, the proceeds will be included in your estate:

- ▼ Ownership is determined by several factors, including who has the right to name the beneficiaries of the proceeds. Generally, to reap maximum tax benefits you must sacrifice some control and flexibility as well as some ease and cost of administration.
- ▼ Determining who should own insurance on your life is a complex task because there are many possible owners, including you or your spouse, your children, your business, and an ILIT. (See page 30.)
- ▼ To choose the best owner, consider why you want the insurance, such as to replace income, to provide liquidity or to transfer wealth to your heirs. You must also determine the importance to you of tax implications, control, flexibility, and ease and cost of administration.

Review and update your plan regularly

Like all tax planning, estate planning is an ongoing process. You must regularly review your plan to ensure it fits in with any changes in tax law or in your circumstances, such as:

Family changes. Marriages, divorces, births, adoptions, disabilities and deaths can all lead to the need for estate plan modifications.

Geographic moves. Different states have different estate planning regulations. Any time you move from one state to another, you should review your estate plan. It's especially important, however, if you're married and move into or out of a community property state.

Increases in income and net worth. What may have been an appropriate estate plan when your income and net worth were much lower may no longer be effective today.

Finally, remember that estate planning is about more than just reducing taxes; it's about ensuring that your family is provided for and that you leave the legacy you desire. So even if the estate tax is permanently repealed, you'll want to have an up-to-date plan in place. ▲

Case Study 13

Zero-out GRAT zeroes in on future appreciation

Let's say you transfer securities in a company with great potential to a three-year grantor retained annuity trust (GRAT). The securities are currently valued at \$250,000 (25,000 shares at \$10 per share). Assume that, based on the expected growth rate, current applicable interest rate and your age, you have to set the annual annuity payment at 39% (rounded) to zero out the remainder interest and pay no gift tax on the transfer. You'll receive an annuity payment of \$97,500 per year, totaling \$292,500 for the three years.

Assume the stock pays no dividends and its value appreciates to \$12 per share at the end of the first year, \$15 at the end of the second year and \$20 at the end of the third year. You'd receive the following annuity payments at the end of each year:

Year 1: 8,125 shares (\$97,500 divided by \$12 per share).

Year 2: 6,500 shares (\$97,500 divided by \$15 per share).

Year 3: 4,875 shares (\$97,500 divided by \$20 per share).

This would leave 5,500 shares, valued at \$110,000, for your beneficiaries free of gift taxes.



Start lowering your taxes now

TAX STRATEGIES CHECKLIST

If you have any questions about the topics covered in this guide, or if you want more information on how they relate to you, please fill out this worksheet and e-mail, fax or mail this form to your tax advisor for more information, or call to discuss your tax planning needs.

I would like to learn more about:

Tax rates

- How AGI-based provisions could affect my tax situation.
- Making sure I pay enough tax throughout the year so I'm not penalized later.

Timing and AMT

- Ways I can minimize the chances of being subject to the alternative minimum tax (AMT).
- Timing my income and expenses to reduce my tax liability.

Executive compensation

- How tax law changes may have affected my nonqualified deferred compensation plan.
- Ways to avoid unfavorable tax consequences related to stock options or restricted stock.

Investing

- Taking advantage of the low 15% rate on my investments.
- Timing gains and losses in my portfolio to achieve the best tax treatment.

- Planning for passive investments.
- Deferring tax on appreciated assets that I want to sell off.
- How I might benefit from the investment interest deduction.
- Maximizing home-related tax breaks.

Business ownership

- Whether my current business structure is the best for my situation.
- Exit planning.

Charitable giving

- How to give to my favorite charity so we both come out ahead.
- More sophisticated charitable giving strategies, such as trusts and private foundations.

Education and children

- How changes to the "kiddie tax" might affect my family.
- The different types of education savings plans and whether my parents can also contribute on behalf of my children.
- How I can get my kids started on tax-advantaged saving.

Retirement

- How to make the most of employer-sponsored retirement plans.
- What I should do with my employer-sponsored retirement account if I change jobs.
- When I should take retirement plan distributions.

Estate planning

- Ways to make the most of exemptions, deductions and exclusions.
- Setting up a gifting program to benefit my heirs.
- Which trusts are best suited for my particular situation.
- How life insurance fits into my plan.

So your tax advisor can better serve you, please provide your contact information.

NAME _____

TITLE _____

ORGANIZATION _____

ADDRESS _____

CITY _____ STATE _____ ZIP _____

PHONE _____

FAX _____

E-MAIL _____

Mallah Furman invites you to join us as we "Go Green."

Here at Mallah Furman, our corporate logo has been green for over 45 years. But in today's times, being green has taken on a whole new meaning. Green now means taking steps to reduce our carbon footprint in the world. And Mallah Furman is committed to becoming more green, and to helping save time, money and the environment. That's why our electronic tax return filing initiative is more important than ever!

Saving you Money . . . **Saving you Time . . .** **Saving the Environment . . .**

Filing electronically can save you time and money. Time spent driving to the post office and waiting in line can be put to better use. And filing electronically saves you money on gas and postage! No need to worry about a certified postal receipt - A digital receipt of your tax return transmission is provided by the IRS.

And perhaps the greatest savings to the environment are realized when you file electronically. Paperless filing provides the opportunity to reduce consumption of paper resources on many different levels. Trees and materials are spared, and the energy required to produce and transport paper is eliminated.

Go Paperless Whenever Possible

Electronic filing may not be right for every situation, and your Mallah Furman representative can help you decide if it is right for you. But even if you can't file electronically, you can ask us to provide your taxpayer's copies in an electronic format instead of a hard copy. And if you have multiple tax filings, we can provide you with all of your tax return copies on one easy-to-store CD.

And don't forget, throughout the year, whenever your financial and/or lending institutions request a copy of your tax returns, ask if we can send an electronic copy instead. With an e-mail, your copies can be in their hands in minutes instead of hours or days.

Contact your Mallah Furman representative right away, and let us know you want to save time, save money and save the environment in the upcoming tax season!

Why e-file?

More and more Americans have chosen e-file, which lets them electronically file an accurate tax return or get an extension of time to file without sending any paper to the Internal Revenue Service. The 2007 filing season set a series of records, and more than 72 million returns were e-filed during 2007.

According to former IRS Commissioner Mark A. Everson. "Overall, we received more tax returns electronically this year than the number of paper returns we processed for the entire United States in 1966. E-file is changing the way the nation does taxes."

Ask your tax professional to prepare your return, using IRS *e-file*. When your preparer electronically files your income tax return, you don't have to worry if the mail gets through. And, the IRS says that e-filing is so accurate that you are 99% less likely to receive subsequent correspondence from the IRS.