LOWEST TAX IS THE RULE

Published by Simon & Deitz, LLC, CPA's
Tax Preparation, Planning and Problem Resolution – Financial Planning – Registered Investment Advisor and Investment Advisory Representative
23 West Main Street
Freehold, New Jersey 07728-2281
Phone: (732) 780-3665 Fax: (732) 780-4402 Cell: (908) 415-8367
deitzfreeholdcpa@aol.com **www.kendeitzcpa.com**

MID YEAR 2008

We hope you enjoy the latest edition of Lowest Tax is the Rule. At Simon & Deitz, we take great pride in providing our clients with professional services that are second to none. Most people today seek assistance in financial matters from a professional who is knowledgeable, honest and sincere. We believe we offer all of these qualities to our clients AND MORE. Through the years, we have attempted to elevate our services to new levels of excellence. We believe that our clients deserve the best – if you are pleased with our services, please tell a friend.

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ARE WE IN A RECESSION? MANY INDICATORS SAY "YES"

A lot has happened on the economic scene since last year, and unfortunately, none of it has been good. The price of gasoline has skyrocketed to the point where it is changing our daily living habits; many people who bought homes over the past few years are having trouble making their mortgage payments, to the point of losing their homes to foreclosure; the stock market has been negative all year, retreating from the all-time highs it attained in 2007; thousands of people have lost their jobs and the current job market is none-too-promising.

Since the beginning of the year, there have already been many laws enacted at both the Federal and State levels that will have varying impacts on every taxpayer and every business. The following is a summary of what has transpired and the impact on 2008 taxes:

Individual Taxpayers and their families

1. To keep the economy moving, as an encouragement to keep people spending, President Bush pushed for, got passed, and enacted the Economic Stimulus Act of 2008 (H.R. 5140) that provided for "**stimulus" rebates of up to $600 per individual and $300 per qualifying child** (born 1/1/1991 and later), for those with incomes generally less than $75,000 single and $150,000 married filing jointly. (If you qualified, you probably got your rebate by now).

2. Intense efforts to keep people in their houses and keep people buying houses. In addition to stricter laws imposed on the mortgage and banking industries relating to the approval and processing of mortgages and other types of credit the Housing and Economic Recovery Act of 2008 (H.R. 3221) now allows for:

   a. **First-time Homebuyer Credit** – a refundable tax credit equal to 10% of the purchase price of a home, capping at $7,500 ($3,750 if married separate). It must be repaid back to the government over the next 15 years, and repaid in the year the house is sold or is no longer the primary residence. Income limitations apply.
   b. **Property Tax Deduction for Non-Itemizers** - $500 ($1,000 for MFJ) is added to the standard deduction. This applies to every homeowner who doesn't itemize, not just first-time homebuyers.
3. Business use of automobiles deduction has been raised to **58 ½ cents per mile.**
4. The wage base for Social Security tax purposes rises to $102,000.
5. The "kiddie tax" now covers children through their college years, up to age 23.
6. Higher exemptions from the Alternative Minimum Tax (AMT).
7. Larger deduction amounts for IRA's ($5,000, plus an additional $1,000 if over age 50) and 401(k) and 403(b) contributions ($15,500, plus an additional $5,000 if over age 50).
8. Larger income thresholds in which to still be allowed to make a deductible IRA contribution even if covered by an employer plan.
9. New Jersey Homeowner Rebates – income level for which to qualify has been **LOWERED from $250,000 to $150,000.**

Businesses

1. **Bonus depreciation is back for 2008** – you can immediately deduct 50% of the cost of qualifying assets with no limitations, plus still avail the benefits of Section 179 and regular depreciation on the balance of the purchase.
2. The Section 179 (first year expensing) deduction is increased to **$250,000** (up from $125,000) for 2008.

TOUGH ECONOMIC TIMES – LOOK OUT FOR THE WORST TAX TRAP

If you are looking for money to buy a new car or house or to pay off some bills, your 401(k) or IRA account may seem like the perfect stash for which to get your hands on available cash. Additionally, the temptation to tap your retirement funds often comes when you switch jobs and must decide how to handle your account. But in most cases, you are asking for tax torture on next April 15th.

Firstly, there usually is a box to check if you want 20% Federal tax withheld. You check the box, and you immediately think the taxes on the distribution are now taken care of. Unfortunately, this is not the case. Most working people are in the 25% Federal bracket, so they are 5% behind the 8-ball from the get-go. In addition, for those under age 59 ½, the IRS imposes a 10% penalty on distributions from any retirement plan, unless some exclusion is met. Plus, most states also tax early retirement distributions.

EXAMPLE: You take $50,000 out of your retirement, and have $10,000 (20%) Federal tax withheld. With a Federal rate of 25%, penalty of 10%, and a state tax of 5%, the total tax ramification is 40%, or $20,000. You already paid in $10,000, but come tax time, will you have the $10,000 available to pay the difference?

THE CRUEL TRUTH: even in these tough economic times where people are losing their jobs everyday, the government shows no sympathy. There is no relief from the taxation of retirement distributions, even if you need the money to feed your family.

IS A ROTH 401(k) RIGHT FOR YOU?

Haring characteristics of both 401(k) s and Roth IRAs, A Roth 401(k) plan you're your employer allows you to save after-tax dollars in a tax-deferred retirement account without the income restrictions and contribution limits that apply to Roth IRAs, and when you reach retirement, qualified distributions are tax free. (The Roth option may also be available to those with sponsoring 403(b) accounts.)

Currently, only taxpayers whose adjusted gross income (AGI) falls below certain levels ($116,000 a year for single filers and $169,000 for joint filers) are eligible to contribute after-tax dollars to a Roth IRA. These income limits do not apply to Roth 401(k) s. Furthermore, you can save more money in a Roth 401(k) than in a Roth IRA.

The 2008 annual contribution limits for IRAs of all kinds are set at $5,000 for taxpayers under the age of 50 and $6,000 for older workers. The Roth 401(k) is subject to the more generous elective salary deferral limits that apply to conventional 401(k) plans—$15,500 for taxpayers and $20,500 for those over the age of 50 in 2008.

The Roth 401(k) has other advantages over the Roth IRA. Contributions can be easily and conveniently made through payroll deductions. To participate, an employee currently contributing to a traditional 401(k) plan could, for example, simply opt to have his or her contributions diverted to a Roth version of the same plan.

Matching contributions made by employers must be invested in a traditional 401(k), not a Roth account. This means that, even if you make contributions exclusively to a Roth 401(k) account, you would still owe tax in retirement on withdrawals from funds contributed on a pre-tax basis by your employer.

The 401(k) annual deferral limits apply to all 401(k) contributions, regardless of whether they are made on a pre-tax or after-tax basis. If you contribute to a Roth 401(k), you may have to reduce or discontinue your contributions to your employer's conventional 401(k) plan to avoid exceeding these limits; however, you may contribute to both types of 401(k) plans.

With a Roth 401(k), you will be required to begin taking distributions after the age of 70½, and you will not be permitted to withdraw earnings tax free until you have held the account for at least five years and are at least 59½ years old. These provisions could make the Roth 401(k) less attractive to employees who are currently approaching retirement.

In order to decide which option or combination of options works best in your retirement plan, it is important to weigh the advantages and disadvantages of both types of 401(k) s. With a traditional 401(k), you make contributions on a pre-tax basis, which lowers your current taxable income, and earnings are tax-deferred; however, your retirement distributions will be subject to ordinary income tax. With a Roth 401(k), your contributions are not tax deductible, but earnings and distributions are tax free, provided you meet the five-year ownership and age requirements. The right choice for you depends on your current tax situation and your long-term financial goals.

If a Roth 401(k) makes sense for you, ask your company's benefits administrator if the feature is available for your retirement plan. If it is not already in place, expressing interest in the Roth feature increases the likelihood your company will adopt the option.

If you would like to explore the advantages or disadvantages of a Roth 401(k) account, and to see if it is right for you, give the office a call.

THE BEST WAY TO SAVE FOR COLLEGE – SOME SAY THERE ARE GOOD REASONS TO BYPASS A 529 ACCOUNT. DON'T BELIEVE THEM.

Since their introduction in 1996, the state-sponsored 529 college savings plans have been lauded again and again as one of the best tax breaks since the IRA. Named after the section of the tax code that governs them, 529s let you save large sums while your earnings accumulate tax-free; the earnings remain tax-free as long as you use the money to pay for college.

Great as these plans are, however, some 70% of parents saving for college don't use them, according to the College Savings Foundation. Instead, they invest in stocks, bonds, funds or even cash through taxable accounts. Some say they can do better outside a 529. The question: Are they right?

Most of the time, no. **The tax breaks usually make 529s unbeatable**. Say you're in the 28% tax bracket, have a five-year-old and save $200 a month in Utah's low-cost 529, which has annual expenses of 0.38%. Assuming annual average returns of 5%, you'll have $39,100 by the time your kid is 18. Invest the same amount in a taxable account with equal fees and returns, and you'll have $36,200 after taxes. In other words, you'll lose $2,900. **The 529 comes out even further ahead if your state allows you to write off all or part of your contributions (33 states and the District of Columbia will let you do that).**

As for financial aid formulas, starting in January 2009, a 529 even in your child's name will be considered a parental asset - the same as a brokerage, mutual fund or bank account in your name. So there's no reason to bypass a 529 on that score.

All that said in celebration of 529s, expenses can easily eat away at - even cancel out - the tax savings if you're not careful. Though management fees have come down recently, some 529s are still too costly. Going back to the earlier example, put $200 a month in one of Colorado's higher-cost 529 options (1.65% fees) and, at a 5% return, you'll end up with $35,900 by your kid's freshman year; thus, the fees will wipe out the tax benefits and $300 more to boot.

There are a few cases for bypassing a 529 - a big one being that you think you might need the money for something else. If you withdraw the money for anything other than qualified higher education expenses, you'll pay ordinary income taxes on the earnings at the beneficiary's rate plus a 10% penalty. You may be similarly stuck if your child doesn't go to college. You can transfer the money to another beneficiary, but if there's any doubt about your child's intentions, you should not invest in a 529 plan.

Also, if you're a fairly savvy investor, you may not want to make a 529 your first savings tool. (The investment choices within these plans are usually limited.) Instead, start with a Coverdell Education Savings Account. Those who qualify (adjusted gross income of $220,000 or less for couples) can choose any investment; plus, earnings and withdrawals for various education expenses (not just college) are free of federal taxes. Under current rules, you can save $2,000 a year, but the max will drop to $500 in 2010 unless Congress steps in. As a result, the Coverdell is best as a supplement to a 529, not as a substitute.

So, to conclude if you're planning to save for college and have no reason to think your child won't be going, a low-fee 529 is the best savings tool - regardless of what anyone tells you. A 529 almost always beats out a taxable account earning the same return.

WORKERS STRONGLY SUPPORT AUTOMATIC 401(k) ENROLLMENT

While concerns that some employees could resent automatic enrollment in 401(k) plans appears to have stopped some retirement plan sponsors from adopting automated features, most employees actually favor the programs, according to a study recently released by Retirement Made Simpler (RMS, 2007), a coalition formed by AARP and the Financial Industry Regulatory Authority (FINRA) to promote retirement saving.

Researchers surveyed a nationally representative sample of 10,130 U.S. adults. Of these respondents, 696 had been automatically enrolled in an employer-sponsored 401(k) plan, while 48 had opted out of a workplace plan after being automatically enrolled. The survey found that 98% of respondents currently enrolled in an automatic 401(k) plan are generally pleased that their employers offer these plans, with 79% of this group saying they strongly favor automatic enrollment. In addition, 95% of the respondents who are participants in automatic 401(k) plans agreed that automatic enrollment has made saving for retirement easy, and 85% of this sample agreed that this feature has helped them start saving for retirement earlier than they had planned.

The study also cited the example of the U.S. Chamber of Commerce, which recently added automatic enrollment to its 401(k) plan in an effort to boost participation. Particularly with younger employees saving for retirement not being a high priority or focus, an automatic 401(k) helps them do the right thing and it is hassle-free.

CHALLENGES FACING THE NEW PRESIDENT AND CONGRESS

Over the past few years, very little legislation with great impact on taxes has been enacted into law due to the ever-ongoing war in Iraq and the constant power struggles between a Republican President and a Democratic Congress. No matter who will be the last man standing on November 4, much in the way of change that has been put on the back burner will start to cook to a boiling point, beginning in 2009:

1. **Permanency of the Estate Tax**: hailed as the first of many great achievements to come for the Bush Administration, the law passed in 2001 put the Estate Tax law in a state of flux, with there to be no estate tax in the year 2010, and then it going back to 2001 laws effective January 1, 2011. This has now put millions of families, executors, trustees, etc. in a position of great uncertainty. You can be sure some middle ground will be met and a new Estate Tax law will be enacted into law that will exempt most Americans' assets from the estate tax, leaving only the wealthy vulnerable going forward.
2. **Social Security** – I'm sure you know by now that the fastest growing segment of the population is age >65. If the government doesn't do something, the Social Security system will be broke before long. Look for ever increasing ceilings on taxable wages, higher rates of withholding, and possible surcharges on investment income to help keep the system solvent.
3. **Alternative Minimum Tax (AMT) –** created in 1969 (yes, you can blame Tricky Dick for this one too!!) to ensure that those who could manipulate their deductions to wipe out their tax would still pay in something, the AMT now stands to effect over 30 million taxpayers. This is because regular tax rates have been lowered; brackets have been adjusted for inflation, but not for the AMT. It now affects people who are only paying

regular state income and local real estate taxes, and those who have legitimate business deductions, and not just those who defer income and prepay expenses. There has been a call to repeal the AMT, but it raises just too much money. A complete overhaul of the tax system would probably be required if the AMT were repealed.

SUMMARY

What has been discussed in this issue of Lowest Tax is the Rule is only a review of some of the major tax issues that have been brought to the public's attention over the past few months. There are many other areas of the tax laws that have gone through changes that have not bee covered in this issue.

If you have been made aware of something in the area of taxes, the economy, finance, Wall Street, natural disasters, life insurance, retirement planning, paying for college, or anything else related to your wallet that was not touched upon in this issue, please contact this office for discussion, clarification, etc.

TO: SIMON & DEITZ LLC
23 WEST MAIN STREET
FREEHOLD, NJ 07728

FROM: ___________________________

PHONE: ___________________________

E-MAIL: ___________________________

Please contact me in order to discuss:

1. Tax changes for 2008 ________
2. Early distributions from retirement accounts ________
3. Roth 401(k) plans ________
4. Automatic enrollment in 401(k) plans ________
5. Pending tax law changes for 2009 ________
6. Tax savings for businesses ________
7. Retirement planning ________
8. Life insurance ________
9. Saving for college ________
10. Estate planning ________