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Dear Client:

As the end of 2008 approaches and another busy holiday season is soon upon us, we would like to take a moment to thank you for your business and our continued relationship. The world is now facing economic challenges unseen in decades, and it is a near certainty that the coming years will present us with many far reaching changes to the U.S. Tax Code. It is of utmost importance to us that you know we continue to stand ready to provide solid answers and planning for any tax and financial questions you and your family might face.

To achieve our goal of providing you with the highest service possible, we have also had some new developments and additions here at Hodges, Jones & Mabry, PC:

- The firm's Blacksburg office continues to grow at an amazing pace. Our affiliation with the Virginia Tech Knowledge Works Business Acceleration Center has allowed us insight with some of the most innovative and entrepreneurial minds in the country. The future of this partnership is boundless, and we believe it will help to enhance the level of service we provide to all of our clients.
- We welcomed Scott Patterson as a full time accountant in our Blacksburg office in September. Scott grew up in nearby Lexington, Virginia. He graduated in May of 2008 from Virginia Tech with a degree in accounting and is currently pursuing his CPA designation. Scott interned with the firm last spring and was exposed to a variety of different tax and auditing projects during that time. We feel Scott will continue to be a great addition to our team.
- We are also pleased to announce the addition of Patrick Morris as the manager of our growing Radford office. Pat returns to the area after spending four years in the Charlotte/Lake Norman, North Carolina region where he specialized in a variety of tax, valuation and business transfer disciplines. Pat has been a practicing CPA for over sixteen years and is licensed in both Virginia and North Carolina. Furthermore, he is a Certified Valuation Analyst and a Certified Fraud Examiner. We are very excited about the additions of services he brings to the firm.

The following pages contain a list of actions based on current tax rules that may help you save real tax dollars if you act before year-end. This list highlights selected strategies, but there are many others that might apply to your particular situation. If you would like to discuss any of the strategies mentioned in this letter or other ideas for reducing your 2008 tax liabilities, please do not hesitate to call us. We would be pleased to set up a meeting while there is still time to implement these strategies before year-end. In the meantime, we hope you have a blessed holiday season, and we look forward to working with you next year.

Very truly yours,

YEAR-END TAX PLANNING STRATEGIES FOR 2008

The indisputably good news we are certain of is that Congress has acted to “patch” the AMT problem for 2008, has retroactively reinstated a number of tax breaks (such as the option to deduct state and local general sales tax instead of state and local income tax and the above-the-line deduction for higher education expenses), and has created new tax breaks that go into effect for the 2008 tax year (including a tax credit for first-time homebuyers, a non-itemizers' deduction for state and local property tax and a non-itemizers' deduction for certain disaster losses). For 2008, businesses enjoy tax breaks such as a beefed-up expensing option under Code Sec. 179, a 50% bonus first-year depreciation write-off for most new machinery, equipment and software placed into service this year, and a reinstated research credit.

Defer Income and Accelerate Deductions

The most common year-end tax planning strategies are those that defer income from the current year to later years and move deductions from later years into the current year. The underlying reason is that it is better to pay taxes later than sooner due to the time value of money. Because of the nation's economic problems, many pundits are predicting an increase in tax rates in January 2009. If you believe that a substantial increase in tax rates will apply to 2009, then losses and deductions may be worth more in the future than currently. However, we generally do not recommend that you accelerate tax obligations due to the time value of money and because of the uncertainty of what tomorrow's tax rules will bring. It is difficult to properly plan without knowing the rules. With that said some ways to defer income include:

Bonus: If you generally receive a year-end bonus from your employer prior to the end of the year, ask to have your bonus paid in 2009.

Delay Billing: If you are self-employed, delay year-end billing to clients so that payments will not be received until 2009.

Interest and Dividends: Interest income earned on treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income, consider buying short-term bonds or certificates that will not mature until next year. If you have control as to when dividends are paid, arrange to have them paid to you after the end of the year.

Sale of Property: Consider an installment sale that shifts part of the gain to later years when installment payments are received.

On the deduction side, move charitable donations, real estate and state income tax payments, and medical expense payments that you would normally make in 2009 to the end of 2008. You may be able to save taxes this year and next year by applying a bunching strategy to “miscellaneous” itemized deductions, medical expenses and other itemized deductions. Keep in mind an expense is only deductible in the year in which it is actually paid so it may be wise to consider using a credit card to prepay expenses that can generate deductions for this year.

Retirement Savings

Traditional IRA: Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. The annual deductible contribution limit for an IRA for 2008 is \$5,000. For 2008, a \$1,000 “catch-up” contribution deduction is allowed for taxpayers age 50 or older by the close of the taxable year who otherwise qualify for IRA deductions. Thus, the total deductible limit for these individuals may be as high as \$6,000.

Roth IRA: This type of IRA permits nondeductible contributions of up to \$5,000 a year. Earnings grow tax-free, and distributions are tax-free provided no distributions are made until more than five years after the first contribution and the individual has reached age 59½. The maximum contribution is phased out for persons

with AGI above certain amounts: For 2008, a \$1,000 "catch-up" contribution is allowed for taxpayers age 50 or older by the close of the taxable year, making the total limit \$6,000 for these individuals.

401(k) Contribution: The 401(k) elective deferral limit is \$15,500 for 2008. If you will be 50 years old by December 31, 2008, you may contribute an additional \$5,000 to your 401(k) account, for a total maximum contribution of \$20,500.

Maximize Retirement Savings: In many cases, employers will require you to set your 2009 retirement contribution levels before January 2009. You may want to increase your contribution to lower your AGI in order to take advantage of some other tax breaks. Also, maximizing your contribution is generally a good tax-saving move.

Medical Savings Accounts

Health Savings Accounts (HSAs): These are one of the fastest growing ways to save for health care. Qualifying contributions to health savings accounts (HSAs) are fully deductible whether or not you itemize deductions, and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). For 2008, if you have "family" coverage, your HDHP must have a minimum annual deductible of \$2,200 (\$1,100 for self only coverage). For 2008, your maximum contribution to an HSA is \$2,900 (\$3,800 if 55 or older) for self only coverage, and \$5,800 (\$6,700 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less.

Maximize The Benefits: Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year. Don't forget you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.

Business Expenditures

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses and dependents as an above-the-line deduction, without regard to the 7.5% of AGI floor.

Equipment Purchases: Businesses should consider making expenditures that qualify for the up to \$250,000 business property expensing option for assets bought and placed in service this year; the maximum expensing amount will drop to \$133,000 for assets bought and placed in service next year (higher expensing amounts apply to certain specialized assets). Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. This bonus write-off generally won't be available next year (some exceptions apply, such as for businesses affected by presidentially declared disasters).

S-Corporation & Partnership/LLC Interests: If you own an interest in a partnership or S corporation you may need to increase your basis in the entity so you can deduct a loss from it for this year. Further, if your business suffers net operating losses in 2008, you may apply those losses against taxable income going back two tax years. Thus, for example, the loss could be used to reduce taxable income and thus generate tax refunds for tax years as far back as 2006.

Education and Child Tax Benefits

Child Tax Credit: A tax credit of \$1,000 per qualifying child under the age of 17 is available on this year's return. The credit is phased out at a rate of \$50 for each \$1,000 (or fraction of \$1,000) of modified AGI exceeding the following amounts: \$110,000 for married filing jointly; \$55,000 for married filing separately; and \$75,000 for all other taxpayers. A portion or all of the credit may be refundable depending on your income.

HOPE Credit and Lifetime Learning Credit: The maximum HOPE credit is \$1,800 (up from \$1,650 from 2007) for qualified tuition and fees paid on behalf of a student (i.e., the taxpayer, the taxpayer's spouse, or a dependent). The credit is available for only the first two years of the student's post-secondary education. The maximum Lifetime Learning Credit is \$2,000 per family member (20% of qualified tuition and fees up to \$10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking post-secondary classes to acquire or improve job skills. Eligible students include the taxpayer, the taxpayer's spouse, or a dependent. Only one credit can be claimed for the same student in any given year and both credits are phased out for taxpayers with AGI above certain thresholds.

Tuition Deduction: This deduction has been extended through 2009 and you may be able to deduct up to \$4,000 of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. The deduction is taken "above-the-line," meaning that it may be claimed whether or not you itemize your deductions. Taxpayers with modified AGI above certain thresholds aren't entitled to the deduction.

College section 529 Plans: A qualified tuition program allows you to buy tuition credits for a child or make contributions to an account set up to meet a child's future higher education expenses. Contributions to these programs aren't deductible, and the contributions are treated as taxable gifts to the child but they are eligible for the annual gift tax exclusion (\$12,000 for 2008), and a donor who contributes more than the annual exclusion limit for the year can elect to treat the gift as if they were spread out over a 5-year period. The earnings on the contributions accumulate tax-free until the college costs are paid from the funds. Any distributions from qualified tuition programs are tax-free to the extent the funds are used to pay qualified higher education expenses.

Energy Credits & Incentives

Hybrid Vehicles Credit: Taxpayers who buy qualifying vehicles, may receive a hybrid vehicle credit. This hybrid credit is reduced once manufacturers produce over 60,000 energy-efficient vehicles. For example, purchases of hybrid vehicles manufactured by Toyota or Lexus after September 30, 2007 do not qualify for the credit. In addition, Honda hybrid purchases **after 2008** will not qualify for the credit. The tax credit for qualifying hybrid vehicles manufactured by American companies (i.e., Ford, GM) will qualify for the full credit, **at least through the end of 2008**. You can get an updated list of the credit status of all hybrid vehicles by visiting the IRS website at www.irs.gov and typing in "hybrid cars and alternative fuel vehicles." If you are considering the purchase of a hybrid automobile, please call our office. We will help you determine whether the alternative minimum tax (AMT) will reduce or eliminate the tax benefit from the credit since the credit may not offset AMT.

Residential Energy-Generating Equipment Credits: If you place qualifying energy-generating equipment in service with respect to your U.S. residence in 2008, you may qualify for a credit equal to 30% of the equipment's cost. The two most common classifications of qualifying energy-generating equipment, each of which qualifies for a separate credit, are solar water heaters (up to a \$2,000 credit for 2008) and modular solar panels, commonly known as PV panels (up to a \$2,000 credit for 2008 and **no dollar limit after 2008**). These must be used in your principal or secondary residence that meets certain certification requirements. Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify for this credit.

Investment Planning and Gift Planning

The following rules apply for most capital assets in 2008.

New Zero % Tax Rates on Certain Capital Gains: Capital gains on property held one year or less are taxed at an individual's ordinary income tax rate. Long-term capital gains and qualifying dividend income are subject to a tax rate of only 15% for taxpayers in a regular tax bracket of 25% or higher. New for 2008 through 2010, the long-term capital gains and qualified dividends that would otherwise be included in the 15% (or below) ordinary income tax bracket, will be taxed at a 0% rate. Given tax rates as high as 35% for

other types of income, this is quite a break. To be eligible for the lower 15% (or 0%) capital gain rate, a capital asset must be held for more than a year. So, when disposing of your appreciated stocks, bonds, investment real estate, and other capital assets, pay close attention to the holding period. If it's less than one year, consider deferring the sale so that you can meet the greater-than-one-year period.

Harvesting Capital Losses: It is a good idea to periodically review your investment portfolio to determine if there are any losers that should be sold. This is especially true as year-end approaches, since it's the last chance to offset capital gains recognized during the year or to take advantage of the \$3,000 (\$1,500 for married separate filers) limit on deductible net capital losses. But, don't forget the wash-sale rule. This rule defers your loss if you purchase a substantially identical security within the period beginning 30 days before and ending 30 days after the date of sale.

Kiddie Tax: Starting in 2008, the kiddie tax has been expanded and becomes much more complicated. Under the new rules, a child who is not filing a joint return with a spouse will have his or her unearned income in excess of the threshold amount (\$1,800 for 2008), taxed at the parents' tax rate if: 1) The child either has not attained age 18 by the close of the tax year; or 2) The child is age 18 by the close of the tax year and the child's earned income does not exceed one half the child's support; or 3) The child is age 19 through 23 by the close of the tax year and the child is a full-time student and the child's earned income does not exceed one half the child's support.

Dividends: Qualifying dividends received in 2008 are subject to rates similar to the capital gains rates. Therefore, qualifying dividends are taxed at a maximum rate of 15%. Taxpayers in the 15% bracket will enjoy the 0% rate on qualifying dividends through 2010.

Gifts: You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. For 2008, each person is entitled each year to give gifts of \$12,000 to an unlimited number of donees without incurring any gift tax.

Avoiding Penalties

Penalty For Under-Withholding Or Under-Estimating: One way to avoid a penalty for failing to pay or withhold sufficient income taxes for a tax year is to pay 100% of your prior year's tax liability in quarterly estimated payments or through income tax withholding. If your 2007 AGI was over \$150,000, you must pay in 110% of your 2007 tax liability to qualify for this safe harbor in 2008. If you have not paid sufficient estimates to avoid an underpayment penalty for 2008, you may have additional amounts withheld from your wages, year-end bonuses, or IRA distributions **on or before December 31, 2008**. Any withholding for 2008 is deemed paid equally on each quarterly installment date for estimated tax purposes, even if the withholding occurs in December.

FINAL COMMENTS

Please call us if you are interested in a tax topic that we did not discuss. Tax law constantly changes due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes, and we will be glad to discuss any current tax developments and planning ideas with you. Please note that the information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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