

## November 2007

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## Tax Calendar

### November–December 2007

Time for 2007 year-end and 2008 tax planning! This is highly recommended if you have substantial increases in income or fewer deductions than last year. Please call for an appointment.

### December 31, 2007

- Last day to pay deductible expenses for the 2007 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2007.
- Last day to make the minimum required withdrawal of funds from a traditional IRA account in order to avoid a penalty if you turned age 70-1/2 before 2007.
- Last day to set up a Keogh retirement account if you plan to make a 2007 contribution.

### January 15, 2008

The fourth quarter 2007 federal estimated tax payment is due unless the 2007 return is filed by January 31, 2008. Caution: Some states may have different filing dates for state estimated payments.

### January 31, 2008

Deadline for providing 1099s and W-2s to those people you paid during 2007. If you are a business owner or rental property owner and you paid \$600 or more for the services of individuals (other than employees) during the year, you need to provide 1099s for those workers by January 31, 2008. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by February 29, 2008. Our firm can prepare these documents for you.

### February 29, 2008

Deadline for filing (sending) 1099s and W-2s to the government.

### April 1, 2008

Last day to withdraw funds from your traditional IRA if you turned age 70-1/2 in 2007 and haven't taken your 2007 distribution yet! In addition, this is the last day to withdraw funds from a SEP or Keogh plan for individuals who are retired and turned age 70-1/2 in 2007. Failure to take the required distributions can result in substantial penalties.

## April 15, 2008

- Deadline for individuals to file a 2007 federal return or request an extension of time to file.
- The first installment of the 2008 federal estimated tax payment is due.
- The first installment of the 2008 defined benefit pension plan contributions is due.

## Planning Ahead With Year-End Tax Strategies

The end of the year is traditionally a time to celebrate the holidays, and your 2007 taxes may be the furthest thing from your mind. However, with a few exceptions, it is your last opportunity to alter the results of your 2007 taxes. The following are some of the many possible strategies that can be employed before the year's end that can help you achieve tax savings for 2007.

- **State Estimated Tax Payments** – Although the deadline to make the 4<sup>th</sup> quarter 2007 state estimated tax payment is January 15, 2008 for most states, the payment will count as a tax deduction on the federal Schedule A for 2007 if that payment is made before the end of December 2007.
- **Property Taxes** – Generally, your property taxes are billed in installments, and that's how most people pay them. However, the tax can be paid all at once, if it provides a greater tax benefit for the current year.  
*Caution: The preceding two strategies do not benefit taxpayers who are subject to the alternative minimum tax (AMT), since taxes are not deductible to the extent a taxpayer is subject to the AMT. Taxpayers subject to the AMT might, instead, consider deferring deductible tax payments to the subsequent year.*
- **Required Minimum Distributions (RMD)** – If you are 70-1/2 or older, make sure that the minimum distribution amount is withdrawn from your IRA or other qualified plans to avoid the 50% penalty for underwithdrawals.
- **IRA Withdrawals** – If you are retired and taking IRA distributions, make sure you maximize your withdrawal with respect to your tax bracket. It may be tax-effective to actually withdraw more than is needed. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of the Social Security income.
- **Bunch Deductions** – If you are marginally able to itemize each year, it may be appropriate to "bunch" deductions in one year and then claim the standard deduction in the alternate year. This technique frequently can be applied to tax payments, charitable contributions, some medical expenses and to certain business expenses.
- **Roth IRA Conversions** – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost.
- **Review Estimated Tax Payments** – Ensure they are sufficient to meet the "safe-harbor" payment amounts so as to avoid underpayment penalties. This is especially important for taxpayers with windfall income from bonuses, property sales, etc. Employed taxpayers can also increase their withholding for the balance of the year. This is especially helpful in terms of avoiding penalties, since the withholding is treated as if it were received evenly throughout the year.

- **Profits From Stock Sales** – If you have net profits from the sale of stocks or other capital assets during the year, consider selling holdings that will generate losses to offset those gains and even produce a loss up to \$3,000 in excess of the gains.
- **Education Credits** – If you qualify for one of the higher education tax credits and have not paid enough tuition during the year to achieve the maximum credit, the law allows you to prepay tuition for an academic period beginning within the first three months of the next year, and claim the tuition for the current year's credit.
- **Business Deductions** – Before the year's end, business owners can purchase and place into service equipment needed for the business, and utilize the Section 179 expense allowance to write-off the entire cost of the equipment in 2007. There are some limitations. If you are short of cash, the deductible purchase can be made on credit.
- **Energy Credits** – If you are thinking "green," you might consider making some credit-eligible, energy-saving improvements to your home. This is especially important, since most credits, except for solar and fuel cell, expire at the end of 2007. A substantial tax credit is still available for certified hybrid vehicles, excluding Toyota and Lexus vehicles (Toyota and Lexus credits expired for purchases after 9/30/07). Purchases must be made before the year's end.
- **Defer Income** – It might be appropriate to make arrangements with your employer to defer a bonus until early 2008.
- **Charitable Contributions** – If you have been planning to contribute used clothing and household goods to a charity, doing so before the year's end can increase your itemized deductions. But keep in mind that under the stringent new rules, the items must generally be in good or better condition, and your contribution will need to be substantiated. Used vehicle contributions are still allowed, but the deduction is generally limited to the amount that the charity receives from the sale of the vehicle.
- **IRA to Charity Distributions** – 2007 is the final year for taxpayers age 70-1/2 and older to transfer funds from their IRA accounts to charities. The transfer counts toward the year's required minimum distribution but is not counted as either income or a charitable contribution. This is an opportunity for those who do not itemize to effectively benefit from contributions that they would be unable to deduct. At the same time, it reduces the AGI, the amount on which certain deduction limitations are based. A lower AGI may also reduce the amount of Social Security income that is taxed.

If you would like to discuss other possible strategies or how any of the ones listed above applies to you, please call this office.

## **Maximize Your Tax Benefits By Timing Business Asset Acquisitions**

Small to medium-sized businesses can significantly alter their profits for the year by timing asset acquisitions and taking advantage of depreciation and liberal expensing provisions. Understanding these provisions will help you plan your acquisitions so as to maximize the tax benefits and reduce your taxes.

One important goal is to preserve your deductions for years when your taxable income is high. Don't jump the gun and take a big write-off in a low taxable income year. The tax code now allows taxpayers to expense, rather than depreciate, significant capital purchases, and it is tempting to save tax dollars immediately rather than consider the long-range effects of that decision. Therefore, we urge you to plan your purchases carefully.

**Equipment Depreciation** – Generally, tangible business assets must be written off (depreciated) over a period of years. The tax code includes specific recovery periods (number of write-off years) for different types of business assets. For most businesses, these recovery periods fall into three categories: 3-year, 5-year and 7-year life properties. The following are examples of each:

- **3-Year Property** – This category includes tractor units for over-the-road use, race horses over two years old when placed in service and other horses over twelve years old when placed in service.
- **5-Year Property** – Examples in this category include computers, typewriters, copiers, duplicating equipment, heavy trucks, trailers, cargo containers, autos, light-duty trucks and certain technological and research equipment.
- **7-Year Property** – Includes office furnishings, fixtures and equipment.

Generally, the above-type assets are depreciated under the "half-year convention," which means the depreciation deduction for the first year is one-half of a year's depreciation. The accelerated Declining Balance (200% DB) method, which frontloads the deduction, is typically used. To spread the deduction more evenly, a different depreciation method can be selected. The table below illustrates the annual deduction for 3-, 5- and 7-year properties using the 200% DB method and the straight-line method (SL), which applies the deduction evenly over the depreciable life of the asset.

**Half-Year Exception** – *If the total basis of personal property placed in service during the last three months of a tax year exceeds 40% of the total basis of personal property placed in service during the entire year, then a mid-quarter convention must be used instead of the half-year convention for all personal property placed in service during the tax year. The mid-quarter convention tables are too extensive to reproduce in this article.*

<b>Depreciation (% of Asset Cost) – Half-Year Convention</b>						
Year	3-Yr Property		5-Yr Property		7-Yr Property	
	200% DB	SL	200% DB	SL	200% DB	SL
1	33.33	16.67	20.00	10.00	14.29	7.14
2	44.45	33.33	32.00	20.00	24.49	14.29
3	14.81	33.33	19.20	20.00	17.49	14.29
4	7.41	16.67	11.52	20.00	12.49	14.28
5			11.52	20.00	8.93	14.29
6			5.76	10.00	8.92	14.28
7					8.93	14.29
8					4.46	7.14

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As you can see, the second year, rather than the first year, provides the largest write-off for assets being depreciated with the 200% DB method and mid-year convention. Thus, if you expect to buy property in 2008, consider accelerating the purchase into 2007 if you wish to maximize the regular depreciation deduction in 2008.

**Asset Expense Election (Sec. 179 Deduction)** – Generally, if you purchase depreciable tangible personal property (including off-the-shelf computer software) in 2007, you may choose, using the Sec. 179 election, to treat up to \$125,000 as a deduction for property placed in service in the taxable year. However, the benefits of this election begin to phase out if more than \$500,000 of qualifying property is placed in service. (The maximum amount that can be expensed [\$125,000] is reduced “dollar for dollar” for eligible property placed in service in excess of \$500,000.) The \$125,000 amount is increased to \$160,000 for qualifying property placed in service by a qualifying “enterprise zone business.” This election is allowed only in the first year that the property is placed in service and is generally limited to the taxable income from the trade or business. However, if more than can be claimed is taken in the first year, the excess can be carried over to subsequent years, providing a way to benefit from this deduction in more than one year.

If you are thinking of applying the Sec. 179 expense deduction to a business vehicle, you should be aware that vehicles with a gross unladen weight of 6,000 pounds or less are limited to a first-year depreciation deduction of \$3,060 (\$3,260 for light trucks) in 2007; those weighing more than 6,000 and not exceeding 14,000 pounds (typically SUVs) are limited to a Sec. 179 expense of \$25,000.

**AMT Depreciation** – The alternative minimum tax (AMT) is imposed on corporations and individuals and is added to the regular tax if, and to the extent that, the tentative AMT exceeds the regular tax. AMT is based on alternative minimum taxable income (AMTI), which consists of a taxpayer’s regular taxable income increased by various adjustments for certain tax preferences and items of deferral, such as depreciation. “Small” corporations with average gross receipts of less than \$7.5 million for the prior three taxable years (less than \$5 million if the corporation had only one prior year) are exempt from the AMT. For purposes of depreciation, the AMT adjustment is the difference between the 200% and 150% declining balance methods of depreciation. Thus, taxpayers who elect to use the 150% or straight-line methods will not have an AMT depreciation adjustment. **Planning Tip:** There is no AMT adjustment for a deduction of payments for leased property or the Sec. 179 expense deduction.

**Leasehold Improvements** – Generally, any leasehold improvements made during 2007 are deducted over a 15-year period.

**Real Property** – The depreciation deduction is stretched out over 27.5 years for residential rental property and 39 years for nonresidential property, both using straight-line methods and mid-month conventions. Real property is ineligible for the Sec. 179 deduction. Thus, in terms of depreciation method and recovery period, there are generally no planning opportunities for real estate property depreciations.

If you are in the market to purchase equipment in the near future, let us help you maximize the tax benefits.

## Say Hello and Say Goodbye

With Congress changing tax laws faster than a speeding bullet, it is sometimes difficult for taxpayers to keep up. In recent years, Congress has made a number of changes at the last minute, so there is a chance that some of these provisions might be extended or modified after this newsletter has been printed. Here is a brief overview (not all the details and limitations are included) of some of the extended and future business tax provisions:

- **Section 179 Expense Deduction Increases Extended and Enhanced** – For 2007, the amount that a taxpayer can deduct annually as a Sec. 179 expense (instead of depreciating) was increased to \$125,000, and the phase-out threshold amount was upped to \$500,000. Both values will be inflation-adjusted beginning in 2008. After 2010, the maximum deduction will revert back to \$25,000. Extended through 2010 is the provision treating off-the-shelf computer software as eligible Sec. 179 property.
- **Spouses May Elect Out of Partnership Rules** – Effective for 2007 and later tax years, a husband and wife operating a business together who file a joint return may elect out of the partnership rules. Thus, a joint venture between them is not treated as a partnership for tax purposes. Instead, all items of income, gain, loss, deduction and credit are divided between the spouses according to their respective interests in the venture, and each spouse takes into account his or her respective share of these items as if they were attributable to a trade or business conducted by the spouse as a sole proprietor. Thus, each electing spouse will report his or her shares on the appropriate form, such as Schedule C.
- **Domestic Production Deduction** – For 2007 through 2009, the deduction percentage has been increased to 6% (from 3% in 2006 and 2005). Then, in 2010 and future years, the percentage will increase to 9%. The deduction is essentially equal to the lesser of the applicable percentage multiplied by the net income from eligible production activities or 50% of the W-2 wages paid to employees during the year properly allocated to the qualified production activity.
- **Work Opportunity Tax Credit Extended and Expanded** – The elective work opportunity tax credit (WOTC) provides a tax credit of as much as \$2,400 per eligible employee hired from one or more of nine targeted groups (higher for certain veterans and special categories). The credit will now offset the alternative minimum tax (AMT) and has been extended by 44 months to August 31, 2011. The requirements were eased for “high-risk youths,” and the provisions for hiring certain veterans were enhanced. If you have questions regarding this credit, please give us a call.
- **Research and Development Credit** – The research and development credit (R&D), which expired at the end of 2005, was reinstated retroactively for 2006 and extended through 2007. In addition, for tax years ending after 2006, the new law enhances the credit by increasing the rates of the alternative incremental credit and creates an alternative simplified credit that does not use gross receipts as a factor, thus allowing newer businesses to qualify for the credit.

- **Last Year for Sales Tax Deduction** – Even though 2007 is the last year that taxpayers who itemize their deductions on their individual returns will be allowed to deduct the greater of the state income tax or state and local general sales tax, sales tax incurred as a business expense will continue to be deductible as part of the expense of the purchased item or capitalized as part of the item's cost, as applicable.

If you have any questions regarding these tax issues and how they may impact your unique tax situation, please give us a call.

## **Six Tax Penalties You Want to Avoid!**

Generally, taxpayers don't intentionally incur tax penalties, but many do simply because they are unaware of the penalties and the impact that they can have on their pocketbooks. The following is a rundown on some of the more commonly encountered penalties:

**Underpayment of Estimated Taxes and Withholding** – Taxpayers are essentially required to pay their tax liability throughout the year, either through withholding or by making estimated tax payments. If the taxpayer owes more than \$1,000 when filing his or her return for the year, the IRS will assess the underpayment of estimated tax penalty, which is currently 8% of the underpayment computed quarterly. There are "safe-harbor" payments that can protect you from this penalty; they include paying the following amounts: 90% of the current year's tax liability or 100% (110% for high-income taxpayers) of the prior year's tax liability. Farmers and fishermen need only prepay 66-2/3% of the current liability or 100% of the prior year's liability.

**Late-Paying Penalty** – When the tax owed on a return is paid after the unextended due date of the tax return, the taxpayer is subject to a penalty of 1/2% per month (maximum 25%) on the unpaid balance. Taxpayers are frequently caught by this penalty when they have an extension of time to file their tax returns. Many fail to realize that the extension does not include an extension to pay. The only way to avoid or minimize this penalty is to have no or little balance due on the return when it is finally filed. The extension form includes a provision to pay the projected balance owed when filing the extension.

**Late-Filing Penalty** – If the return is filed after the due date, including extensions, a late-filing penalty of 4.5% per month (maximum 22.5%) applies. The automatic extended due date for 2007 returns is October 15, 2008. Thus, the penalty would generally apply to 2007 returns filed after that date.

**Negligence** – 20% of the tax underpayment is charged when the underpayment is due to negligence on the part of the taxpayer or when there are errors in tax valuations. This penalty is frequently encountered when the IRS adjusts a filed return due to unreported income or overstated deductions.

**Dishonored Check** – The penalty for dishonored checks is 2% of the check amount but not less than \$25.

**Missing ID Number** – This penalty of \$50 for each missing number is charged when a taxpayer doesn't provide a required Social Security number (SSN) for him/herself, a dependent or another person on the tax return. This also applies when he or she doesn't provide his/her SSN to another person when required.

There are more severe penalties that are not mentioned here which apply to fraudulent actions or claims. In some cases, it is possible to have some of the penalties abated for reasonable cause. If you have questions related to the application of any of these penalties, please give us a call.

## **Vacation Home Rentals: Are the Tax Rules On Your Side?**

If you have been considering acquiring a second or vacation home, this soft real estate market may be the right time to make this purchase. However, vacation home rental rules include some interesting twists that should be considered beforehand.

Although some individuals prefer to never rent out their homes, others find this to be a helpful way to cover the cost of the home. If you choose not to rent it out at all and it is your designated second home, the property taxes and the home mortgage interest may be written off as part of your itemized deductions. However, the interest is deductible only as long as the acquisition debt on your first and second homes does not exceed \$1,000,000. In addition, the interest on up to \$100,000 of equity debt can be deducted. If you are unfortunate enough to be subject to the alternative minimum tax (AMT), to the extent that you are taxed by the AMT, the property taxes and equity debt interest will not be deductible.

If the home is partly rented out, then there are three rules to consider, based on the length of the rental:

- **Rent Less Than 15 Days** – If the property is rented out for less than 15 days, the money can be pocketed tax-free, and the interest and taxes can continue to be deducted as if the property were not rented out at all. In this situation, any other directly-related rental expenses, such as the agent fee, utilities, post-rental cleaning, etc., are not deductible. This rule has led to some significant tax-free income for individuals who own a home or second home that is suitable as a filming location.
- **Personal Use is Less Than the Greater of 15 Days or 10% of the Rental Days** – In this scenario, the home's use would be allocated into two separate activities, a rental and a second home. Let's say that the home is used 5% for personal use; 5% of the interest and taxes would be treated as home interest and taxes that can be deducted as an itemized deduction. The other 95% of the interest and taxes would be rental expenses, combined with 95% of the insurance, utilities, allowable depreciation and 100% of the direct rental expenses. The result can be a deductible tax loss, which would be combined with all other rental activities and limited to a \$25,000 loss per year for taxpayers with adjusted gross incomes (AGI) of \$100,000 or less. This loss allowance is ratably phased out between \$100,000 and \$150,000 of AGI. Thus, if your income exceeds \$150,000, the loss cannot be deducted; it is carried forward until the home is sold or there are gains from other activities

that can be used to offset the loss.

- **Personal Use Exceeds the Greater of 14 Days or 10% of the Rental Days** – In this scenario, no rental tax loss is allowed. Let's assume that the personal use of the home is 20%. As for the remaining 80%, it is used as a rental. The rental income is first reduced by 80% of the taxes and interest. If, after deducting the interest and taxes, there is still a profit, the direct rental expenses (such as the rental portion of the utilities, insurance and any other direct rental expenses) are deducted, but not more than will offset the remaining income. If there is still a profit, you can take depreciation, but it is again limited to the remaining profit. **End result:** No loss is allowed, but any remaining profit is taxable. The other personal 20% of the interest and taxes is deducted as an itemized deduction, subject to the interest and AMT limitations discussed earlier. Take note that if the rental income becomes less than the business portion of the interest and taxes, the balance of the interest and taxes is still deductible as home mortgage interest and taxes.

**Sale of the Vacation Home** – When the sale of the home results in a loss, the loss may or may not be deducted. If the property is treated partly as personal-use property and partly as a rental (as discussed above in the example, where the personal use was 5%), then the loss would be divided between a nondeductible personal-use portion and the deductible rental portion. In all of our other scenarios, the loss would not be deductible at all.

Unlike your primary home, the second home does not qualify for the home gain exclusion. Any gain would be taxable, unless the rental is the *primary* residence for two of the five years preceding the sale. If so, the rental is converted for the personal use of the taxpayer, and any gain is deferred until the property is ultimately sold. This option may be ideal for someone who wants to buy a home while prices are low, rent it out for a while, and eventually occupy the home full-time as a retirement residence. If the rental is residential and is occupied by the taxpayer for at least two years after the conversion (and otherwise meets the requirements), the rental would qualify for the home sale gain exclusion. Thus, the gain, in excess of the depreciation previously claimed on the home, could be offset by the home gain exclusion (\$250,000/\$500,000 for a married couple filing jointly where the spouse also qualifies).

As with all tax rules, there are certain exceptions to be aware of. Please call our office so we can discuss your particular situation in detail.

## **Tax Treatment of Business Computer Software**

Tax law is sometimes complicated as it relates to a buyer's treatment of business computer software. Generally, the treatment depends on how the software is billed to the taxpayer.

- **Software Cost Included in Computer Cost** – If a charge for computer software is included in the purchase price of the computer hardware without a separate identification of the charge for the software, then the buyer capitalizes and depreciates the cost as part of the cost of the hardware. In lieu of depreciating the cost of the computer, part or all of

the expense generally may be claimed as a Sec. 179 deduction (explained below).

- **Software Costs That Are Separately Stated** – If the charge for the software is stated separately, then it can be amortized over 36 months using the straight-line method. However, see special rules for off-the-shelf and intangible software below.
- **Off-the-Shelf Software** – Off-the-shelf software purchased and placed in service before the year 2011 can be expensed under the Sec. 179 expensing rules, which allow up to \$125,000 worth of equipment and off-the-shelf software to be expensed in 2007. For years after 2007, the \$125,000 is inflation-adjusted. If the amount of the total cost of equipment and off-the-shelf software placed in service during the year exceeds \$500,000, then the \$125,000 expense allowance is reduced one dollar for each dollar that the \$500,000 is exceeded. The Sec. 179 deduction is further limited by the net profit for the year from the business, but any excess carries over to future years.
- **Licensed Software** – The cost of software licensed for a specific period of time (unless properly chargeable to a capital account) is generally deducted over the term of the license agreement.
- **Developed Software** – The costs of developing computer software, other than software falling under the intangible rules, can be either:
  - (1) Consistently expensed currently, or
  - (2) Consistently treated as capital expenditures recoverable through deductions for ratable amortization over a period of:
    - 60 months from the date of completion of the development, or
    - 36 months from the date the software is placed in service.

Costs of developing software for internal use may also qualify as research and experimental expenditures. The cost of software for sale to the general public, which is not subject to a nonexclusive lease and has not been substantially modified, would generally be included in the inventory.

- **Software Acquired in Connection With the Acquisition of a Business** – Generally, software acquired in this manner is treated as an intangible (the same as goodwill, going concern value, operating systems, etc.), and is amortized over a period of 15 years.

Like most situations regarding tax issues, software has its complications. If you have questions regarding your specific business circumstances or are planning a software acquisition, please give us a call.

## Since You Asked...

**Q:** I recently replaced the computer system for my unincorporated business office, and plan to donate the old system to charity. How do I determine what my charitable deduction is?

**A:** You may or may not have a deduction. Assuming your use of the computer was all business, you would have been writing off the cost of the computer by depreciating it or expensing it under the special Sec. 179 expense allowance. Keep in mind that a taxpayer can't deduct something twice. Thus, if it was already written off for business, then there are no further deductions available for the cost of the computer. If it has not been completely written off, then a taxpayer can scrap it and take the remaining value as a loss from the disposition of a business asset on his or her tax return but not as a charitable contribution. (Note: Charitable contributions are not allowed on a sole proprietor's Schedule C and must be deducted as itemized deductions.)

**Q:** I heard that the Medicare B premium might increase next year. Is that correct?

**A:** It all depends upon the amount of your income for the 2006 tax year. The increase applies only to higher-income taxpayers. Thus, if you didn't have an increase last year and your income in 2006 was near the same as it was in 2005, you probably will not see an increase in 2008. The federal government has been supplementing the Medicare B insurance premiums for some years, even as the costs have exceeded the funds generated from the premiums. Beginning in 2007, the premiums were increased for higher-income individuals based upon their modified (includes tax-free income) adjusted gross incomes (AGI) for the year two years prior. The increase is a tiered increase starting at \$160,000 for joint-filing taxpayers and \$80,000 for most others (these amounts will be inflation-adjusted). The increases are being phased in over three years, with the increases starting at 13.33% and going as high as 73.33% for the 2007 premium. The increase in 2008 will be double those amounts and triple in 2009.

**Q:** I have been trying for years to contribute to a Roth IRA. My wife and I have pension plans at work and no existing IRA accounts, and our joint incomes are above the limits to deposit into a Roth account. Is there anything we can do?

**A:** Beginning in 2010, the income limitations for converting a traditional IRA to a Roth IRA will be removed, thus allowing you to open a Roth IRA. If you would like to get a jump on it, you can contribute now to a designated nondeductible traditional IRA for the years leading up to 2010, and then convert those nondeductible traditional IRAs into Roth IRAs. The only conversion tax would be tax on the earnings from those accounts between now and the time the conversion is made. This would allow each of you to set aside about \$15,000 (more if you are over 50) that can be converted in 2010.

**Q:** I am self-employed and work out of my home. I converted a den in the home to an office that I use only for business. We also have a guesthouse on the property that I have been considering remodeling and using as my office. I recall reading or hearing that it might not be a good idea. Are you aware of any reason that could make that a bad tax move?

**A:** If you own and use the home for two of the prior five years preceding the sale of the home, you are allowed to exclude up to \$250,000 (\$500,000 if you are married and both you and your spouse qualify for the exclusion) of gain from the home. The

fact that a portion of the residence is not being used as a home presents no problem if the home office is an integral part of your residence. The exclusion is allowed against the entire gain, except that you are required to recapture as income the depreciation deducted on the home office after May 6, 1997. However, if the portion of your home that you use as an office is located in a separate structure, then the sale would be treated as two sales: one for the home portion and the other for the business portion. The exclusion would not be allowed against the business portion. Let's say the guesthouse represents 20% of the entire residential complex. Then, 20% of the gain would not qualify for the exclusion of gain. This is probably what you recall. Although complicated, it is possible to combine a home sale subject to the exclusion and a tax-deferred exchange for the business portion where the gain on the office portion is deferred into a replacement office. This is a simplified explanation of a very complex set of rules. Not all of the issues can be covered here, so we recommend that you contact this office for additional details.