



Advanced Planning Strategies

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The recently passed Economic Stimulus Package is described in detail in the inside report. Conventional wisdom would indicate that we are unlikely to see much additional tax legislation in an election year. However, that may not be the case due to a couple of factors. First, some items may become a political issue and may prompt bi-partisan action. For example, the alternative minimum tax (AMT) is generally deemed in need of a permanent solution. Second, many extenders were not passed at the end of 2007, and at least some of these items will probably be dealt with before the end of the year.

One issue related to tax revenues, known as the Medicare Trigger, might be addressed before the end of 2008. The Medicare Trigger provision was included in the 2003 legislation that added prescription drug coverage to Medicare. The trigger is “pulled” if two consecutive annual reports of the Medicare trustees estimate that general tax revenues will cover more than 45 percent of the Medicare costs within the following 6 years. This projection actually occurred in the 2006 and 2007 reports.

After the Medicare trigger is pulled, the President is required to submit legislation to keep the costs within the 45 percent limit. The Congress presumably would be required to initiate legislation if the President does not comply. Note: There is a constitutional question about whether the President is compelled to comply with this requirement of the 2003 legislation. Presumably, Medicare legislation to reduce the use of general revenues would have to contain benefit cuts and/or some combination of increases in the payroll tax and Medicare premiums. Now that would be an interesting debate during an election year.

The Economic Report of the President again called for the permanency of the 2001 and 2003 tax cuts with an estimated \$2.19 trillion price tag over the next 10 years. It seems unlikely that this could be addressed before the end of 2008, but it could generate some significant discussion by the candidates prior to the general election in November.

Knowledge is not power. Only knowledge in use is power.

ECONOMIC STIMULUS ACT of 2008

On February 7, both the Senate and House voted in favor of an amended version of H.R. 5140, the "Economic Stimulus Act of 2008." President Bush signed the legislation into law on February 13, and many Americans can expect to receive rebate checks in late spring or early summer.

PROVISIONS AFFECTING INDIVIDUAL TAXPAYERS

Rebate Checks

The rebates are technically a tax recovery credit under the code. Rebate checks will be provided only to qualifying individuals who file a 2007 federal income tax return.

The minimum rebate credit amount for qualifying individuals is \$300 (\$600 if married, couples filing jointly). The taxpayer will receive this amount if he or she has at least \$1 of tax liability or \$3,000 in qualifying income, defined as the sum of earned income (including self-employment income), veterans' disability payments (including payments to survivors of disabled veterans), and Social Security benefits. Dividends, interest, and capital gains are not included when determining qualifying income. Supplemental Security Income does not count as qualifying income for the stimulus payment. Also not included in qualifying income are non-veterans or non-Social Security retirement income (such as IRA distributions).

The maximum rebate credit amount for qualifying individuals is \$600 (\$1,200 if married, filing jointly). The taxpayer's rebate under this credit will be equal to the minimum of his or her 2007 tax liability or 10 percent of the first \$6,000 of taxable income (\$12,000 if married, filing jointly).

Qualifying Child Credit

If a taxpayer receives \$1 of the income tax rebate and has children, the taxpayer will also receive \$300 per child. A qualifying child is defined by reference to the child tax credit definition of qualifying children (IRC Sec. 24(c)), which means a qualifying child under the dependency exemption rules of IRC Sec. 152(c) who has not attained age 17.

Who Won't Receive a Rebate Check

The amount of the credit (including both the basic credit and the qualifying child credit) is phased out for individual taxpayers at a rate of 5 percent of adjusted gross income beginning at \$75,000, with a complete phaseout at \$87,000. Married joint filers begin to lose the \$1,200 rebate at \$150,000, with the rebate completely phased out at \$174,000. Taxpayers ineligible for the basic rebate credit due to the phaseout provisions will not be eligible for the additional qualifying child credit. In addition, individuals claimed as a dependent on another's tax return are ineligible for the credit. Furthermore, stimulus payments will be subject to offset against outstanding tax and nontax liabilities in the same fashion as regular tax refunds.

Residents of U.S. possessions will also receive the benefit. However, the provision denies the basic credit and the qualifying child credit to individuals if their tax return does not include valid identification numbers (i.e., Social Security numbers) for all persons listed on the return.

BUSINESS TAX PROVISIONS

The stimulus package provides incentives for businesses to invest in capital expenditures by temporarily increasing write-offs. The current expensing of new investment under IRC Sec. 179 are increased to the highest level in history for 2008.

Increased Current Expensing under IRC Sec. 179

The Act increases the expensing limit under Sec. 179 to \$250,000 and the phaseout to \$800,000 for 2008. This is an increase from the 2008 scheduled expensing limit of \$128,000 and the phaseout threshold of \$510,000 (as provided under the Small Business and Work Opportunity Tax Act of 2007).

The above adjustments apply only to taxable years beginning in 2008. For fiscal year taxpayers, this provision cannot be used until the first fiscal year beginning in 2008, but the qualifying purchases will continue until the end of that fiscal year. For example, a November fiscal year taxpayer will be permitted to make purchases only on or after December 1, 2008, but the taxpayer can continue to purchase qualifying assets through November 30, 2009.

Bonus Depreciation Rules

The Act also allows a trade or business to depreciate an additional 50 percent of the cost of an asset acquired and placed into service in 2008. The types of property eligible for “bonus” depreciation are the same as included in previous depreciation packages:

- tangible property that has a recovery period not exceeding 20 years
- purchased computer software
- water utility property
- qualified leasehold improvement property

Similar to prior legislation, the original use of the property must commence with the taxpayer after December 31, 2007, and be placed in service before January 1, 2009. (The term “original use” means the first use to which the property is put, whether or not this use corresponds to the taxpayer’s use of the property.)

The bonus depreciation deduction will be allowed under the AMT. As with other depreciation methods, the basis of the property is reduced to reflect the bonus depreciation deduction. This deduction is not affected by a short taxable year. The taxpayer may elect out of bonus depreciation for any class of property for any taxable year.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (IRC Sec. 280F) is increased in the first year by \$8,000 for automobiles that qualify (and the owner does not elect out of the increased first-year deduction). The \$8,000 increase is not indexed for inflation.

OTHER STIMULUS PROVISIONS

The remaining provisions of the Act include provisions that temporarily increase conforming loan

limits for the Federal Housing Authority (FHA).

The Act raises the FHA's loan limit (the dollar amount of a mortgage that FHA can insure) for its single-family program from 87 percent of the conforming loan limit to as high as 175 percent (effectively \$362,790 to \$729,750) of that limit in certain geographic regions where the cost of housing is very high and from 48 percent to 65 percent (effectively \$200,160 to \$271,050) of the limit in less expensive markets. FHA would also have the authority to raise the loan limits by up to an additional \$100,000 if market conditions warrant these increases. This provision expires on December 31, 2008.

RECENT CASES AND RULINGS

SPOUSAL ROLLOVER PERMITTED FOR IRAs LEFT TO REVOCABLE TRUST

A decedent had two IRAs at the time of his death. He had not yet begun taking distributions from them because he had not yet reached the required beginning date of age 70½. A trust benefiting his surviving spouse was named as the designated beneficiary of the IRAs. She was the sole trustee of the trust, which stipulated that all net income of the trust be provided to her during her lifetime. In addition, the surviving spouse had the power to revoke the trust at any time. She directed that the IRAs be distributed to the trust and then directly to her as the trust beneficiary. She rolled over the IRAs within 60 days to a new IRA maintained in her name.

The IRS (Ltr. 200807026) ruled that the IRAs will not be treated as inherited IRAs under the provisions of IRC Sec 408(d)(3)(C) and that the transaction will be treated as a qualified spousal rollover. Ordinarily, the regulations do not permit the rollover of an IRA even if the spouse is the sole trustee and beneficiary of the trust. However, the preamble to the regulations provides that a surviving spouse who actually receives a distribution from an IRA is permitted to roll over that distribution if the IRA assets pass through a trust or estate. Note, however, that this preamble should not be read as broadly as it sounds. The key provision in this case is the surviving spouse's ability to cause a distribution of all of the IRA due to the power to revoke the trust and distribute all principal to the surviving spouse as the sole beneficiary. As we have seen in previous editions of this newsletter, it is important to carefully consider the beneficiary designations of an IRA or qualified retirement plan. If a trust is the designated beneficiary, specific provisions must be included to avoid incurring income taxes faster than necessary.

This letter prepared, with the help of a nationally recognized tax authority, intends to promote interest in more comprehensive tax and estate planning. References are intentionally brief. If a topic interests you, you should investigate it more thoroughly with your qualified tax advisor. Effective tax and estate planning should involve competent advisors in relevant law, accounting, trusts, life insurance and investments. The knowledge and experience of each in their specialties can make the difference between a wealth transfer that works as intended and one that does not. Please seek competent counsel to determine and satisfy your individual needs. Securities and Investment Advisory Services offered through Capital Analysts Incorporated, Member FINRA/SIPC. AEG and CAI are independent non-affiliated entities.

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for the future*



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