
Tax strategies for the 2008 year end — Part 2

Allen Schiff

by Allen M. Schiff, CPA, CFE

For more on this topic, go to www.dentaleconomics.com and search using the following key words: tax strategies, tax planning, taxes, income tax returns, tax advice, tax savings. Welcome back! Here is the completion of the article that appeared in last month's issue of Dental Economics®.

Educational savings plans

Consider establishing either a Coverdell Educational Savings Account or a College Savings Plan (also known as a 529 plan) for your children. Contributions to educational savings plans are not tax-deductible. Income earned in the plan is not taxable as long as withdrawals are used for qualified purposes. Some states offer deductions for contributions to 529 plans sponsored by your state of residence. Funds from the Coverdell account may be used for grades one through 12 or for college. Funds from a 529 plan can only be used for college. However, the limitation on contributions to a Coverdell ESA is significantly lower than that of a 529 plan. It is permissible to establish both accounts for the same child.

Avoiding the "kiddie tax"

When a qualifying child has unearned (investment) income in excess of \$1,700, the income is taxed at the parent's tax rate. There is a standard deduction available against income of the greater of \$900 or total earned income, with a maximum of \$5,450. A qualified child is one who does not file a joint return and is either under the age of 18, an 18-year-old who supplies less than one-half of his or her support with earned income, or a 19- to 23-year-old full-time student who provides less than one-half of his or her support with earned income. Earned income, such as salary income, is not subject to the "Kiddie Tax" and is taxed at the regular single rates. You will lose the personal exemption for the child, so you will need to assess which approach generates the lower total tax. For 2008, the personal exemption amount is \$3,500, and the standard deduction for single filers is \$5,450. Your child will not pay tax on the first \$5,450 of earned income if the child is claimed as a dependent on your individual income tax return for 2008. If your child does provide more than 50% of his/her own support, then the \$5,450 increases to \$8,950. Please consult your tax adviser.

Consider the operating entity of your practice

Most dentists start their practices as self-employed individuals. This is the simplest form to create. Once you have your license to practice, you apply for a federal employer identification number and any required state accounts (state income tax withholding and unemployment, for example), and you are ready to go. However, if your state provides for it, consider forming a limited liability company (LLC). You will have the legal protection of a corporation (of course, you still need professional liability insurance) and will be able to employ your children under age 18 without having to pay Social Security or Medicare tax.

As your practice matures and your net income approaches \$300,000, consider incorporating your practice and electing S Corporation status. S Corporations do not pay taxes at the corporation level; the net income passes directly through to the shareholders and is taxed on their individual income tax returns. Under current tax law, it is not subject to Social Security or Medicare taxes. CAUTION: Please do not be tempted to minimize your salary to save additional Social Security and Medicare taxes and make up for it by increasing your S Corporation distributions. This is one of the IRS's "hot buttons." Your salary must be reasonable in amount to avoid IRS scrutiny.

A regular (C) Corporation is generally not attractive as a choice of entity, as tax on any income left in the C Corporation is taxed at the rate of 35%, plus any additional state taxes.

Disability tax credit

If your office is not yet compliant with the American Disabilities Act of 1990, there is a tax credit of one-half of the costs of coming into compliance up to \$5,000. This credit is available each year. Additionally, you may also elect to expense up to \$15,000 in barrier removal expenses, and on parking lots associated with your practice.

The IRS has disallowed credits claimed for purchases of digital radiography machines, intraoral camera systems, and X-ray equipment advertised as being practical for patients in wheelchairs. The IRS has held that these were acquired in the normal course of business and not specifically to benefit the disabled patient, and thus are not eligible for the disability tax credit.

Charitable contributions

Are you considering funding year-end contributions with stock that has appreciated in value? (As a side note, hopefully you have appreciated stock in 2008 with this stock market!) Consider not selling it and donate the stock to your favorite charity. You receive a deduction (Itemized Deduction — Schedule A) for the appreciated value and are not taxed on the capital gain. Be sure to receive acknowledgement from both the charity and your broker.

Short on cash until January? You can still make the contribution in December 2008. Most charities accept credit cards, so consider using one to make the contribution. But it must appear on your credit card statement with a December 2008 date. So to be safe, do not wait until Dec. 31, 2008, to do this. You then pay for the contribution in January 2009 when you receive the credit card statement.

Investments

Tax harvesting — If you have stocks in a loss position, consider selling them. You can deduct up to \$3,000 capital loss per year, with any excess loss carried over to future years. Your broker can inform you the last day to sell these stocks to qualify for a 2008 loss. If the stock is in a company you like, purchase a replacement lot at least 31 days before or after the sale of the high-priced original lot; otherwise the loss is not deductible and is added to the cost basis of the new stock.

If you have stocks in a gain position, you can gift up to \$12,000 per child in 2008 (\$24,000 if your spouse joins the gift). For 2008, the tax on the long-term capital gain will be \$0 as long as the child's taxable income is below \$32,550. However, be wary of the "Kiddie Tax." If you are not able to gift the stocks, be aware that long-term capital gains may cause you to be subject to AMT (Alternative Minimum Tax). This is because long-term capital gains are taxed at 15%, and the AMT rate is 26%.

Consider moving your fully taxable investments into tax-exempts. But please be very careful — many tax-exempt investments generate income that is subject to AMT. Rates of return will be lower, but you do not lose any of the income to tax. If you are in the 30% tax bracket, a 4% tax-exempt yield is equivalent to a 5.7% fully taxable return after taxes.

If you have investments other than publicly traded securities, such as real estate, consider an installment sale stretched over multiple years. Gains associated with installment sales are recognized as principal is collected. By using the installment sale method of recognizing the gain, you will minimize, if not completely avoid, the AMT.

Consider your filing status

If your spouse has a reasonably low income and significant deductions that are subject to a floor such as medical or miscellaneous itemized deductions subject to 2% of adjusted gross income, consider electing to file separate rather than married filing joint. Please be sure to check the results of filing both ways as the married filing separate tax rates are approximately double those of married filing joint.

Consider prepaying your 4th quarter 2008 state income taxes

Consider prepaying your fourth quarter 2008 state estimated tax payment on or before Dec. 31, 2008, rather than waiting until Jan. 15, 2009, which is normally the due date for such tax payment. CAVEAT: If you will be subject to AMT in 2008, please do not do this unless you have consulted with your Dental CPA. Under AMT, there is an excellent chance you will lose this deduction as a 2008 itemized deduction.

Business start-up costs

If this is your first year in business or if you incorporated your practice in 2008, you are allowed to deduct up to \$5,000 of start-up or incorporation costs immediately. Any costs in excess of the \$5,000 must be amortized over 15 years.

Partnership or S Corporation losses

In order to deduct losses generated by your practice operating as either a partnership or S Corporation, you must have "tax basis." If you need basis to deduct the loss in your partnership, consider making a capital contribution or personally guaranteeing a loan to the partnership. If your practice is an S Corporation, consider making a loan to the corporation (guaranteeing a loan to an S Corporation does not usually give you basis). Recourse debt (debt where the creditor can look to you for payment if the partnership defaults) gives you basis in a partnership; it usually does not in an S Corporation.

Proposed legislation

Although not law yet, there are quite a few tax bills before Congress that bear watching at the time of this writing. Here are some of them:

- **H.R. 6727** — Currently to take a charitable deduction in excess of \$500 for a vehicle donated to a charity, you must have a written appraisal. This bill increases the \$500 to \$2,500.
- **H.R. 6436** — Allows individuals a \$1,000 tax credit to offset the rising cost of energy.
- **S. 2540** — Allows a current year deduction for business equipment placed in service during 2008 and 2009. Unlike the current Section 179 deduction, there appears to be no limitation on the amount of the deduction.
- **S. 2886** — Extends expiring provisions in the tax law relating to the alternative minimum tax, individual and business taxpayers, energy conservation, and tax administration.
- **S. 3032** — For 2008, increases the business, medical, and moving mileage rate to 70 cents and 40 cents for charitable usage.

Conclusion

There are many issues to consider during the fourth quarter of 2008 to help save taxes and accumulate wealth. Please consider the effect of each action you take. For example, if you maximize your Section 179 deduction, it may reduce or even eliminate your ability to make a profit-sharing contribution. Consultation with a Dental CPA is a must.

Allen M. Schiff, CPA, CFE, is the managing member of Schiff & Associates, LLC. In addition, Schiff cofounded the Academy of Dental CPAs in October 2001. Schiff has more than 30 years of expertise in the area of dental practice management. He can be reached by e-mail at aschiff@schiffcpa.com or www.adcpa.org.

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