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CLIENT BULLETIN

NEWS TO HELP YOU BUILD PROFITS

WINTER 2008

Emergency Economic Stabilization Act of 2008

On October 3, 2008, the massive Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. Understandably enough, most of the commentary about this legislation has focused on the broad economic implications. Relatively little attention has been given to the fact that the Act also includes literally hundreds of federal tax changes that will affect millions of individuals and many businesses, large and small alike. Most, but not all, of the changes are taxpayer-friendly.

This letter briefly summarizes what we think are the most important tax changes. However, we encourage you to contact us for more details because there are many changes that we simply don't have the space to even mention here. Some of them could affect you, family members, or your business.

We will start with changes that affect individuals and their personal returns.

Personal Tax Changes

One-year AMT "Patch" Has Two Parts. The Act includes another one-year "patch" to prevent millions of individuals from being hit with the dreaded Alternative Minimum Tax (AMT) for the 2008 tax year. As in previous years, the patch has two parts.

1. *Expanded AMT Exemption Amounts.* Without this part of the patch, the AMT exemption amounts for 2008 would have been drastically lower than the amounts for 2007. The Act provides exemptions that are slightly larger. When your 2008 Form 1040 is prepared, these exemptions will be subtracted from income in calculating the amount (if any) that will be taxed under the AMT rules. Here are the expanded exemptions for 2008:

- \$69,950 if you're a married joint-filer or a surviving spouse (up from \$66,250 for 2007).
- \$46,200 if you're unmarried (up from \$44,350).
- \$34,975 if you use married filing separate status (up from \$33,125).

Unfortunately, these exemptions are phased out for higher-income taxpayers, and the new law doesn't make any changes in the phase-out rule.

2. *Personal Tax Credits Can Reduce AMT Liabilities.* The second part of the patch allows you to offset your AMT amount with designated personal tax credits, which reduces the odds that you will actually owe the AMT for 2008. This favorable provision applies to the following tax credits:

- Child credit (up to \$1,000 per child).
- Hope Scholarship education credit (up to \$1,800) and Lifetime Learning education credit (up to \$2,000).
- Child and dependent care credit.
- Adoption credit.
- Credit for certain energy-efficient items installed in your home.
- Retirement saver's credit.
- Credit for elderly and disabled individuals.
- Mortgage credit.
- First-time DC homebuyer credit.

Popular Personal Tax Breaks Are Extended. As expected, Congress extended the following popular personal tax breaks.

- *College Tuition Deduction.* The Act extends for 2008 and 2009 the deduction for up to \$4,000 of col-

lege tuition and related fees. If you qualify, you can benefit from this write-off even if you don't itemize.

- *Optional Sales Tax Deduction.* The Act extends for 2008 and 2009 your option to claim an itemized deduction for state and local sales taxes instead of state and local income taxes.

- *Nonitemizer Deduction for Real Property Taxes.* Another law enacted earlier this year established a temporary new real property tax write-off for individuals who don't

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Let us help with your ERP software and IT needs!

Accounting software needs analysis, selection, implementation, training and support

Manufacturing and distribution solutions

Third-party software integration

Creating meaningful management reports using Crystal Reports or FrX

Assessing your IT controls and practices

Reviewing your internal processes and controls for efficiency as well as fraud prevention practices



SAGE MAS 200

SAGE MAS 90



News from the inside...

PLEASE HELP US "CAN HUNGER" IN OUR COMMUNITY!

The months after the holidays are typically periods of extremely harsh weather and diminished donations to area food banks. With so many families struggling during these tough economic times, food banks need added support and donations. As we prepare for the 2008 tax return season, the time to support our neighbors in need is more critical than ever.

Once again this year, Shannon & Associates has organized a "Can Hunger Campaign" to help supply food banks in our community.

We are asking for your help! For every tax return we prepare for you between now and April 15, we ask you to bring in a non-perishable food donation (or cash donation made out to the Kent Food Bank). Shannon & Associates will match your donation!

We feel this is a small yet important step in providing for the needs of those less fortunate in our community. Please help us have a successful campaign to "can hunger."

**THANK YOU FOR CARING
AND
FOR YOUR PARTICIPATION!**

WELCOME TO SHANNON & ASSOCIATES!

Welcome Lois Vankat to our staff! Lois is a Certified Public Accountant and is joining us as a senior accountant with over 25 years of accounting experience.

After graduation, Lois began her career working in audit for a public accounting firm, then went to work for a client and started an internal audit department. After moving to Washington, she worked for a small public accounting firm in Federal Way, focusing on tax as well as accounting services.

Lois is married and has two children, ages 21 and 16. She enjoys walking, hiking, reading and traveling.



Shannon & Associates is proud to be known as the only firm in the Northwest to be a part of Nexia International, a worldwide network of independent auditors, business advisers and consultants. Nexia International is the ninth largest network of accounting firms in the world, with member firms in 97 countries. This global representation with Nexia enables us to offer our expertise in international taxes and accounting around the world and provide top quality service to our clients with foreign and domestic financial needs.

... *Emergency Economic Stabilization Act*

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itemize. Under this provision, you can deduct up to \$1,000 if you're a married joint-filer or up to \$500 if you're not. Originally, the new nonitemizer deduction was only allowed for 2008, but the Act extends it through next year.

- **Teacher Expense Deduction.** The Act extends for 2008 and 2009 the deduction for up to \$250 of personal expenditures made by eligible teachers and school employees to purchase supplies for their schools. If you qualify, you can benefit from this write-off even if you don't itemize.

- **Charitable Donations from IRAs.** If you've reached age 70½ and want to make donations to IRS-approved charities directly out of your IRA, your right to do so has been extended for 2008 and 2009. You can arrange to transfer a total of up to \$100,000 for each year from IRAs that you own. Your spouse can do the same for IRAs that he or she owns. Please contact us if you want to learn more about the tax advantages of making charitable donations in this fashion.

- **Credits for Energy-saving Expenditures for the Home.** The Act extends through 2016 the tax credit for up to 30% of expenditures to install solar electricity generation equipment, solar water heating equipment, and fuel cell equipment in your home. Some favorable changes were made as well. For 2008–2016, you can claim the credit for up to 30% of expenditures for wind energy equipment and geothermal heat pumps. In

general, credit amounts for qualifying expenditures are subject to annual dollar caps on each type of expenditure. However, for 2009–2016, there's no longer any cap on the credit for 30% of expenditures for solar electricity generation equipment (before this change, the cap was \$2,000 per year). Finally, this credit can now be used to reduce your AMT liability as well as your regular tax liability for 2008–2016.

- The Act also restores for 2009 the separate tax credit for installing qualifying energy-efficient insulation, windows, doors, roofs, and heating and cooling equipment in your home. However, this credit was not renewed for 2008. Since the maximum credit is only \$500 reduced by any amounts you claimed in prior years, this is not a big tax-saver. That said, it can be helpful if you qualify.

- **Tax-free Treatment for Forgiven Mortgage Debt Extended through 2012.** Legislation passed at the end of last year allows tax-free treatment for up to \$2 million of forgiven principal residence mortgage debt. The Act extends this provision for three additional years through 2012. Therefore, this provision is now available for qualifying mortgage debt forgiveness transactions that occur in 2007–2012.

Good News If You Have Unused AMT Credits. If you generated unused AMT credits in one or more prior years (typically because you exercised some profitable incentive stock options), you

may finally be able to turn those unused credits into cash. This is because the new law makes big, and very favorable, changes to the so-called refundable AMT credit rules. While the new provisions are somewhat complicated, the important thing to know is that you can collect 50% of any unused AMT credits generated in pre-2005 years after filing your 2008 Form 1040. You can collect the remaining 50% from pre-2005 years after filing your 2009 return. If you have unused AMT credits generated in 2005 or later, you can also collect them over two years, but you have to wait until they are over three years old to start cashing them in under the new refundable AMT credit rules. Please contact us if you have questions about this very beneficial change.

Additional Relief for Qualifying AMT Victims. Another very favorable change expunges unpaid individual AMT liabilities that were outstanding as of 10/3/08 if they were caused by exercising incentive stock options before 2008. Any related interest and penalty charges assessed by the IRS are also wiped away. If you have already paid interest and penalty charges related to such AMT liabilities, you can recover them over two years under the new-and-improved AMT credit rules.

Higher Personal Casualty Loss Deductible for 2009. For many years, individuals have had to reduce personal casualty and theft losses by \$100 for each casualty or theft event. The total amount of losses remaining for the year after applying the deductible rule is then reduced by 10% of your adjusted gross income

for that year. You can claim any amount left after these two reductions as an itemized deduction on Schedule A of Form 1040. The Act increases the \$100 per-event deductible to \$500, but only for the 2009 tax year. After that, the longstanding \$100 per-event deductible will once again apply.

New Tax-free Fringe Benefit for Bicycle Commuters. Starting next year, the Act allows employers to give a new tax-free fringe benefit to employees who commute to work on bicycles. Specifically, an employer can give tax-free reimbursements to cover amounts an employee pays to buy, improve, repair, or store a bicycle that is regularly used to commute to work. However, the amount that can be reimbursed tax-free under this provision is limited to \$20 for each month of bicycle commuting. So, the maximum annual tax-free reimbursement is \$240.

See [Emergency Economic Stabilization Act](#) reverse of insert

Thank you for your referrals!

We appreciate the confidence you have in our services to refer to us other individuals and businesses!

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More-generous Refundable Child Credit Rule. For qualifying lower-income individuals, the government will refund all or part of the \$1,000 per-child tax credit that remains after the credit has been used to reduce that year's federal income tax bill to zero. Generally, the refundable amount is limited to the lesser of: (1) 15% of earned income in excess of the applicable threshold for the year or (2) the amount of credit left over after the tax bill for the year has been zeroed out. The Act lowers the earned income threshold for 2008 from \$12,050 to \$8,500, which will mean bigger credit refunds for some individuals.

Business Tax Changes

The new law also includes many tax changes that can potentially impact businesses. Here are quick summaries of the ones we think are most likely to affect small and medium-sized operations.

15-year Depreciation Rule for Leasehold Improvements and Restaurants Extended and Expanded. The Act extends for 2008 and 2009 the favorable 15-year straight-line depreciation provision for qualified leasehold and restaurant building improvements. In addition, restaurant buildings themselves can now be eligible for the 15-year depreciation rule (for qualified build-

ings placed in service in 2009).

New 15-year Depreciation Rule for Retail Space Improvements. Under a new provision, favorable 15-year straight-line depreciation is allowed for qualified retail improvements placed in service in 2009, but only for improvements put into use more than three years after the building itself was placed in service. The new 15-year depreciation privilege is not available for improvements related to: (1) building enlargements, (2) elevators or escalators, (3) structural components that benefit common areas, or (4) the internal structural framework of a building.

New Five-year Depreciation Rule for Farming Equipment. The Act includes a new rule that permits five-year depreciation for qualifying assets used in farming. Absent this change, these assets generally would be depreciated over seven years. Only new (not used) assets placed in service during 2009 are eligible for the five-year depreciation break, and it's not allowed for grain bins, cotton ginning assets, or fencing and other land improvements.

Research Credit Is Extended and Modified. The new law extends the research tax credit for qualified expenses paid or incurred in 2008 and 2009. However, the option of

claiming the alternative incremental research credit will no longer be available for tax years beginning after 2008, and the alternative simplified research credit rate is increased to 14% for tax years ending after 2008.

Enhanced Deduction for Charitable Food Donations Is Extended. The new law extends for 2008 and 2009 the enhanced charitable donation deduction for non-C corporation businesses that contribute food to charity. Deductions are normally limited to the lesser of: (1) the basis of the food or (2) fair market value. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis.

New Break for Charitable Food Donations by Farmers and Ranchers (12/31/08 Deadline). The Act includes a special short-term break for charitable donations of food by qualified farmers and ranchers. The donations must occur between 10/3/08 and 12/31/08. Deductions for such donations can be as much as 100% of the taxpayer's adjusted gross income. Excess deductions can be carried forward for 15 years. If a nonpublicly traded corporation is a qualified farmer or rancher, deductions for food donations between 10/3/08 and 12/31/08 can be as much as 100% of the corporation's taxable income (calculated before any deductions for charitable donations). Excess deductions can be carried forward for 15 years.

Enhanced C Corp. Deduction for Book Donations Is Extended. The new law extends for 2008 and 2009 the enhanced charitable contribution deduction for C corporation donations of books to qualified schools. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis.

Enhanced C Corp. Deduction for Computer Donations Is Extended. The Act extends for 2008 and 2009 the enhanced charitable contribution deduction for C corporation donations of computer equipment and related technology to educational organizations and libraries. The enhanced deduction equals the lesser of: (1) basis plus one-half the value in excess of basis or (2) two times the basis. Items must be donated within three years after the corporation acquired them new or built them.

Provision to Encourage S Corp. Donations of Appreciated Property Is Extended. The new law extends for taxable years beginning in 2008 and 2009 a special stock basis rule that applies when an S corporation contributes appreciated long-term gain property to charity. Under the special rule, an owner's basis in his or her S corporation stock is only reduced by his or her

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Year-End Gift & Estate Tax Planning

When it comes to year-end planning for gift and estate tax, there are some certainties and some unknowns. It's certain that this is a good time to make gifts, if giving away assets is part of your estate plan. With respect to estate tax, though, you'll find it difficult to plan now. Estate tax legislation is likely in 2009, but you can't know what will be in a future tax law. Therefore, you should build flexibility into your estate tax planning.

Good time for giving

Wealthy individuals and married couples often make gifts to younger relatives. The assets you give away, along with any future appreciation, will not be part of your taxable estate. If you're careful, you can make such gifts without paying gift tax. Two tax code provisions allow such generosity:

- **Annual gift tax exclusion:**

In 2008, you can give away up to \$12,000 worth of assets to any number of recipients and avoid all tax consequences. Married couples may give \$24,000 per recipient.

- **Lifetime gift tax exemption:**

Over and above gifts covered by the annual exclusion, you can make up to \$1 million worth of gifts without paying gift tax (up to \$2 million for married couples). Such gifts will reduce your estate tax exemption. For example, if you make \$300,000 worth of gifts under your gift tax exemption, your estate tax exemption will be \$300,000 lower than it would have been if you had not made those gifts.

Within this framework, it may make sense to give away now assets which have declined in value, such as stocks and real estate. You can transfer more assets while staying within the

\$12,000 exclusion and \$1 million exemption amounts.

Example #1: Bill Young's estate plan calls for him to make gifts from his large position in ABC Co. stock. In late 2007, when that stock was trading at \$100 per share, Bill gave 120 shares to his son George. Bill gave George \$12,000 worth of stock (120 shares worth \$100 apiece), so the gift was covered by the \$12,000 annual gift tax exclusion. Bill incurred no gift tax consequences from this transfer.

Similarly, in 2007 Bill gave 120 shares of ABC to his daughter Melanie and 120 shares of ABC to each of his 5 grandchildren. Each of those gifts also was covered by the \$12,000 gift tax exclusion. Thus, Bill was able to remove 840 shares of ABC (120 shares to each of 7 recipients) from his estate without incurring gift tax consequences.

In 2008, ABC shares are trading at \$60. Therefore, Bill can give away 200 shares to each of those 7 loved ones if he wishes. Instead of removing 840 shares of ABC from his estate, Bill now can make tax-free gifts of 1,400 shares. If ABC shares move back up eventually, Bill's children and grandchildren will reap the benefits. (In 2009, the annual exclusion will increase to \$13,000, so Bill might want to give away more depressed shares of ABC early next year.)

The same reasoning applies to Bill's \$1 million lifetime gift tax exemption. By acting now while asset values are down, he can give away more assets without paying gift tax.

Evaluating estate tax

Under current law, anyone who dies in 2008 can leave unlimited amounts to a spouse (if the

survivor is a U.S. citizen) and to charity; no federal estate tax will be due. You can leave up to \$2 million to other heirs, but bequests above that level are taxed at 45%. This \$2 million federal estate tax exemption is scheduled to rise to \$3.5 million in 2009. There will be no estate tax imposed for deaths in 2010, but the estate tax will return with a \$1 million exemption in 2011.

Such a schedule is unlikely to remain in effect. One reason why is that fiscal pressures probably will prevent the federal government from forgoing estate tax collections for 2010. Therefore, some estate tax legislation probably will pass in 2009. Judging by proposed changes, the federal estate tax exemption might remain frozen at \$3.5 million or could be increased, probably over time, perhaps to \$4 million or \$5 million. Such uncertainty makes planning difficult, especially for married couples who might leave estates in the \$3.5 million to \$10 million range.

Example #2: Joe and Beth Johnson are both in their 70s. Their net worth (including real estate, business interests, securities, and other assets) is now about \$5 million. Thus, the Johnsons face a dilemma. If they plan for the first spouse who dies (assume it's Joe) to leave everything to the survivor (assume Beth), then Beth might have \$5 million in assets after Joe's death. That amount would provide her with a comfortable lifestyle. However, if Beth dies soon afterward and the federal estate tax exemption is then \$3.5 million, her estate might owe \$675,000 in federal estate tax: 45% of the excess \$1.5 million.

On the other hand, Joe might leave \$3.5 million to his children, using his full estate tax exemption and thus avoiding estate tax. That would leave Beth only \$1.5 mil-

lion, so no estate tax would be due at her death. This approach, though, would deprive Beth of the use of 70% of the couple's assets.

A matter of trust

"For many individuals and families, the best strategy is to build flexibility into your estate plan," says Sanford J. Schlesinger of the New York law firm Schlesinger Gannon & Lazetera LLP. Doing so may mean allowing others to make some decisions after your death.

One solution suggested by Schlesinger would be for Joe to leave up to \$3.5 million to a trust. The trust beneficiaries could be Beth and their children. Such a bequest would avoid estate tax at Joe's death, assuming the federal estate tax exemption is at least \$3.5 million. The trust assets would not be included in Beth's estate, so they would not be subject to estate tax at her death either. Such a trust is known as a "bypass" (or unified credit) trust because the assets escape estate tax altogether.

"An institution or an individual other than (or in addition to) the spouse could serve as trustee or co-trustee," says Schlesinger, former chair of the New York State Bar Association's Trusts and Estates Law Section. "That trustee could have the discretion to distribute trust assets to the surviving spouse, under certain conditions." In our example, Beth might have access to the couple's \$5 million in assets, in case they're needed, yet no federal estate tax would be paid.

This is just one way to build flexibility into your estate plan. Our office can help you put together an estate plan that includes tax strategies if that's appropriate for you and your loved ones.

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donated property (rather than his or her share of the fair market value of the donated property). This provision is helpful to shareholders because it leaves them with higher basis in their S corporation stock.

Big Change for Investors (Starting in 2011)

Under today's rules, securities brokers must provide information returns to their customers and copies to the IRS after securities are sold. Specifically, gross sales proceeds must be reported on Forms 1099-B, but that's it. Changes included in the Act will eventually require brokers to calculate gains and losses, classify them as short-term or long-term, and report this additional information to both investors and the IRS. However, this expanded reporting requirement won't kick in until the following dates:

- January 1, 2011: For corporate stock and mutual fund shares.
- January 1, 2012: For shares for which the use of an average basis method is allowed (for example, mutual fund shares acquired in different blocks).
- January 1, 2013: For other specified securities including notes, bonds, commodity contracts, and whatever other

securities and financial instruments are designated by the IRS in forthcoming rules.

Note: The Act also extends the brokerage firm deadline for giving Forms 1099-B to investors. The old deadline was January 31 of the year following the year in which transactions occur. The new deadline is February 15, and this new deadline applies to Forms 1099-B due after 2008. The next deadline for your brokerage firm Forms 1099-B will be 2/15/09 rather than 1/31/09.

Changes Affecting Energy Tax Breaks

The Act includes a host of extended, modified, and new tax breaks for energy-related expenditures. Here are the highlights.

Business Energy Credit Is Extended and Expanded. The new law extends through 2016 the existing business energy tax credit for qualifying solar, fuel cell, micro-turbine, and certain geothermal energy equipment. Qualified small wind energy equipment and geothermal heat pump systems placed in service after 10/3/08 are added to the list of property eligible for the credit. Finally, the credit is allowed to offset the taxpayer's AMT liability for tax years beginning after 10/3/08.

New Personal and Business Credit for Plug-in Electric Vehicles. The Act establishes a new tax credit for plug-in electric vehicles, for qualifying vehicles purchased in tax years beginning after 2008. However, they must be purchased by no later than 12/31/14. The credit amount is \$2,500 for a vehicle powered by a battery with a capacity of at least 4-KW hours. An additional credit of \$417 is allowed for each additional KW hour of battery power until the credit reaches a cap of \$7,500. However, for heavy vehicles weighing over 10,000 pounds, the credit cap can go up to \$15,000. This new credit is allowed for both individual and business taxpayers, but it will be phased out after 250,000 qualifying vehicles have been sold in the U.S. The credit is allowed against the AMT for individual taxpayers.

Credit for Building Energy-efficient Homes Is Extended. The new law extends the \$2,000 tax credit for a contractor that builds a new energy-efficient home in the U.S. for one year through 2009. The contractor must sell the home by no later than 12/31/09 for use as a residence to qualify for the credit.

Deduction for Making Commercial Buildings Energy-efficient Is Extended. The Act extends for five more years the existing provision allowing immediate deductions for the cost of qualified energy-saving improvements to commercial buildings. The deduction is now

available for qualified energy-efficient commercial building property placed in service through the end of 2013.

And Much, Much More. The Act includes other tax incentives to encourage expenditures for energy-efficient equipment as well as incentives for the electricity generation and transmission industries.

Conclusion

Even though this letter is too long, we have not even scratched the surface. We have not mentioned many tax changes that fall into the business, energy, and disaster-relief categories, and there are also changes regarding tax-exempt bonds, tax-credit bonds, tax-exempt organizations, and excise taxes. Since we know you don't want to read a whole book here, we ask you to contact us if you want additional information or if you have questions. We will be pleased to help.



The staff at Shannon & Associates wishes our Clients and Friends a Happy Holiday Season and a Prosperous New Year!

Our office will be closed at noon on December 24th and reopen on December 29th

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