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**CLIENT
BULLETIN**

NEWS TO HELP YOU BUILD PROFITS

SPRING 2009

The American Recovery & Reinvestment Tax Act of 2009

The American Recovery and Reinvestment Tax Act of 2009 (the "Act") was enacted on February 17, 2009, and contains several federal tax provisions aimed at stimulating the economy and providing job creation. Both individual taxpayers and businesses stand to benefit from the tax-relief measures in the Act.

Many of the Act's individual income tax provisions contain income phaseouts that limit the benefits available to higher-income taxpayers. The Act is designed to provide temporary tax relief in an effort to spur spending. Here is a summary of the law's provisions.

Individual Tax Relief

"Making Work Pay" Credit. This refundable tax credit (up to \$400 for individuals, \$800 for couples filing a joint return) seeks to stimulate spending by generally providing an increase in take-home pay through the reduction of income taxes withheld.

Economic Recovery Payment. A one-time payment of \$250 is available to adults who are eligible for Social Security, Railroad Retirement, veterans' disability compensation or pension benefits,

or Supplemental Security Income benefits.

First-time Homebuyer's Credit. Increased to \$8,000 for couples filing jointly, the Act provides a credit for qualifying principal residence purchases. The Act also eliminates the prior law's requirement that the credit be paid back to the government, as long as certain conditions are met.

Child Tax Credit. The Act expands the Child Tax Credit (\$1,000 for 2009 and 2010) for each qualifying child under age 17 by reducing the income "floor" that applies when determining the refundability of the credit from \$8,500 in 2008 to \$3,000 in 2009 and 2010.

AMT Exemption Increase. The Act increases the Alternative Minimum Tax exemption amounts for 2009 and provides for the use of various non-refundable tax credits to offset both regular tax and AMT.

Private Activity Bond Interest and AMT. Tax-exempt interest on private activity bonds issued in 2009 or 2010 is not deemed an AMT preference item.

Deduction for Taxes on Car Purchases. The Act provides for an income tax deduction for state and local sales taxes

paid on up to \$49,500 of the cost of a qualified vehicle.

American Opportunity Tax Credit. The Hope Scholarship credit is modified and replaced with the American Opportunity Tax Credit, which equals up to \$2,500 for the cost of qualifying tuition and related expenses (per year, per student).

529 Plans and Computer Costs. The Act expands the definition of qualified higher education expenses to encompass certain computer technology for 529 college savings plan distribution purposes.

Transportation Fringe Benefits. Employees can exclude from income an increased amount of certain qualified transportation fringe benefits under the Act.

COBRA Insurance Continuation. Under the Act, an individual who has been involuntarily terminated on or after September 1, 2008, through the end of 2009 is required to pay only 35% of the group health insurance premium to secure COBRA continuation coverage (for up to nine months).

Income Exclusion for Unemployment Compensation. Federal and state unemploy-

ment benefits received (up to \$2,400) in 2009 may be excluded from gross income.

Business Tax Relief

Section 179 Expensing. The Act extends the enhanced Section 179 expensing limit (\$250,000) for qualifying property placed in service in tax years beginning in 2009.

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Securing Your Securities

Let us help with your ERP software and IT needs!

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News from the inside...

CONGRATULATIONS!

We are pleased to announce two promotions. In January both Emma McArdel and Cherie Shepard were promoted to Senior Accountants.

Emma is entering her 4th year with Shannon & Associates. She works with various industries and areas including accounting, audit and tax.

Cherie is entering her 2nd year with Shannon & Associates and previously spent 10 years in private industry accounting. Cherie also works with various industries in accounting, audit and tax.

Congratulations to Paul Weseman who recently passed all 4 sections of the CPA exam and has now obtained his CPA license!

WELCOME TO SHANNON & ASSOCIATES!

We are pleased to welcome back Mike Briggs to our staff. Mike was with us from 1998 until 2006 when he left briefly to join a private company where he worked in their International Tax Department. Mike is a licensed CPA and brings to us over 10 years of accounting and tax experience and is a Manager with Shannon & Associates.

Welcome also Lisa Brittain and Samantha Simons to our staff!

Lisa joined Shannon & Associates in January. She previously worked for a year as a staff accountant with a public accounting firm in Spokane. She and her fiance recently moved to Kent. Lisa has a Bachelor of Science Degree in Business Administration, with an emphasis in Accounting, Economics and Finance from Eastern Washington University. She has passed 2 portions of the CPA exam and will be completing the remaining 2 later this year.

Samantha will be graduating from Central Washington University with a Bachelor of Science Degree in Accounting in September. She plans to finish her 5th year requirement and study to take the CPA exam in the coming year.

In February we welcomed Roger Jones to our staff as a senior manager. Roger is a licensed CPA and brings to us over 20 years of public accounting experience. Roger's primary focus is in audit. He spent over 16 years with several national firms focusing in the areas of credit unions, bank audits and consulting. He also spent several years in private industry where he served as a Senior VP and CFO for a privately held company with commercial bank, mortgage banking and fee income subsidiaries.

Taking a 401(k) Loan May Be Borrowing Trouble

You may find it difficult to get a loan in today's credit crunch. If you need money, one option is to borrow against your 401(k) account. Before you take that step, however, consider the downsides as well as the advantages.

Pros

Many employers allow 401(k) participants to borrow against their account. Federal law limits these loans to 50% of the vested 401(k) account balance or \$50,000, whichever is less. These loans are easy to get: You won't be rejected because your credit score or income is too low. And they're easily processed, with little or no paperwork.

Once you borrow from your 401(k), you'll repay the debt from paycheck deductions. Therefore, you'll be paying interest to yourself rather than a bank. In effect, the terms of the loan assure that you put money back into your retirement account, with interest.

Cons

If 401(k) loans are simple and straightforward, what are the negatives? One is the risk that the consequent paycheck reduction will be daunting. You might cut back on your regular 401(k) contributions

in order to repay the debt and ultimately save less for your retirement.

These arrangements present a tax trap as well. The money used



to repay the debt will come out of your regular paycheck, not from a salary deferral, so you'll be using after-tax dollars. Because you'll pay tax on eventual 401(k) withdrawals, you'll actually pay tax twice on those amounts.

Moreover, the current economic climate poses extra

risks for 401(k) borrowers. If you are laid off, you'll have to repay the outstanding loan balance, perhaps within 60 days of leaving the company. If you fail to comply, you might owe income tax on any unpaid amounts and a 10% early withdrawal penalty if you're younger than 59 1/2.

Therefore, you should consider borrowing from your 401(k) only if you truly need the money, you have no other practical source of funds, and you're reasonably confident of your job security.

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“Bonus” First-year Depreciation. The additional first year depreciation deduction of 50% available for certain types of depreciable property is generally extended for another year.

Net Operating Loss (NOL) Carryback. Smaller business taxpayers may elect to increase the NOL carryback period from two to five years for an NOL for the tax year ending in 2008 (or, at the taxpayer's election, the tax year beginning in 2008).

Work Opportunity Tax Credit (WOTC). Two new targeted groups have been included for purposes of the WOTC: disconnected youths and unemployed veterans.

The amount of the credit that an employer may claim is based on first-year wages.

Small Business Estimated Tax Payment Relief. Generally, for tax years beginning in 2009, the Act eases the annual estimated tax payment requirements for certain small business owners.

Qualified Small Business Stock (QSBS). The Act generally increases to 75% the percentage of capital gain that a noncorporate taxpayer can exclude upon the disposition of QSBS acquired after February.

S Corporation Built-in Gains. The Act temporarily

reduces the recognition period for a converted C corporation on built-in gains from ten to seven years for tax years beginning in 2009 and 2010.

Can We Help?

The American Recovery and Reinvestment Tax Act of 2009 provides a number of tax-planning opportunities for individuals and businesses. This summary covers only the tip of the iceberg as to the new law, and professional advice is recommended to help determine how the Act's measures relate to your specific tax situation.

Thank you
for
your
referrals!

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

Securing Your Securities

Some brokerage firms have suffered heavy losses during the bear market. If your broker goes out of business, what will happen to the securities the firm is holding for you?

Nothing, in most cases. Brokerage firms are required to keep customers' securities and cash separate from their own assets. Therefore, even if your brokerage firm goes under, the stocks, bonds, and mutual funds the firm is holding for you should be yours to move elsewhere or keep with a successor firm. As explained later in this article, if a firm or its employees steal from their clients, investors may lose out. However, investors historically have retained their assets after most brokers' failures, and there's an industry group that protects victimized investors.

Custody battles

Brokerage firms generally fall into one of two categories:

- *Custodial firms. They hold customers' assets.
- *Noncustodial firms. They make arrangements with other firms to hold their customers' assets.

As you can see, if your broker is a noncustodial firm that goes out of business, your assets won't be affected. They're still at the custodial broker.

However, if a custodial broker is in financial distress, another firm might acquire it. Regulators may even promote such mergers. In such cases, your assets simply move from one custodian to another, presumably winding up at a firm with greater financial strength. Even if a failing broker liquidates rather than merges, regulators try to arrange for another custodian to acquire customers' assets.

Although the process of transferring your assets sounds straightforward, you may face difficulties while it's under way. You may not be able to sell those securities to raise cash during a transition period, for example. Therefore, you should know which brokerage firm is holding your securities. If you learn that your custodial broker is in financial trouble, you might decide to move your account to a stronger firm.

Protected, not insured

As previously mentioned, this custody system has protected investors in most brokerage failures. However, some brokerage firms or their employees have committed theft or fraud. In those situations, some or even all investors' securities have not been safe after a brokerage failure.

As an investor, you have no federal insurance for such situations. Instead, you have coverage from the Securities Investor Protection Corporation (SIPC), an industry group to which virtually all brokers belong. Members contribute to a fund for re-



imbursing victimized investors. SIPC coverage won't reimburse you for market losses, however.

Example #1: Joanne Collins had \$100,000 worth of stocks at XYZ Brokerage.

During the bear market, her stocks fell to \$60,000 and XYZ went out of business. An inventory showed that Joanne's stocks had vanished. In this scenario, Joanne can collect from the SIPC. However, her coverage will be \$60,000, the value of the missing securities at the time that XYZ closed its doors. The SIPC won't pay for the securities' loss in value resulting from falling prices.

The SIPC coverage limit is \$500,000 per customer account, including up to \$100,000 in cash. If you have multiple accounts at the same brokerage, you may have multiple SIPC protection.

Example #2: Joanne Collins' husband Doug also had an account at XYZ. After its failure, Doug's account had \$500,000 of SIPC coverage in addition to Joanne's coverage.

You may have sufficient SIPC coverage at your broker. However, if your securities portfolio is very large, you might want to spread it among multiple brokers, staying below the \$500,000 limit, for more protection.

The New Law Revives Old Tax Benefits

Several important tax breaks for individuals expired at the end of 2007; the new law extended them for 2008 and 2009. Some of these extensions are even longer.

Tuition and fees deduction. Individuals with modified adjusted gross income (MAGI) below a threshold amount can deduct up to \$4,000 in qualified higher education costs from their gross income. For 2008 tax returns, due in 2009, single taxpayers and heads of household must have MAGI no higher than \$65,000. Couples filing a joint return can deduct \$4,000 worth of qualified higher education costs with MAGI up to \$130,000.

Some taxpayers with slightly higher MAGI can take a \$2,000 deduction rather than a \$4,000 deduction. Single taxpayers and heads of household in the \$65,001–\$80,000 range can deduct up to \$2,000 of qualified higher education costs, while joint filers can take the \$2,000 deduction with MAGI over \$130,000 but not over \$160,000.

The tuition and fees deduction is available for qualified taxpayers whether or not they itemize deductions on Schedule A of their tax return. Individuals eligible for the tuition and fees deduction also may be eligible for a Hope or Lifetime Learning credit; if so, they can choose the tax deduction or credit that produces the greater savings. However, you can't use both breaks in the same year.

State and local sales taxes. Taxpayers who itemize their deductions on Schedule A can opt to deduct state and local sales taxes instead of state and local income taxes. The sales tax deduction is the amount allowed by an IRS table based on household size and income for each state. However, the basic deduction amount can be increased by the sales tax on certain big ticket



items such as a car, boat, or home building materials. Thus, while this provision primarily benefits individuals who live in states with no income tax, even those who live in a state with an income tax may find the sales tax deduction to be larger than the one for income tax.

IRA charitable transfers. Individuals who are 70 or older can transfer up to \$100,000 from their IRA directly to a public charity in 2008 and 2009 and exclude this distribution from income. However, no charitable contribution deduction will be allowed for this transfer.

Suppose, for example, you are 75 years old and have pledged \$30,000 to your favorite charity this year. Thanks to this revived tax provision, you can tap your IRA to fulfill your pledge. For most taxpayers, taking \$30,000 from a traditional IRA would generate \$30,000 worth of taxable income. You might get a \$30,000 tax deduction as an offset, but you might not.

Various limits on allowable charitable deductions and the phaseout of itemized deductions faced by high-bracket taxpayers may delay or devalue your tax deduction. What's more, taking \$30,000 from your IRA would increase your AGI by \$30,000; this increase could cause other tax benefits to be lost or reduced.

Because you are over age 70, however, you can have your IRA custodian send \$30,000 to the charity. You won't get a tax deduction, but you also won't pick up extra income that could inflate your tax bill. What's more, after age 70 you must take minimum required distributions (MRDs) from

your IRA, even if you don't need the money. If you make charitable contributions from your IRA this year, those donations can fulfill your MRD obligation without swelling your AGI.

Discharge of indebtedness income. Homeowners who have some or all of their debt forgiven on their home mortgage during a foreclosure or mortgage workout may not have to include this debt forgiveness in income. This break, which was created by the Mortgage Forgiveness Debt Relief Act of 2007, had been set to run through 2009, but the new law extends the exclusion through 2012.

Additional deduction for residential real estate taxes. Homeowners who do not itemize their deductions can add an additional amount to their standard deduction in 2008 for real estate taxes, up to \$500 for singles and \$1,000 for joint filers. The new law extends this break for 2009. You can count only property taxes for a principal residence.

Child tax credit. The earned income threshold for the refundable child tax credit has been reduced, allowing more individuals to qualify for the refund. Before the new law was passed, the credit had been limited to 15% of a taxpayer's earned income in excess of \$12,050 for 2008. The new law lowers the earned income threshold for 2008 to \$8,500.

Businesses Get Some Breaks

Several business tax breaks expired at the end of 2007 or were scheduled to expire at the end of 2008. The new law extends some of those tax benefits:

Research credit. The new law restores the research credit for 2008 and 2009. This credit generally is 20% of incremental research expenses.

In 2007, there had been two other ways to figure the research credit besides the 20% solution: an alternative incremental research credit and an alternative simplified credit. Under the new law, the alternative incremental research credit has been repealed. Moreover, the alternative simplified credit has been increased to 14% of qualified research expenses that exceed 50% of the average qualified research expenses for the three preceding years. In 2007, the credit percentage had been 12%.

Amortization for leasehold and restaurant improvements. The 15-year amortization period for qualified leasehold and qualified restaurant improvements was extended for 2008 and 2009. Without this special treatment, such expenditures must be depreciated over 39 years. The same 15-year amortization period applies to certain improvements to retail space in 2008 and 2009.

New markets credit. This credit, which is designed to encourage investments and loans to small businesses located in economically distressed areas, has been extended for 2008 and 2009.

Deduction for energy-efficient commercial building property. The deduction for owners of commercial building property had been set to expire at the end of 2008; it has been extended through 2013. The deduction may be as much as \$1.80 per square foot for a building that meets certain energy usage standards

There is a modified deduction of 60 cents per square foot for a commercial building that attains some measure of energy efficiency but not enough to warrant the \$1.80 per square foot deduction.

Credit for manufacturers of certain energy-efficient appliances. The credit for manufacturing certain appliances, including clothes washers, dishwashers, and refrigerators, has been extended through 2009 or 2010, depending upon the appliance.

Renewable energy. The credit for producing elec-

tricity from qualified wind facilities will run through 2009. The credit for producing electricity through biomass and other qualifying renewable sources will run through September 30, 2011. The credit for solar energy, fuel cell, and microturbine property will run through 2016.

Domestic production activities deduction. Starting in 2010, the domestic production activities deduction is set to rise from the current 6% rate to 9%. The new law retains the 6% rate for oil and gas production. This 6% rate applies to qualified production

activities income from producing, refining, processing, and transporting or distributing oil or gas, or any primary product of oil and gas.

Charitable contributions. There are four tax extensions relating to charitable contributions by businesses, as follows:

1. Basis adjustment required for S corporation shareholders for corporate donations of appreciated property. Pursuant to the S corporation rules made by the Pension Protection Act, for 2006 and 2007, the amount

of the shareholder's basis reduction in the stock of an S corporation will be equal to his or her pro rata share of the adjusted basis of the contributed property. The new law extends this treatment for two more years. Please contact us if you would like to discuss how this provision may apply to you.

2. Donating computers and peripherals to schools and libraries. This break, which applies only to C corporations, has been extended through 2008 and 2009. A special rule allows donors to increase their deduction by 50% of the difference between the basis and the fair market value of the computers, but not by more than 200% of the basis of the computers.

3. Contributing food inventory. The deduction, which is calculated in the same way as the deduction for computer donations by C corporations, can be used by any business entity. The food must be wholesome and meet all labeling standards.

4. Contributing books to qualifying schools. Again, the deduction is enhanced the same way as the deduction for computer donations by C corporations but it is not limited to C corporations. A company seeking this deduction must give books to a public school, grades K-12, for use in an education program.



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