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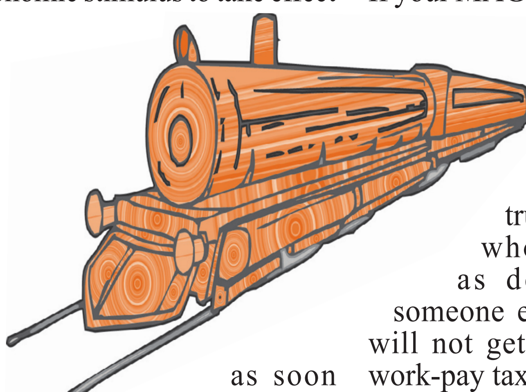
Faster, Slimmer Stimulus Payments

In the Economic Stimulus Act of 2008 (Stimulus Act), most taxpayers were given stimulus payments of $600 each to spur a sputtering economy. Generally, they received another $300 for each child under age 17. Some low-income retirees received $300. In 2009, with the U.S. economy still struggling, the American Recovery and Reinvestment Act of 2009 (Recovery Act) provides another round of stimulus payments. There are some key differences in this year's law.

Making work pay

The new law provides two years of stimulus payments for most workers and their spouses. In 2009 and 2010, working individuals get a refundable tax credit of up to $400, while married couples filing jointly get a refundable tax credit up to $800. (There are no tax credits for children.)

Technically, this tax credit is calculated at a rate of 6.2% of earned income: 6.2% is the amount of tax withheld from workers' paychecks for Social Security. Thus, this tax credit effectively offsets a worker's contributions to Social Security. The tax credit generally will be distributed to workers via reduced paycheck withholding on the first $6,452 of earnings ($12,904 for married couples filing joint tax returns). You probably have seen this increase in your paychecks already because the federal government wanted the economic stimulus to take effect as soon as possible. With $800 in annual savings, a married couple will have about $65 per month in extra take-home pay. (New withholding tables for employers are available at www.irs.gov/pub/irs-pdf/n1036.pdf.)



Self-employed individuals and other workers who do not receive paychecks will not get these stimulus payments via withholding. Instead, they can claim the tax credits on their 2009 and 2010 tax returns. If you pay quarterly estimated income tax, contact our office for help in adjusting your payments to account for this tax savings.

The Stimulus Act's payments were not extended to high-income taxpayers, and this year's law has similar constraints. The new tax credits phase out for taxpayers with modified adjusted gross income (MAGI) in excess of $75,000 ($150,000 for married couples filing jointly). If your MAGI is over $95,000 ($190,000 on joint returns), you will get no tax credit. Also, nonresident aliens, estates, trusts, and people who are claimed as dependents on someone else's tax return will not get these making-work-pay tax credits.

Payout to pensioners

Recipients collecting Social Security, Supplemental Security Income, Railroad Retirement benefits, and Veterans' Disability Compensation benefits will get a one-time payment of $250 ($500 to married couples if both spouses qualify) in 2009. Similarly, federal and state pensioners who are not eligible for Social Security retirement benefits will receive a one-time refundable tax credit of $250 in 2009. These $250 payments won't be withheld from paychecks, so they'll be distributed in the same manner (generally, direct deposit) as the 2008 stimulus payments.

The payout will be limited to $250 per person, even for those who receive more than one of the benefits listed in the preceding paragraph. What's more, people who get this one-time $250 benefit will get a $250 reduction of any making-work-pay tax credit to which they would be entitled.

IN THIS ISSUE

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

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Microsoft CERTIFIED Partner

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NEXIA INTERNATIONAL

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.

News from the inside...

Canned Hunger Drive a Success!

Thank you to all of our clients and friends who participated in our annual "Can Hunger" campaign. We asked our clients to contribute a canned food item or make a cash donation for each tax return we prepared. This year we collected over $997 in food and cash donations. The firm matched your donations for a total contribution made to the Kent Food Bank of $1,950. Thank you again for your contribution to our community.

Banking Service Group

We are pleased to announce the formation of our new banking service group with the addition of Roger Jones, CPA. Roger spent over 20 years as a banking industry expert, working at both Moss Adams, LLP, and McGladrey & Pullen, LLP, in their Financial Institutions practices. For years, Roger has also volunteered his support of industry trade associations, including the Washington Banker's Association, Oregon Banker's Association and the Western Independent Bankers. Roger will be putting his industry background and expertise to use at Shannon & Associates, conducting annual audits, providing internal audit support and handling all facets of CPA services needed by community banks and credit unions.

Nexia Update

Richard Lackey, Shannon & Associates' managing partner, recently attended the North American conference of Nexia in Toronto. He had an opportunity to meet partners from the three newest firms to join Nexia International. The three firms are all from the Midwestern states and are great additions to the Nexia network of accounting firms, which is now the ninth largest network in the world. One of the major subjects discussed is Canada and Mexico's adoption of the International Financial Reporting Standards (IFRS) in 2011. The U.S. will continue to use GAAP as the reporting standards until further notice.

Lois Vankat, a senior at Shannon & Associates, went to Nexia's first state and local tax group (SALT) meeting. Many North American Nexia firms sent representatives to Arizona for the meeting. The group discussed being resources to each other for SALT questions and compared notes on their particular practices.

How the Bear Market Affects Your Retirement

For investors, 2008 was one of the worst years since the 1930s. How this market dive affects your retirement plans depends largely on your stage in life.

Young workers

If you are 15 or more years from retirement, recent market turmoil actually may be beneficial. There are several reasons for this counter intuitive result:

1. **Modest losses.** Many young workers have used their earnings to repay student loans, save up to buy a house, and pay the expenses of starting a family. As a result, they may have only small investment portfolios. The less you had invested prior to last year's crash, the less you have lost, in absolute dollars.

2. **More time for recovery.** With 15 or more years to retirement, you probably will have ample time for your investments to recover before you'll tap your portfolio. If markets stay down for some time, you'll have an extended opportunity to invest at low prices. By investing regularly, perhaps through a 401(k) plan, you can build up a low-cost portfolio in anticipation of the next bull market.

3. **Lessons learned.** Investment markets' performance in 2008 illustrates the importance of diversification. You should not load up on shares of your employer because that company stock could fall sharply. Also, you should include not only stocks but also high quality bonds or bond funds in your portfolio because such bonds provided a valuable cushion last year.

Preretirees

The closer you are to retirement, the more you'll feel the impact of a plummeting portfolio. You may have suffered greater losses after many years of investing, and you'll have fewer years to rebuild your retirement fund. As you approach retirement, your planning becomes a numbers game. Will you be able to stop working and still afford your customary lifestyle? One way to approach this calculation is to assume you'll need as much spending money in retirement as you need before retirement. You won't have to save for retirement, however.

Example #1: Kim Grant, age 62, earns $100,000 per year and contributes $20,000 to her 401(k) plan. Once Kim stops working, she won't continue those contributions. Thus, Kim figures she can retire comfortably on $80,000 per year. Kim calculates how much she can expect from Social Security by looking at the estimates of benefits she receives each year from the Social Security Administration. Then Kim eyes other likely sources of retirement income: a pension, earnings from part-time consulting, and so on.

Kim then can estimate the amount she can safely withdraw from her investment portfolio.

See *Bear Market continued on page 3*

Auto Buyers Get a Break, Too

The above-the-line deduction for vehicle sales tax applies to tax paid on the purchase of new cars, light trucks, and motorcycles weighing no more than 8,500 pounds; this deduction also applies to new motor homes. You must purchase or have purchased the vehicle from February 17, 2009–December 31, 2009. You won't get an above-the-line sales tax deduction for leasing a vehicle.

Over the limit

You may deduct the sales tax you pay on a purchase price up to $49,500; if you pay more for the vehicle, you'll get a partial deduction.

Example: Jerry Harris pays $60,000 for a sports car plus $2,400 (4%) in sales tax. Jerry can deduct $1,980 (82.5% of $2,400) because $49,500 is 82.5% of $60,000.

This deduction is phased out for taxpayers with modified adjusted gross income (MAGI) over $125,000 ($250,000 for married couples filing a joint return). If your MAGI is over $135,000 ($260,000 filing jointly), you can't use this above-the-line tax break. If you qualify, you can claim it on your 2009 tax return. However, you won't be able to take the above-the-line deduction if you also claim an itemized deduction for state and local sales taxes.

On the other hand, if you do claim an itemized deduction for state and local sales taxes, you can deduct the sales tax paid for a vehicle on Schedule A, and this deduction won't be subject to the limits previously mentioned. Typically, you'll find the standard sales tax you can deduct, based on your income and place of residence, in an IRS table, and then add the sales tax paid on certain big-ticket items to get your total itemized sales tax deduction.

Retirement Plan Services

You may not be aware that one of the services we offer is Retirement Plan Design and Administration, specializing towards the unique needs and expectations of the small business community. The right retirement plan not only has a significant impact on your ability to attract and retain quality employees, it also can be used to appropriately and adequately reward a company's key employees.

If you took a step back and examined your plan, would you find that it is a valued benefit for your key staff? What about yourself? Are you receiving maximum benefit from your plan? If the answer to any of these questions is "no," then perhaps we can help.

We design and administer the following types of retirement plans:

- 401(k)
- Cross-Tested / New Comparability
- Profit Sharing
- Money Purchase Pension

Our Retirement Plan Consulting group operates independently of insurance companies, banks, trust companies, and legal firms. We cooperate fully with such organizations as directed by our clients. Our firm is compensated on a fee basis to assure that advice and services provided to our clients is impartial and objective. We act solely in the interest of our clients and on a wholly professional basis.

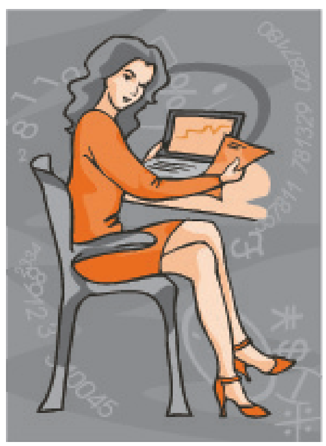
If you have any questions regarding your current plan design and whether or not it is maximizing your retirement benefits, please call us to set up an appointment to discuss these concerns. We would be glad to help design a plan that better fits your needs.

A Bigger Incentive to Invest in Small Companies

The tax code includes several incentives to invest in small businesses. Section 1202, one of those incentives, has provided individual investors a 50% tax exclusion on gains from selling certain small business stock. The new law increases the tax exclusion from 50% to 75% on gains from the sale of such stock issued after the date of enactment (February 17, 2009) and before January 1, 2011.

Until the Recovery Act was passed, § 1202 effectively limited the tax rate on qualified sales to 14% (50% of a 28% rate in effect during prior years). Under the new law, with a 75% exclusion, you would owe only 7% in tax on qualified sales: 25% of that former 28% rate. If you'd rather not pay 7%, you can roll over any gains and defer the tax bill.

Example: Cindy Roberts invests $50,000 in a small company and receives stock issued in 2009. She sells that stock in 2016 for $150,000. Section 1202 permits Cindy to exclude 75% of her $100,000 gain: $75,000. The other $25,000 of gain will be taxed at 28% under §1202, so Cindy owes only $7,000 in tax on her $100,000 gain. Cindy also has the option of re-investing her $100,000 gain in another small company and deferring all tax on her gain.



To get this tax break, you must meet the following conditions:

•You must invest in a domestic C corporation and receive stock in the company's original issue.

•The gross assets of the company can't exceed $50 million before or right after issuance.

•The company must be in a qualified trade or business. The IRS defines "qualified trade or business" as excluding the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, farming, hotel services, restaurant services, and the production or extraction of minerals, oil, or natural gas.

•You must hold the stock for five years before selling.

•The amount of gain eligible for the § 1202 exclusion is limited to the greater of 10 times the investor's basis in the stock or $10 million.

Going for more gains

If you invest in a company that meets the preceding conditions and you hold this qualified small business stock for more than six months, you can roll over any capital gain on a sale of the stock into another qualified small business within 60 days. The tax can be deferred, and the ultimate sale can qualify for the § 1202 tax exclusion.

The expansion of § 1202 can help small companies attract investors. Therefore, if you start a new business between now and the end of 2010, you should consider choosing C corporation status. You'll give up the tax benefits of an S corporation or a limited liability company, both of which let you avoid corporate income tax and deduct company losses on your personal tax return. With a C corporation, however, you might find it easier to raise needed capital.

How the Bear Market Affects Your Retirement

... continued from insert

Many financial advisors tell people retiring in their mid-60s to start with a 4% withdrawal. Then retirees can increase the annual withdrawal amount to keep pace with inflation. Such a strategy probably will keep an investment portfolio intact for 25–30 years.

Example #2: Suppose that Kim Grant estimates she will receive $30,000 per year from Social Security and other nonportfolio sources of income. Her retirement fund is now $500,000. Withdrawing 4% of $500,000 in Year 1 of her retirement would give her $20,000. Altogether, Kim can count on $50,000 of cash flow when she retires. Assuming she wants $80,000 of cash flow to maintain her lifestyle in retirement, Kim might have to keep working for several more years. Extending her career may increase Kim's Social Security benefits and allow her to make substantial contributions to her retirement fund.

Example #3: Assume the same facts as in Example 2, except that Kim has a $1 million portfolio. If she retires now and withdraws $40,000 (4%), Kim will have $70,000 of cash flow in Year 1, close to her $80,000 target. Thus, Kim may be able to retire in a few years if she puts more money into her retirement fund and her investments recover to some extent.

If you are thinking about retiring soon, our office can go over your specific situation and help you decide if you need to keep working in order to build a larger retirement fund.

Retirees

If you already are retired, you may have been tapping your portfolio for spending money. Your previous actions probably will influence what you can do in the future.

Example #4: Larry and Jill Martin retired a few years ago with $1 million in investments. They started with a $40,000 (4%) portfolio withdrawal and have increased that withdrawal each year to match annual inflation rates. After last year's bear market, the Martins' portfolio is down sharply. If they keep up their practice of increasing withdrawals to match inflation, their 2009 withdrawal will be about 5.5% of their portfolio. Although cutting their withdrawals may help in the long run, the Martins can maintain their spending if they'd like. The so-called "4% rule," based on historic patterns of investment returns, generates a high probability that a portfolio will remain intact for 25 - 30 years.

On the other hand, suppose that the Martins started with a $70,000 (7%) withdrawal and have made similar withdrawals during their retirement. With their depleted portfolio, keeping up this pace of withdrawals might mean spending over 10% of what's left this year. If they continue to spend at that level, the Martins run a risk of depleting their retirement fund.

Again, our office can help you determine a reasonable level of portfolio withdrawals during your retirement.

Turning Losses Into Gains

In most cases, a company that sustains a net operating loss (NOL) may carry back that loss to the prior two taxable years and use the NOL to offset taxable gains that the company reported. Such a company could recover income tax it had paid for those years. If this company does not fully use up its NOL with a two-year carryback, it can carry forward the remaining NOL to each of the succeeding 20 taxable years to offset future gains.

The Recovery Act changes the treatment of NOLs incurred in 2008, but only for companies with gross receipts of $15 million or less. If your company is in that category, it can carry back a 2008 NOL and recover income tax paid in the previous five years. If your company already has filed its 2008 return showing an NOL, our office can help you start the process to receive a refund of taxes previously paid.

Encouraging Equipment Expenditures

The Recovery Act also extends some tax benefits designed to increase the purchase of business equipment and thus stimulate economic activity. One provision involves § 179 of the tax code, which allows small companies to buy business equipment and take an up-front tax deduction rather than recovering those outlays over several years.

In 2008, Congress increased the maximum first year "expensing" election from $128,000, indexed for inflation, to $250,000. This year's Recovery Act retains the $250,000 cap for 2009; the new law also keeps the 2008 phaseout threshold at $800,000 for 2009.

Example #1: ABC Corp. spends $350,000 on business equipment in 2009. It can immediately deduct $250,000.

Example #2: XYZ Corp. spends $1 million on business equipment in 2009. The company's expenditures are $200,000 over the $800,000 phaseout threshold, so its expensing election is reduced by $200,000, from $250,000 to $50,000.

As you can see, if a company spends $1,050,000 or more on equipment this year, no expensing will be permitted.

A bonus for business

In the preceding discussion, ABC Corp. had $100,000 of equipment purchases in 2009 that it could not deduct via § 179, and XYZ Corp. had $950,000 of purchases that it could not deduct. The new law extends another tax benefit — "bonus depreciation" — which covers such outlays. Under this provision, property purchased and first placed in service in 2009 for use in the U.S. may qualify for 50% first-year depreciation if it can't be expensed.

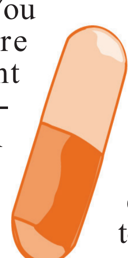
Example #3: As illustrated, XYZ Corp. buys $1 million worth of equipment this year. It can expense $50,000 worth. Of the other $950,000, it can take another $475,000 (50%) deduction for bonus depreciation. Of the remaining $475,000, XYZ can deduct $95,000 (20%), assuming the property qualifies for a 20% first-year write-off under prior law. Thus, XYZ Corp. can deduct $50,000 plus $475,000 plus $95,000, for a total of $620,000 out of the $1 million it spends on equipment in 2009. The Recovery Act also retains the limitation imposed on sport utility vehicles, which have a § 179 expensing limit of $25,000.

The new law also retains first-year write-offs of around $11,000 for cars, vans, and light trucks purchased in 2009 and used primarily for business. This is another form of bonus depreciation initiated in 2008.

Health Care Help for Former Employees

With the economy in recession, unemployment has increased. For many people, the loss of a job also means losing health insurance. To help people maintain coverage through their employer after being laid off, the Recovery Act provides a 65% subsidy for Consolidated Omnibus Budget Reconciliation Act (COBRA) continuation premiums for up to nine months. This 65% subsidy applies not only to COBRA, a federal law, but also to any similar laws on the state level.

Under COBRA, if you were a participant in your former employer's health insurance plan, you can extend your group health coverage after leaving the company. You have to pay the entire premium, which might be steep, plus administrative costs. COBRA coverage is generally limited to 18 months. The new law will make it easier for workers who lose their jobs to afford nine months of COBRA payments.



Example: William Patterson lost his job in January. He had health insurance for his family through that job. Under COBRA, William is entitled to maintain his health coverage for 18 months if he pays the full price. If the full price of his COBRA is $1,000 per month (approximately the national average), William can purchase his coverage for 35% of the full price ($350 per month) for up to nine months. His former employer will be required to pay the remaining $650 per month (65%) during that period. However, his employer effectively will be reimbursed via federal tax credits against the income tax withholding and payroll taxes it normally remits to the federal government.

To qualify for this subsidy, a worker must be or have been involuntarily terminated from a job between September 1, 2008, and December 31, 2009. Individuals must have modified adjusted gross income (MAGI) of no more than $125,000 ($250,000 for joint filers) in any year they receive this subsidy to get the full amount. With MAGI up to $145,000 ($290,000 on joint returns), a partial subsidy is available. The subsidy will terminate in fewer than nine months if the worker is offered employer-sponsored health care coverage or becomes eligible for Medicare.

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