

TAX NEWSLETTER

RECAP OF 2008 TAX CHANGES

October 9, 2008

To My Clients & Other Friends-

Well, where do I start? Since this is a tax newsletter, I will not address the current financial merry-go-round other than to say I do feel a lot smarter than I did before. And it is not because I have done anything smart (my investments are down about 35% like most other people). However, this mess has shown a lot of the Big Boys and Girls in the financial world, who I thought were much smarter than me, to be really dumb. I have definitely moved up in the competition.....

This has not been a quiet tax year even with the pending election. According to my count, there have been 5 pieces of legislation with material tax provisions:

- Emergency Economic Stabilization, Energy Improvement and Extension, Tax Extenders and AMT Relief Act (i.e. the \$700 billion bailout/rescue act)
- Housing Assistance Tax Act of 2008
- Heartland, Habitat, Harvest, and Horticulture Act of 2008
- Heroes Earnings Assistance and Relief Tax Act of 2008
Economic Stimulus Act of 2008

I will try to highlight the changes that may affect my clients. As you will see, our government continues to use the tax laws for social engineering. They try to encourage certain behavior by rewarding some actions with tax credits and deductions and punishing other actions with higher taxes and take-aways. As a result our tax system is almost impossible to administer – by either the government or we tax professionals.

First, the tax breaks -

Extended tax breaks (there are 16 more I have not listed since they should not affect my clients):

- Sales tax: the option to deduct state and local sales tax is extended through 2009
- Tuition deduction: extended through 2009
- Teacher expense deduction: extended through 2009
- IRA transfers to charity: extended through 2009
- Research and development credit: extended through 2009
- 15 year write-off for leasehold, restaurant and retail improvements: extended through 2008
- Residential solar property credit: extended through 2016
- Residential energy-efficiency credit: extended through 2009

AMT tax relief: sets the AMT exemption amount to \$69,950 for joint filers and \$46,200 for singles for just 2008. Again they are trying to mitigate a problem they created. Congress enacted AMT a number of years ago to snare a few millionaires that were not paying tax. Since they did not index the various AMT parameters for inflation, they are now snaring the middle class. Whoops – their bad. So, on an annual basis they have been setting a new AMT exemption amount.

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AMT credit allowance: many people who had incentive stock options paid a chunk of AMT when they exercised their options. By the time they sold the stock, it had dropped considerably in value. The net result was a large AMT credit they theoretically could use against their regular tax. Unfortunately they would have to live to be 300 years old to ever come close to using it all. This change speeds up a previous speed-up in the ability to take this credit.

Property Tax Deduction- If you do not itemize on your return, you can still deduct some property tax in 2008 and 2009. The limits are up to \$500 for a single taxpayer and up to \$1,000 for a joint taxpayer.

Mortgage debt forgiveness: don't get your hopes up. This does not give you the right not to pay your mortgage. However, if you do negotiate a reduction in your mortgage with your lender, you will not have to pay tax on the reduction as you would have under prior law. Most people were not aware this was even a problem, but many times the tax laws do hit you when you are down!

Plug-in electric drive vehicle credit: You could qualify for a credit of \$2,500 to \$7,500 (depending on the capacity of the battery running the car). I guess the bigger the Bunny, the bigger the credit.

Bicycle commuters: employers can provide employees who commute by bike limited tax-free fringe benefits to offset the cost. An example would be bike storage.

General energy-related credits and deductions: It would be impossible to explain them all. They include credits or deductions for carbon capture, cellulosic biofuels, alternative refueling stations, smart meters and grid systems, solar and wind systems, and recycling. If you are improving energy efficiency you should be able to find a credit for it – just don't expect me to know it off the top of my head.

First-time home buyer credit: subject to income limits, first time buyers can take a credit of 10% of the purchase price up to a maximum of \$7,500. This is really an interest free loan since you will have to pay it back to the IRS over the following 15 years or when you sell the house. You have to buy the house between April 9, 2008 and July 1, 2009. For purposes of the law, a "first-time buyer" is someone who has not owned a principal residence for 3 years. See – in tax law, the words do not necessarily mean what you think.

Now some revenue raisers -

Tightening of the home sale exclusion: Under prior law, homeowners could exclude up to \$500,000 of home sale gain. This applied even if some of the gain was "earned" while the home was not their principal residence (such as a vacation home or rental). Under new law, for sales after 2008, homeowners will have to pay tax on the part of the gain earned while the home was not used as their principal residence. Only "non-residence" use after 2008 will be considered.

Banks to report credit card sales: Starting in 2011 banks will have to report to the IRS the amount of sales a business has through credit card sales. This is an attempt by Congress to catch small businesses who are not reporting all of their income. I am willing to bet that the IRS will then develop profiles based on business type to determine how much in cash sales the business should be reporting in proportion to the charge sales reported by the banks. They feel many small businesses are not reporting all of their cash sales.

Stock basis reporting by brokers: Starting in 2011 stock brokers must report to you and the IRS the basis of any securities you sell. I am not sure how they will handle it when the basis in the security changes. Is the broker just going to be able to take your word for the new basis? Again this is an attempt by Congress to raise revenue by stopping taxpayers from being less than truthful about the basis in their stock sales. Are you getting the idea that Congress really doesn't trust us.....?

Some miscellaneous stuff-

Partnership/LLC and trust tax return due date: Starting with the 2008 returns (due in 2009) the extended due date for partnership and trust returns will now be September 15th instead of October 15th. Under prior law extended personal returns and extended partnership and trust returns were due on October 15th (got yours done yet?). Many individuals were put in the situation of waiting until the last minute to get information from a partnership return that was also waiting until the last minute. This also made my job harder and me crankier.

Wooden Arrows designed for use by children are exempt from excise tax: Don't laugh – I am serious. Under old law all arrows were subject to a 43 cent excise tax. Since kid's arrows normally sell for less than this, it was hard to make money (kinda like sub-prime lending). So, arrows sold after October 3, 2008 for kids (but not "real" arrows) will be tax free. This law just gives you a small idea on how Congress shafts the American taxpayer in hidden ways.

I really wish I could list all of the tax changes Congress made this year. I did not even touch any the special laws passed just for farmers (race horses are now depreciated over 3 years, in case you are interested). I bet that if Congress ever passed a flat-tax, it would take them less than a year to start making it back into the complex, social engineering, special interest focused, tax regime we now have.

I have just recapped many of the new laws. Please contact me if you have any questions.

Thanks,

Tim

Now, to keep the insurance company happy-

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