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Advisor

Beyond Your Numbers



Information to Help You Make Smart Business & Financial Decisions

2007 tax planning overview

This special edition focuses on year-end planning issues to help individuals and businesses reduce their 2007 tax liability and to help plan for 2008.

As we go to press, Congress has yet to pass a “patch” extending alternative minimum tax (AMT) relief for individuals, but legislators waited until late last year to do so. Without Congressional intervention, millions more taxpayers will be subject to AMT, and year-end planning will need to be adjusted accordingly. Also in question is whether Congress will extend a number of other significant tax breaks set to expire at the end of this year.

Keep planning goals in mind

As with all tax planning, year-end planning is a practical journey that should arrive at a sensible economic destination. The first step? Don’t go it alone. What works for others may not be right for you. For example, many planning ideas recommend deferring taxable income to 2008, but you may want to accelerate income if you expect to be in a higher tax bracket next year or are in AMT.

Work with your BKD tax advisor to properly structure and implement strategies appropriate for your situation. For more planning ideas, browse our archived PDFs of earlier BKD Advisor editions at bkd.com/mediacenter/Newsletters

Small Business Act, FIN 48 introduce major changes

While Congress continues to discuss the “tax gap,” the Internal Revenue Service (IRS) continues with plans to increase its examinations and enforcement practices.

One significant change is the new rules that govern paid tax return preparers. The *Small Business and Work Opportunity Tax Act* (Small Business Act)

imposes tougher standards for signing tax returns and increases and expands penalties on return preparers.

Under the old rules, preparers generally couldn’t sign a return if it contained a tax position the preparer knew, or should have known, didn’t have a “realistic possibility” of success, *i.e.*, a one-out-of-three chance of success. Such positions had to be properly disclosed to the IRS.

The new rules are largely effective for returns filed after 2007 (2007 calendar-year returns). Unless a tax position has a realistic possibility of success and is properly disclosed to the IRS, the new rules will impose a penalty on any preparer who signs a return containing a position he/she knew—or should have known—did not have a more-likely-than-not chance of success (more than a 50% chance).

Another significant change for enter-

prises issuing GAAP financial statements is Financial Accounting Standards Board (FASB) Interpretation Number 48 (FIN 48), *Accounting for Uncertain Tax Positions*. Effective for financial statement periods beginning after December 15, 2006, FIN 48 prohibits such enterprises from recognizing tax benefits of uncertain tax positions in financial statements. (For more information, see below: “FIN 48, transfer pricing & multinationals.”)

As we go to press, FIN 48 is in the process of being postponed until years beginning after December 15, 2007, for most privately held companies and not-for-profit organizations.

Stay tuned in 2008, which promises to be an interesting year for tax. Presidential and Congressional elections offer a platform to discuss tax policies and issues that often result in new tax legislation. ♦♦♦

FIN 48, transfer pricing & multinationals

Because FIN 48 applies to transfer pricing, it is critical for multinational enterprises that issue financial statements based on generally accepted accounting procedures (GAAP) to plan accordingly.

FIN 48 specifically includes “the allocation of income between jurisdictions” among the tax positions falling under its scope. In the first quarter of 2007, public companies, including those with inter-company transactions, were required to disclose any uncertain tax positions. One survey found at least 150 public companies with transfer pricing-related FIN 48 disclosures.



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FIN 48 will likely have a more adverse affect on private companies because, compared to public companies, they are less likely to have robust transfer pricing documentation in place. Improper transfer pricing may cause misallocation of income and/or deductions among jurisdictions, resulting in potentially uncertain tax positions.

FIN 48 requires enterprises to consider the following when analyzing potentially uncertain positions in relation to transfer pricing:

- ◆ The issue will be discovered by taxing authorities
- ◆ The law of each jurisdiction of that country will be applied properly
- ◆ Penalties and interest will be levied where applicable
- ◆ All jurisdictions involved in the intercompany transactions must be analyzed to see if these transactions yield an arms-length result, *i.e.*, not just the U.S. side
- ◆ Competent authority relief will likely not be available

Enterprises with intercompany transactions should proactively address FIN 48 as it pertains to transfer pricing practices, policies and documentation.

Report foreign bank & financial accounts

U.S. persons are required to disclose to the U.S. government any financial interests in (or signature authority over) foreign financial accounts with a balance or value exceeding \$10,000 at any time during the year. U.S. "persons" include citizens and residents, domestic corporations, partnerships, trusts and estates.

Persons with such authority or ownership are required to annually file a Report of Foreign Bank and Financial Accounts (FBAR) with the U.S. Treasury Department on or before June 30 of the following year. Financial accounts include traditional bank accounts and brokerage-type accounts, as well as other financial arrangements.



This disclosure was originally intended to increase transparency of offshore passive-income vehicles. Despite civil and criminal penalties for noncompliance, enforcement has been rare; however, the government is focusing more attention on FBAR due to increased concern about money launderers and terrorist financiers. For this purpose, foreign bank and financial accounts include the following:

- ◆ Traditional foreign bank accounts and brokerage-type accounts
- ◆ Legal title to (or a joint interest in) a foreign account
- ◆ Accounts held by foreign nominees
- ◆ A 50% or more ownership interest in a corporation, partnership or trust that has a foreign financial interest
- ◆ Accounts maintained with foreign branches of U.S. banks

If you think you have a financial interest in (or signature authority over) such a foreign account, notify your BKD advisor during year-end tax return preparation.

Don't get hooked by phishing scams

Phishing is an all-too-popular tactic used by Internet identity thieves to bilk unsuspecting victims out of their personal information. Some thieves masquerade as IRS officials by sending emails that appear to be from that agency.

The email purports to notify the recipient of an awaiting IRS refund that will be issued on provision of certain personal information, *e.g.*, Social Security numbers and bank account information. The official-looking emails direct victims to a website that also appears authentic. **Beware: The IRS never contacts taxpayers by email or phone.**

If you are contacted by someone claiming to be from the IRS, do not provide any information and report the incident to local law enforcement and your BKD advisor. For more details about phony IRS phishing scams—and to view a sample phony email—visit the IRS website at www.irs.gov and enter "phishing" as a keyword/search term.

Itemize deductions for long-term care premiums

Long-term care insurance is gaining popularity as more and more of us seek control of our long-term care needs. For middle-aged individuals, proper planning and insurance coverage can make it possible to maintain independence longer, reducing the financial burden on family members and providing more choices for care.

Amounts received under a qualified long-term care insurance contract are not taxable up to \$270 per day in 2008—up from \$260 in 2007. In addition, amounts paid for insurance that cover qualified long-term care services are deductible as itemized medical expenses up to specified dollar limits that vary with age:

- ◆ The 2008 limit will be \$310 if you are 40 years old or younger (up from \$290 in 2007)
- ◆ If you are over age 40 but not over 50, the limit will be \$580 (up from \$550 in 2007)
- ◆ If you are over age 50 but not over 60, the limit will be \$1,150 (up from \$1,110 in 2007)
- ◆ If you are age 60 but not over 70, the limit will be \$3,080 (up from \$2,950 in 2007)
- ◆ If you are over age 70, the limit will be \$3,850 (up from \$3,680 in 2007)

Expanded kiddie tax & lower capital gains

In general, an individual's net capital gain is taxed at a maximum rate of 15%. However, for 2007, net capital gain is taxed at 5% for taxpayers in the 10% and 15% marginal tax brackets—and at 0% for 2008 through 2010 (for brackets, see "Individual Tax Rate Schedule," page 6). Qualified dividend income is also eligible for this tax break.

For 2007, children under age 18 are generally subject to the kiddie tax and must pay tax at their parents' highest marginal rate on investment income exceeding \$1,700. Beginning in 2008, the kiddie tax expands to include children under age 19 and full-time students under age 24. These changes may warrant year-end tax planning:

- ◆ If you will be in the 10% or 15% top marginal tax brackets in both 2007 and 2008, defer the sale of appreciated capital assets to 2008.
- ◆ If you will be in the 10% or 15% brackets in 2008 but in a higher bracket in 2007, defer such a sale to 2008.
- ◆ If you will be in the 10% or 15% brackets in 2007 but in a higher bracket in 2008, accelerate such a sale into 2007; however, if your child owns the asset to be sold, be aware kiddie tax rules may put him/her in a higher tax bracket.
- ◆ If you are in a higher tax bracket, make year-end gifts of appreciated capital assets to low-bracket family members who can then sell the assets next year and achieve an overall 15% tax savings for the family. Again be aware of the kiddie tax rules.
- ◆ If you are in a higher tax bracket, gift appreciated capital investments to a low-bracket child who isn't subject to

the kiddie tax in 2007 but will be in 2008. The child can sell the assets before the end of 2007; compared to the 15% tax you would pay on the sale, the child would pay only 5%.

Finally, children who turn between the ages of 18 and 22 at the end of 2007 are not subject to the kiddie tax rules for 2007 but may be in 2008; therefore, they should consider accelerating investment income and capital gains into 2007.

FICA tip credit becomes more valuable

The *Federal Insurance Contributions Act* (FICA) tip credit allows employers in the food and beverage industry to claim a credit for the Social Security and Medicare taxes they pay on employee tip income that exceeds the federal minimum wage.

Recent tax law changes make this credit more lucrative: Although the federal minimum wage increased to \$5.85

per hour, an accompanying law froze the minimum wage amount at \$5.15 for purposes of determining the credit. So, while employers must pay a higher minimum wage, the amount of available FICA tip credit is increased, which can be used against the AMT, effective for taxable years beginning on or after December 31, 2006.

Before this change, the credit's value was reduced significantly because it could only be used to offset regular tax in excess of tentative minimum tax. With the AMT limitation gone, employers who chose not to pursue this credit should reconsider it.

Small tax exempts must now e-file

Beginning in 2008, small tax-exempt organizations that previously were not required to file a return may be required to file



Several tax breaks set to expire

Several noteworthy tax breaks are set to expire after 2007, but keep them on your radar during year-end tax planning because they could be extended after you receive the *BKD Advisor* year-end planning edition.

Accelerate expenditures into 2007 to take advantage of the following items:

- ◆ Taxpayers age 70½ and older may distribute to charity up to \$100,000 of assets in an individual retirement account (IRA) without paying tax on the distribution (will not be available after 2007).
- ◆ The deduction for qualified higher education tuition will expire after 2007, although higher education tax credits will still be available.
- ◆ Mortgage insurance premiums are deductible by certain lower-income individuals for 2007 only.
- ◆ The credits for qualifying energy-saving home improvements expire after 2007. If you are thinking of making energy-saving improvements to your home, *e.g.*, installing extra insulation or energy-saving windows, consider doing so before year end.
- ◆ Qualified leasehold and restaurant improvements placed in service before 2008 may be written off over 15 years instead of 39 (expires after 2007).
- ◆ For 2007 only, if an S corporation makes a charitable contribution of appreciated property, shareholder stock basis is reduced by the tax basis of the contributed property, not the value of the deduction; thus, charitably minded S corporations have an additional one-time incentive to donate appreciated property.
- ◆ Business taxpayers may take upfront deductions for qualified environmental remediation expenditures (expires after 2007).
- ◆ For tax years beginning before 2008, percentage depletion deductions for oil and gas production are not limited to the taxable income from the associated property (expires after 2007).
- ◆ Accelerated depreciation of Indian reservation business property will not apply to property placed in service after 2007.
- ◆ The tax credit for employing qualifying Indian tribe members is set to expire after 2007.
- ◆ The option to deduct state and local sales and use taxes is set to expire after 2007.
- ◆ The research tax credit is set to expire after 2007. ♦♦♦

an annual Form 990-N, Electronic Notice (e-Postcard) for Tax Exempt Organizations Not Required to File Form 990 or 990-EZ.

A provision of the *Pension Protection Act of 2006* (PPA), the e-Postcard applies to tax years beginning after December 31, 2006, and applies to small tax-exempt organizations not required to file Form 990 or 990-EZ because their gross receipts are normally \$25,000 or less.

However, not every small tax-exempt organization is required to file the e-Postcard. Some exceptions are organizations included in group returns, as well as private foundations required to file Form 990-PF. The requirement does not apply to churches, their integrated auxiliaries or to church conventions and associations.

This summer, the IRS sent letters to notify affected small tax-exempt organizations of the potential e-Postcard filing requirement. It is also developing a filing system and will publicize those procedures when the system is ready for use. **Note: There will not be a paper Form 990-N.**

The PPA requires the IRS to revoke the tax-exempt status of any organization that fails to meet its annual filing requirement for three consecutive years. Therefore, if your organization is required to annually file the e-Postcard, do so without fail or risk losing your tax-exempt status.

Document cash donations to charity

If you make cash contributions to charity, get a receipt or other documentation from the charity; otherwise, the IRS may disallow your deductions.

Under new rules, all cash donations—no matter how small—must be document-

ed by a receipt. Before this law change, taxpayers were only required to get a receipt for cash donations of \$250 or more.

If you give by check or credit card, back up your deduction with either a receipt from the charity or copies of cancelled checks or credit card statements.

Actively plan for passive activities

A passive activity is any trade, business or investment in which you do not materially participate. Losses and credits generated by passive activities that exceed passive income are not deductible. Instead, they carry over to future years or until the activity is fully disposed.

Rental activities are per se passive activities regardless of material participation (with an exception for qualifying real estate professionals). However, subject to income limitations, you can deduct up to \$25,000 of losses from rental real estate activities if you actively participate.

And what about *material* participation? You materially participate if you meet the following criteria:

- ◆ Participate in the activity more than 500 hours during the year
- ◆ Participate more than 100 hours if no one else participates more
- ◆ Participate more than 500 hours in all your significant participation activities (SPA); an SPA is when you participate for more than 100 hours but do not otherwise materially participate

You actively participate if you participate in a significant way, *e.g.*, you make management decisions, including approving new tenants, setting rent policies and terms; and approving capital expenditures or repair decisions in a rental activity.

Discuss these rules with your BKD advisor and consider if you are subject to limitations on losses from a passive activity. If you are, you may be able to take steps to avoid these limitations by planning or increasing your participation. ♦♦♦

Don't leave

by Doug Stucker, dstucker@bkd.com

Recent 2007 legislation makes it more likely for you to earn income tax credits by simply hiring employees with particular attributes. These are not deductions but actual dollar-for-dollar income tax credits you may be entitled to if your company is located within a specific business site or “zone” and employs or hires people who reside in that same zone.

Many businesses are unaware of numerous, lucrative federal and state incentive tax programs. Businesses may not be aware their facility is located within a zone: Because zones do not generally share boundaries with common geographic areas, such as ZIP codes, municipalities or counties, it is not usually obvious if a business is located within a certain zone.

Businesses may also assume the credit qualification process is too complex and confusing or simply too time consuming. The good news is BKD has access to tools that can greatly simplify and enhance the process.

Location-based credits

Your business may earn federal income tax credits if it is located in one of many community renewal zones

designated nationwide and also employs people who live in the same zone. While many of these zones are in depressed urban and rural areas, many are located in areas with more advanced economic development.

Other federal income tax benefits may be available to businesses located in a zone. These credits



Some of the information in this BKD Advisor is specific to 2007 and may not be relevant after December 31, 2007. As always, talk with your BKD advisor before taking any action. Contact BKD to schedule a presentation on tax planning strategies for members of your community, business, civic or charitable organizations.

valuable incentive credits on the table

may be available for all open years (often the past three years). Also, the credits generally flow through to owners of pass-through entities. And, for those businesses with net operating loss (NOL) deductions, credits generally are available for carry-forward for 20 years. These zones exist in most states, including Empowerment Zones (38 states), Renewal Communities (20 states) and Native American Tribal Lands (43 states).

State credits are often earned when a business is located in a zone and increases the number of employees and/or makes capital investments in the zone. State credits may be in the form of income or franchise tax credits, property tax abatements and credits and sales tax refunds and exemptions.

Generally, state programs are divided between prequalification and nonprequalification. Prequalification requires a business be located within a certain zone and complete the approval process *before* it hires more employees (or makes investments in the location) so it can receive the tax benefits.

Often, simply being located in a zone will allow a business to take advantage of the tax benefits without an additional approval process, which is how the nonprequalification program works. Additional eligibility requirements may also exist for state programs: a minimum number of new employees or investment amount, targeted industries and different levels of benefit for specific locations within a state.

WOTC can help eligible employers

If you hire an employee in one of the following categories, you may be eligible for a federal income tax credit equal to a percentage of the employee's first year's wages (two years for certain eligible employees).

The federal Work Opportunity Tax Credit (WOTC) is generally 40% multi-

plied by eligible wages up to \$6,000, has a maximum credit of \$2,400 per qualified employee and applies in the year of hire. On the day they offer the applicant the job, employers are required to complete certain paperwork and file it (within 28 days of hire) with the state employment agency for certification.

The number of eligible employees will expand due to two new categories that were added recently:

- ◆ Disabled veterans
- ◆ Residents of rural renewal counties (RRCs) ages 18 to 39. There are 403 RRCs, representing some 13% of U.S. counties. Group D has been



expanded from ages 18 to 24 to ages 18 to 39.

Also, effective for taxable years beginning on or after December 31, 2006, you may use the WOTC against the AMT. Before, these credits could only be used to offset regular tax exceeding tentative minimum tax. Employers that may not have pursued these credits because of the AMT limitation should reconsider them.

These programs are meant to encourage and reward businesses that hire employees who often may be more difficult to place.

* * *

You may be eligible for these credits, but you can only benefit if you pursue them. If you are a qualifying employer, your BKD advisor can help you leverage WOTC tax credits in a cost-effective way. ◆◆◆

Nine WOTC categories

Prior to a recent expansion of the credit, qualifying employees had to belong to one of nine different categories:

Group A - Qualified recipients of Temporary Assistance to Needy Families (TANF)

Group B - Qualified veterans who receive food stamps

Group C - Qualified economically disadvantaged ex-felons

Group D - High-risk youth ages 18 to 24 who reside in Renewal Communities, Enterprise Communities or Empowerment Zones

Group E - Vocational rehabilitation referrals

Group F - Qualified summer youth ages 16 to 17 who reside in Renewal Communities, Enterprise Communities or Empowerment Zones

Group G - Qualified food-stamp recipients ages 18 to 24

Group H - Qualified recipients of Supplemental Security Income (SSI)

Group I - Long-term recipients of either TANF or Aid to Families with Dependent Children (AFDC) ◆◆◆

Individual year-end tax planning strategies

- ✓ If your employer offers a flexible spending account or cafeteria plan, take full advantage of it.
- ✓ If you have any capital gains or losses from sales of stock or other capital assets, or if you have stock or other capital assets that are ripe for sale, coordinate gain/loss timing to reduce tax on your gains and increase the tax benefit from your losses.
- ✓ If you own an interest in a partnership or S corporation, you may need to increase your basis in the entity to deduct a loss from it this year.
- ✓ “Bunch” miscellaneous itemized deductions, medical expenses and other itemized deductions to reduce the impact of threshold limitations and income phase-outs.
- ✓ If you are facing a penalty for underpayment of estimated tax consider increasing your withholding.
- ✓ Self-employed individuals should consider setting up a self-employed retirement plan.
- ✓ You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give \$12,000 in 2007 to an unlimited number of individuals but you can't carry over unused exclusions from one year to the next.
- ✓ Contribute to a traditional IRA or a Roth IRA.

- ✓ Donate appreciated securities instead of cash. If you have held the securities for at least one year and one day, your charitable deduction (before certain limitations) is equal to the value of the securities, and you are not taxed on the appreciation.
- ✓ Do you have reportable transactions? It is essential to consider

them at year end. For more details, visit bkd.com/service/tax/ReportableTransactions.htm.

- ✓ If you expect to pay AMT this year, consider deferring the payment of state taxes and miscellaneous itemized deductions until next year. Also, consider divesting private activity bonds.
- ✓ Contribute to a Section 529 higher education tuition plan. Investments in these plans grow tax free, and many states provide for tax-deductible contributions. ❖❖❖

Individual Tax Rate & Schedule

Status	2007 Rates		Estimated 2008 Rates*	
	Rate	Bracket	Rate	Bracket
Single	10%	\$0 - 7,825	10%	\$0 - 8,025
	15%	7,826 - 31,850	15%	8,026 - 32,550
	25%	31,851 - 77,100	25%	32,551 - 78,850
	28%	77,101 - 160,850	28%	78,851 - 164,550
	33%	160,851 - 349,700	33%	164,551 - 357,700
	35%	Over 349,700	35%	Over 357,700
Head of Household	10%	\$0 - 11,200	10%	\$0 - 11,450
	15%	11,201 - 42,650	15%	11,451 - 43,650
	25%	42,651 - 110,100	25%	43,651 - 112,650
	28%	110,101 - 178,350	28%	112,651 - 182,400
	33%	178,351 - 349,700	33%	182,401 - 357,700
	35%	Over 349,700	35%	Over 357,700
Jointly	10%	\$0 - 15,650	10%	\$0 - 16,050
	15%	15,651 - 63,700	15%	16,051 - 65,100
	25%	63,701 - 128,500	25%	65,101 - 131,450
	28%	128,501 - 195,850	28%	131,451 - 200,300
	33%	195,851 - 349,700	33%	200,301 - 357,700
	35%	Over 349,700	35%	Over 357,700
Married Filing Separately	10%	\$0 - 7,825	10%	\$0 - 8,025
	15%	7,826 - 31,850	15%	8,026 - 32,550
	25%	31,851 - 64,250	25%	32,551 - 65,725
	28%	64,251 - 97,925	28%	65,726 - 100,150
	33%	97,926 - 174,850	33%	100,151 - 178,850
	35%	Over 174,850	35%	Over 178,850

Long-term capital gains and dividends are subject to a maximum tax rate of 15% (5% and 0% for 2007 and 2008, respectively, for taxpayers in the regular 10% and 15% tax brackets).

*These brackets have been adjusted for inflation. However, the IRS has not yet released the official amounts.

Gift Exclusions & Exceptions

	2007	2008
Annual Gift Tax Exclusion	12,000	12,000

Retirement Plan Contribution Limits

Individuals age 50 and over can make elective catch-up contributions to their retirement accounts in addition to existing contribution limits. The maximum allowed elective deferral retirement contributions are as follows:

	2007	2008
401(k), 403(b), 457 & SAR-SEP Plans – Under age 50	\$15,500	\$15,500
401(k), 403(b), 457 & SAR-SEP Plans – Age 50 & Older	\$20,500	\$20,500
Traditional & Roth IRA's – Under age 50	\$4,000	\$5,000
Traditional & Roth IRA's – Age 50 & Over	\$5,000	\$6,000
SIMPLE Plans – Under age 50	\$10,500	\$10,500
SIMPLE Plans – Age 50 & Over	\$13,000	\$13,000

Elective deferrals are amounts an employee instructs the employer to take out of regular pay and put into a pension account. Employers with profit-sharing plans are required to contribute funds to employee's pension accounts. The total sum of an employee's combined pension contributions can't exceed \$45,000 for 2007 and \$46,000 for 2008. An employer's tax deduction for contributions can't exceed 25% of all employees' annual compensation, taking into account individual compensation. The annual benefit limitation for defined benefit plans will increase to \$185,000 in 2008 from \$180,000 in 2007.

Dependency Exemption

	2007	2008
Personal Exemption	\$3,400	\$3,500

Personal exemptions begin to phase-out at the following amounts of adjusted gross income:

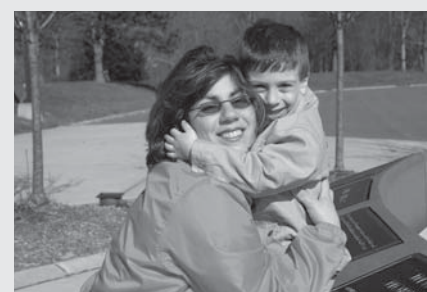
	2007	2008
Married-Joint	\$234,600	\$239,950
Head of Household	\$195,500	\$199,950
Single	\$156,400	\$159,950
Married-Separate	\$117,300	\$119,975

Basic Standard Deduction

	2007	2008
Married-Joint	\$10,700	\$10,900
Head of Household	\$7,850	\$8,000
Single	\$5,350	\$5,450
Married-Separate	\$5,350	\$5,450
Married-Joint & over 65 or blind	\$11,750	\$11,950
Single & over 65 or blind	\$6,650	\$6,800

The allowable amount of itemized deductions will be reduced if adjusted gross income exceeds:

	2007	2008
Married-Separate	\$78,200	\$79,975
All others	\$156,400	\$159,950



Business year-end tax planning strategies

- ✓ Consider placing in service by year end, equipment that qualifies for the \$125,000 Section 179 business property expensing option.
- ✓ Accelerate depreciation deductions for building components with a cost segregation study.
- ✓ Many business owners are unaware that certain activities they perform are eligible for the lucrative research and development tax credit. A research credit study can help you identify qualifying expenditures.
- ✓ Consider the election to expense “brownfields” environmental remediation costs.
- ✓ You may be able to use the Section 199 deduction for qualifying production activities.
- ✓ Review methods of accounting for income and deduction items for opportunities to defer tax.
- ✓ C corporations should consider reasonable year-end bonuses to owners to reduce the double tax effect.
- ✓ Accrue bonuses to non-owners. If structured correctly, accrual-method taxpayers can pay these by March 15, 2008, but deduct them in 2007.
- ✓ Don't overlook state and local tax (SALT) issues. If your business conducts activities in multiple states, gauge your exposure to their state and local taxes. If, years later, taxing authorities find nexus was established, the amount assessed for prior years—plus interest and penalties—can be significant.
- ✓ If your business issues GAAP financial statements, consider the effects of FIN 48, *Accounting for Uncertain Tax Positions*. Some or all the benefits of uncertain tax positions cannot be recognized for GAAP. Address FIN 48 proactively.

- ✓ If yours is a cash-basis business, you may be able to postpone income to 2008. You are not eligible if the income has been constructively received, *e.g.*, holding and not depositing a check until 2008. Also, consider purchasing items you know you

will need in January or prepaying certain expenses.

- ✓ If your business is accrual basis, you may defer advanced payments received for goods or services. You may also postpone income by deferring the right to payment until 2008, *e.g.*, delay billing.
- ✓ Businesses that offer a nonqualified deferred compensation plan should consult with qualified counsel to make sure they meet Section 409A requirements. ❖❖❖

Travel Rates

New, simplified per diem travel rates became effective October 1, 2007. Instead of reimbursing actual business travel expenses, employers may give employees these per diem allowances, which greatly simplifies record-keeping requirements needed to substantiate deductions for business travel.

	Beginning October 2006	Beginning October 2007
Lodging, meals & incidentals - “high-cost localities”	\$246 per day	\$237 per day
Lodging, meals & incidentals - other localities	\$148 per day	\$152 per day
Meals & incidentals only - “high-cost locality”	\$58 per day	\$58 per day
Meals & incidentals only - other localities	\$45 per day	\$45 per day
Transportation industry: Meals & incidentals - continental U.S.	\$52 per day	\$52 per day
Transportation industry: Meals & incidentals - outside Continental U.S.	\$58 per day	\$58 per day

FICA Tax Schedule

	Rate	2007 Wage Base	2008 Wage Base
Social Security	6.20%	\$97,500	\$102,000
Medicare	1.45%	Unlimited	Unlimited



Standard Mileage Rates

Business	48.5 cents per mile
Charitable	22 cents per mile
Medical & Moving	22 cents per mile



Section 409A regulations are broad by design

by Mark Welker,
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In 2004, Congress added Section 409A (409A) to the Internal Revenue Code (IRC) to regulate the taxation of “deferred compensation.” It generally applies to amounts deferred during 2005 or later, but, because the Internal Revenue Service (IRS) did not issue final 409A regulations until April 2007, employers have until December 31, 2008, to amend documents to revise times and forms of payment. However, the requirement that the operation of all deferred compensation arrangements must comply with 409A was not delayed and remains effective.

409A deserves attention

Section 409A was a consequence of the Enron debacle: Enron executives received deferred compensation shortly before the collapse, while the retirement accounts of the rank and file suffered huge losses. Congress intended 409A to prevent executives from being advantaged, but 409A goes far beyond that.

Although its genesis was an abuse occurring at a public company, 409A applies to *all* companies—large and small, public and private. Also, the deferred compensation regulated by 409A is extremely broad by design to thwart the mischief of clever professionals who would otherwise design arrangements to avoid its effects.

Why does 409A deserve the attention of every business? Because failure to comply with it may result in (1) deferred compensation being taxable income to the service provider at the time of vesting, with (2) the service provider owing a 20% excise tax and a higher-than-normal interest rate.

Deferred compensation is any written or unwritten arrangement that might result in compensation paid after the first year any services were performed that gave rise to such compensation. **Note:** This applies even to arrangements that provide a mandatory (not elective) delay in payment.

There are a number of exceptions, but three are most common:

- ✓ Payment is made within two and a half months after the year in which the compensation becomes vested
- ✓ The arrangement is a stock option or stock appreciation right related to certain common stock of the service recipient; no deferral of gains is permitted, and the exercise price can never be less than fair market value on the grant date
- ✓ The service provider is an independent contractor who provides “significant” services to more than one “unrelated” service recipient

Arrangements that qualify

The following are examples of written and unwritten arrangements that might give rise to deferred compensation:

- ✓ Employment, noncompete and consulting agreements, including offer letters
- ✓ Severance agreements and plans
- ✓ Separation agreements
- ✓ Bonus plans and programs
- ✓ Change-in-control agreements
- ✓ Long-term incentive programs
- ✓ Supplemental executive retirement plans
- ✓ Nonqualified 401(k) mirror plans
- ✓ 457(f) deferred compensation plans for tax-exempt and governmental entities
- ✓ Elective top-hat deferred compensation plans
- ✓ Shareholder agreements and stock purchase agreements
- ✓ Options or stock appreciation rights with an exercise price below fair market value on the grant date
- ✓ Phantom stock arrangements

Among other things, arrangements that constitute deferred compensation must be in writing and contain certain required provisions. In addition, any deferral

of compensation or changes in payment dates must meet strict election timing requirements; this applies to elections by either the service provider or recipient. Deferred compensation is required to be paid only upon certain events or times.

How to handle violations

Examples that might involve 409A violations include:

- ✓ Extending stock option exercisability for severed employees
- ✓ Retaining discretion to accelerate or delay compensation
- ✓ Failure to delay by six months, severance pay to key employees of public companies

As yet, there is no procedure to fix a 409A violation; the service recipient is required to report it to the IRS on the applicable W-2 or 1099. Therefore, the following demands immediate consideration:

- ✓ Identify all arrangements to which 409A might apply
- ✓ Identify the best alternatives for satisfying 409A

To comply with 409A, amend all covered arrangements by December 31, 2008, and obtain (by December 31, 2008) any new payment elections offered to anyone deferring compensation. Contact your legal counsel and your BKD advisor for more information or to help you determine if any arrangements you have will give rise to deferred compensation.

* * *

Guest columnist Mark Welker is an attorney and partner with Blackwell Sanders LLP. ♦♦♦♦

Page one of the September 2007 BKD Advisor contained 409A coverage that included an example of annual bonuses paid after year end. To clarify, such bonuses are nonqualified deferred compensation only if earned by year end but paid more than two and a half months after year end.



Contact BKD Wealth Advisors for investment,

Market commentary: mixed economic

by Jeff Layman, Wealth Advisors,
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Economic news flow in the early part of the third quarter was positive, as second-quarter GDP growth was reported at a surprisingly strong rate of nearly 4%. Despite the negative impact on growth from the continued deterioration in housing, overall consumer spending still grew 1.5%.

In addition, the weakening dollar helped improve the trade deficit, as U.S. goods become more attractive to buyers abroad. Exports grew at nearly double the rate of imports in the quarter, with the U.S. manufacturing sector a primary beneficiary. Business spending was also very strong, increasing by more than 10%.

By the middle of the second quarter, however, news flow turned decidedly negative, as the slowdown in housing affected the credit markets. Though Federal Reserve Bank (Fed) Chairman Ben Bernanke has made it clear he does not believe it's the Fed's responsibility to protect lenders or investors from the financial decisions they make, the Fed became concerned about the impact of the rapid deterioration in credit conditions on the broader economy.

The Fed's first step was to lower its discount rate August 17. This not only improved liquidity conditions, but also reassured investors the Fed was concerned about economic growth and was willing to take action to protect it. Given this preliminary action, a reduction in the more important Fed Funds rate at the September 18 Federal Open Market Committee meeting was viewed as a "given." Economists' expectations were fairly evenly divided between .25% and .50% of rate cuts. The Fed ultimately delivered .50% of easing that day, which was well received by the financial markets.

We believe the contraction in hous-

ing and related sub-prime mortgage woes will continue to have a negative impact on the economy in the near term. We are monitoring how the deterioration of these areas affects employment figures, as both the construction and financial services industries have eliminated jobs in recent months.

For now, employment conditions appear to be slowing, but not drastically so. The Fed is widely expected to bring additional interest rate cuts between now and year end, with future employment trends providing the likely key economic data that determines when, and by how much, rates are further reduced.

Volatile quarter for stocks

If an investor looked at stock prices at only two points during the third quarter—the beginning and the end—they would surmise it had been a fairly uneventful period, with prices ending a bit higher than where they started three months earlier.

In reality, however, the summer proved to be quite volatile: The market began the quarter by rallying to new year-to-date, all-time highs by the third week of July, a response to strong corporate earnings reports. In both the first and second quarters of 2007, analysts were expecting earnings growth of 3% to 4%, but actual earnings came in closer to 10% in both periods. Then, in late July, sub-prime loan problems returned to the headlines.

As a result of the loan debacle, credit conditions became extremely tight, causing concern among some investors that the economy would fall into recession. By late August, the market had given back the 10% year-to-date gains and briefly dipped into negative territory intraday. Financial stocks were particularly hard hit—as were consumer-related stocks—and both felt the brunt of the impact from these issues.

But one more big reversal during the quarter was in store for stocks, as the Fed

lowered its Fed Funds rate .50% in September. Investors anticipated Fed action and responded well when the central bank lowered rates more aggressively than many expected. This gave stocks a significant boost through the end of the third quarter, leaving the S&P 500 up over 9% for the year.

Market volatility was clearly on the rise this summer, after a prolonged period of relatively calm trading. Between July and August, the U.S. market experienced its first 10% correction in more than four years. Although rare in recent times, the past 75 years have shown the market's propensity to "correct" once a year on average. So, in many respects, this year's trading pattern is more the norm than the exception.

Bond yields decline

Interest rates have also been fairly volatile in 2007. After starting the third quarter above 5%, a "flight to quality" pushed the benchmark 10-year Treasury Note yield down significantly by the end of September, as did the anticipated Fed interest rate cut. By the end of the quarter, the 10-year Treasury Note yield declined to 4.55%, essentially taking interest rates back to where they started earlier in the year.

What this means in the investment-grade arena is that bonds are once again on pace to produce a total return similar to their coupon yield. Year to date, the Lehman Aggregate Index of taxable bonds rose 3.85 %, while the Lehman Municipal bond index gained 1.97 %.

We expect yield spreads to keep expanding toward historical levels as investors reconsider the risk profile of lower-quality bonds. In the near term, this will likely result in the relative outperformance of high-quality bonds over lower-quality issues.

Market outlook

Despite the third quarter's ups and downs, investment returns have been strong again



news during third quarter

in 2007, particularly for equities around the globe. Earnings continue to be robust as well, allowing valuations to remain very reasonable at about 16 times the expected 2007 earnings. Given the relatively low levels of inflation and interest rates and the persistent strength of global economic growth, stocks continue to represent an attractive investment opportunity.

Considering the large number of adjustable-rate mortgage resets yet to occur through the end of 2008, we believe news from the mortgage area will be negative over the near term. The resulting excesses of weak lending standards and an overheated housing market will take awhile to work their way out of the system.

The negative impact of these factors will cause economic growth to slow the remainder of this year and into 2008; however, both the stock and bond markets have discounted this likelihood, so the primary risk going forward is that news flow and economic impact will be more negative than currently expected.

The Fed's decision to lower rates could be the most positive influence on stocks in the near term. Fed actions normally take several months to affect the economy, a factor the stock market builds into stock prices because, in addition to today's news, it considers what is expected to happen over the next six to 12 months.

Lower interest rates typically lead to better economic growth and better financial asset performance. The S&P 500 gained an average 13.70% in the 12-month periods following the seven initial rate cuts since 1985; in six of those occasions, the index gained at least 11% over the next 12 months. Considering that current valuation levels are reasonable, the prospects for stocks appear to be good in the short to intermediate term.

* * *

We remain mindful of risks present in the economy and the markets. The return

of volatility to the markets this summer is a reminder to all investors that appropriate asset allocation is still the most effective way to lower portfolio risk. After four years of

strong investment results, now is a great time for investors to review portfolio structure to ensure it is consistent with their objectives going forward. ♦♦♦

As retirement landscape changes, update planning method

by Chad Tillery, Wealth Advisors,
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Now more than ever, you must take more responsibility for managing your financial assets and ensuring you have sufficient means to meet your retirement needs.

For those who have retired, or are nearing retirement, transitioning from the accumulation phase to the distribution phase can be complex, often because the landscape of retirement distribution planning has changed. That's when support from a qualified financial planner can help make a difference.

Income distribution plan can help balance & protect

There are four main sources of retirement income available to most individuals:

- ✓ Social Security
- ✓ Employer-based plans
- ✓ Personal savings
- ✓ Post-retirement employment

Analyzing the timing and withdrawal priority of each source above can result in tax benefits, but, more importantly, it can increase your odds of meeting retirement objectives. Are your goals asset longevity, wealth transfer or a balance between the two? A financial planner can help you consider your needs and determine the best

distribution strategy for meeting them.

Established wealth management firms also offer defined distribution methodologies designed to meet income needs, while protecting against the eroding effect of inflation over time.

A financial planner can also help you evaluate your personal Social Security decision: As a general rule, delaying the initiation of Social Security benefits past age 62 may better position you to manage the investment and longevity risks associated with the distribution phase.

Planning landscape keeps changing

Another reason the retirement distribution planning landscape is changing is because most employers no longer offer defined benefit plans. The *Employee Retirement Income Security Act of 1974* (ERISA) guarantees pension benefits that are already accrued, but ERISA doesn't require

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As retirement landscape changes, update . . .

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employers to keep providing such benefits in the future.

To attract and retain employees, some employers continue to offer defined benefit plans, which have grown quite costly to administer. Many such plans have been frozen by employers and replaced with defined *contribution* plans, *e.g.*, 401(k) plans, that require employees to assume the risks of investing their own retirement assets.

Traditional retirement distribution planning is based on increasing your tax deferral, but—in certain circumstances—a different, nontraditional strategy may yield better after-tax results.

For example, in 2010, you'll be able to convert a traditional or rollover individual retirement account (IRA) to a Roth IRA, regardless of your income level. If you convert your IRA to a Roth, you can spread your tax owed over two tax years, 2011 and 2012. In addition, Roth IRAs are exempt from the required minimum distribution rules that force you to take annual withdrawals after age 70½.

The biggest beneficiaries of this change may be high-income employees who rolled a former employer's 401(k) into a traditional IRA and now wish to convert some or all of that money into a Roth. Depending on your circumstances, it may be wise to convert your traditional or rollover IRA into a Roth.

Boomers may redefine traditional retirement

For many baby boomers entering the distribution phase, retirement may not signal an end to their working lives. If you belong to this generation, you may do one or more of the following:

- ✓ Change the nature of the work you do or decide to work fewer hours
- ✓ Continue working to supplement your retirement income:
 - Because you need more funds to support or elevate your lifestyle
 - Because you were unable to save enough during the accumulation phase
- ✓ Continue working to keep your health insurance benefits
- ✓ Decide to do a different kind of work you may not have had the opportunity to pursue earlier in life, including voluntary charitable or humanitarian activities

Finally, many baby boomers may continue to work simply because they enjoy the mental stimulation and the challenges work provides during this phase of life.

* * *

It would be convenient if a one-size-fits-all solution were available to address every retirement planning issue and chal-

lenge that the distribution phase raises, but such a solution has yet to be discovered. In the meantime, contact your BKD Wealth Advisor to learn how a qualified financial planner can guide you through this changing landscape. We can help you determine a strategy for managing your tax liabilities and help you increase your retirement assets—for you and your heirs. ♦♦♦

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