

Year packed with change; more change likely with political shift

2008 has been a year filled with multiple tax law changes. This year-end edition of the **BKD Advisor** will discuss the recently passed *Emergency Economic Stabilization Act*, *Energy Improvement Act* and the *Tax Extenders and Alternative Minimum Tax*

Relief Act. It also includes various tax tables, reminders and year-end planning ideas.

The recent presidential and congressional elections and the subsequent shift in political power will likely bring changes in policies and tax laws.

In the year to come, please stay in contact with your BKD tax advisor. As always, it is important to follow the various developments in tax and federal law. Your BKD advisor can help you analyze the impact of any new legislation. ♦♦♦

New tax laws have multiple, important provisions

The *Emergency Economic Stabilization, Energy Improvement and Extension, and Tax Extenders and AMT Relief Acts of 2008* and other recent tax legislation (the new tax laws), enacted October 3, 2008, have a number of provisions:

- ✓ Disaster relief
- ✓ Alternative minimum tax (AMT) relief
- ✓ Relief for community banks
- ✓ Energy incentives and other new relief provisions
- ✓ Extensions for several tax breaks set to expire and other provisions

Following is a brief summary of the more notable tax provisions.

Disaster Relief

The provisions passed with the new tax laws provide tax relief for businesses and individuals affected by presidentially declared disasters.

The following temporary tax relief provisions apply to all taxpayers affected by presidentially declared disasters.

These do not apply to the Midwestern disaster area except where noted. See the additional information for Midwestern disaster relief provisions.

- ✓ Limits on personal casualty losses are waived for disasters in 2008 and 2009 and such losses can be deducted whether the taxpayer itemizes deductions or not
- ✓ Qualified disaster net operating losses from disasters declared in 2008 and 2009, can be carried back five years and are deductible against 100 percent of AMT income
- ✓ Taxpayers may expense qualified disaster expenses (cleanup, demolition and repair) that otherwise must be capitalized
- ✓ Increased Section 179 expensing and 50 percent bonus depreciation for qualifying disaster property, which rehabilitates or replaces property damaged in the disaster

Temporary tax relief provisions apply to taxpayers in a Midwestern

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disaster area (Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin) that were declared major disaster areas by the President on or after May 20, 2008, and before August 1, 2008, due to floods, severe storms and tornadoes. Tax relief provisions apply to all counties in these states and include:

- ✓ Increased Section 179 expensing and 50 percent bonus depreciation for qualifying property that rehabilitates or replaces property damaged in the disaster
- ✓ Relief for disaster victims who take loans or early distributions from an IRA or qualified retirement plan
- ✓ Limits on personal casualty losses are waived
- ✓ Additional \$500 exemption is available for 2008 or 2009 for taxpayers who house people displaced in the Midwestern disaster area
- ✓ Discharges of nonbusiness debt of affected individuals are excluded from income

Additional notable temporary tax relief provisions apply to the hardest hit counties in the Midwestern disaster area:

- ✓ Additional low-income housing credit allocations for 2008 through 2010
- ✓ Taxpayers may elect to expense 50 percent of demolition and debris removal costs otherwise required to be capitalized
- ✓ Expensing of qualified environmental remediation expenditures
- ✓ Increased rehabilitation tax credit
- ✓ Net operating loss (NOL) carryback period is extended from two to five years for qualified disaster recovery losses and can offset 100 percent of AMT (instead of 90 percent)
- ✓ Hope and Lifetime Learning credit maximums are doubled in 2008 and 2009 for the higher education expenses of students attending eligible

education institutions located in the Midwestern disaster area

- ✓ Value of up to six months of lodging provided to qualified employees and their families is excluded from employees' income
- ✓ Thirty percent employer housing tax credit for up to six months lodging provided to employees and their families
- ✓ Credit for qualifying employers for retaining employees of inoperable facilities
- ✓ Temporary suspension of limitations on charitable deductions for qualified Midwestern disaster area donations
- ✓ Charitable standard mileage rate for Midwestern-related relief is increased to 70 percent of business mileage rate (from 14 cents per mile to 41 cents per mile) from the disaster date through December 31, 2008
- ✓ Volunteers donating services for Midwestern-related relief can exclude from income mileage reimbursements from the disaster date through December 31, 2008

The hardest hit counties include:

Arkansas: Arkansas, Benton, Cleburne, Conway, Crittenden, Grant, Lonoke, Mississippi, Phillips, Pulaski, Saline and Van Buren

Illinois: Adams, Calhoun, Clark, Coles, Crawford, Cumberland, Douglas, Edgar, Hancock, Henderson, Jasper, Jersey, Lake, Lawrence, Mercer, Rock Island, Whiteside and Winnebago

Indiana: Adams, Bartholomew, Brown, Clay, Daviess, Dearborn, Decatur, Gibson, Grant, Greene, Hamilton, Hancock, Hendricks, Henry, Huntington, Jackson, Jefferson, Jennings, Johnson, Knox, Lawrence, Madison, Marion, Monroe, Morgan, Owen, Parke, Pike, Posey, Putnam, Randolph, Ripley, Rush, Shelby, Sullivan, Tippecanoe, Vermillion, Vigo, Washington and Wayne

Iowa: *All counties other than Buena*

Vista, Calhoun, Carroll, Cherokee, Clay, Dickinson, Emmet, Ida, Jefferson, Lyon, O'Brien, Osceola, Palo Alto, Plymouth, Pocahontas, Sac, Shelby, Sioux, Taylor, Wayne and Woodbury

Missouri: Adair, Andrew, Barry, Callaway, Cass, Chariton, Clark, Gentry, Greene, Harrison, Holt, Jasper, Johnson, Lewis, Lincoln, Linn, Livingston, Macon, Marion, Monroe, Newton, Nodaway, Pike, Putnam, Ralls, St. Charles, Stone, Taney, Vernon and Webster

Nebraska: Buffalo, Butler, Colfax, Dawson, Douglas, Gage, Hamilton, Holt, Jefferson, Kearney, Platte, Richardson, Sarpy and Saunders

Wisconsin: Adams, Calumet, Columbia, Crawford, Dane, Dodge, Fond du Lac, Grant, Green, Green Lake, Iowa, Jefferson, Juneau, Kenosha, LaCrosse, Manitowoc, Marquette, Monroe, Milwaukee, Ozaukee, Racine, Richland, Rock, Sauk, Sheboygan, Vernon, Walworth, Washington, Waukesha and Winnebago

Alternative minimum tax relief

The new tax laws extend temporary, partial relief from the AMT to individual taxpayers. Without this relief, millions of additional taxpayers would be subject to the AMT.

The AMT is a parallel tax system, which does not permit several of the deductions permissible under the regular tax system, such as state, local and property taxes. If a taxpayer's liability is greater under the AMT system, that is what the taxpayer owes the federal government. Originally enacted to make sure wealthy Americans did not escape paying taxes, the AMT has started to apply to more middle-income taxpayers, in part because the AMT exemptions are not indexed for inflation.

In recent years, Congress has provided successive one-year patches and has again done so for 2008. Under the new

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law, for tax years beginning in 2008, the AMT exemption amounts are increased to \$69,950 in the case of married individuals filing a joint return and surviving spouses; \$46,200 in the case of unmarried individuals other than surviving spouses and \$34,975 in the case of married individuals filing a separate return. This raises the AMT exemption amounts enough to keep most middle-income taxpayers out of the AMT.

The new law also provides AMT relief for taxpayers claiming personal tax credits. The tax liability limitation rules generally provide that certain nonrefundable personal credits (including the dependent care credit, the elderly and disabled credit and the Hope Scholarship and Lifetime Learning credits) cannot offset AMT.

However, temporary provisions permitted these credits to offset the entire regular and AMT liability through the end of 2007. The new law extends this temporary provision, beginning in 2008.

Another provision in the new law liberalizes the AMT refundable credit amount that was first enacted in 2006 to help taxpayers who were stung by the AMT because of exercising incentive stock options (ISOs).

Under the regular tax, ISOs are not taxed upon exercise. Under the AMT, however, a taxpayer must pay tax on the stock value when the option is exercised. The economic downturn in 2000 resulted in many individuals having to pay tax on "phantom income" because the stock prices dropped dramatically after the date of exercise. In 2006, Congress provided relief for these situations but did not correct the problem entirely.

The new law provides additional relief to affected taxpayers by accelerating the refund of taxes paid on the phantom income and by stopping further IRS efforts to collect those taxes. Specifically, the new law allows 50 percent of long-term unused minimum tax credits to be refunded over each of two years (instead

of 20 percent over each of five years as was allowed under the old law). This eliminates a rule that limited the relief available to higher-income taxpayers and abates any underpayment of tax outstanding on the date of enactment related to ISOs and the AMT, including interest.

Tax relief for community banks

Fannie Mae (FNMA) and Freddie Mac (FRMC) preferred stock holdings became almost worthless when the government bailed those companies out. Some community banks have already sold these holdings and others may do so in the future. Without a tax law change, these community banks would have had capital losses on the sale of these holdings that they could use only to offset capital gains.

The new legislation allows community banks to treat recognized losses on their FNMA and FRMC preferred stock as ordinary losses that can offset ordinary taxable income. This provision applies only to FNMA and FRMC preferred stock owned on September 6, 2008, or sold between January 1, 2008, and September 6, 2008.

Energy tax incentives

The new tax laws also include a package of energy-related tax incentives designed to spur investment and create jobs in the renewable energy industry.

Key provisions include:

- ✓ The suspension of the taxable income limit for depreciating a marginal oil or gas well is extended for 2009
- ✓ The renewable energy production tax credit is extended through 2009 in the case of wind and refined coal and through 2010 in the case of other sources. The types of facilities qualifying for the credit are expanded to include new biomass facilities and those that generate electricity from marine renewables, *e.g.*, waves and tides
- ✓ The 30 percent investment tax credit for solar energy property and qualified fuel cell property, as well as the 10 percent investment tax credit for

microturbines, are extended through 2016. The cap for qualified fuel cells is increased and small commercial wind is added as a category of qualified investment. A new 10 percent investment tax credit is provided for combined heat and power systems and geothermal heat pumps. These credits may be used to offset the AMT

- ✓ The credit for residential solar property is extended through 2016, and the \$2,000 credit cap for solar electric investments is removed. Residential small-wind investments, capped at \$4,000, and geothermal heat pumps, capped at \$2,000, are added as qualifying property. The credit may be used to offset the AMT
- ✓ The new law provides \$1.5 billion in new tax credits for the creation of advanced coal electricity projects and certain coal gasification projects that demonstrate the greatest potential for carbon capture and sequestration technology
- ✓ The new law provides a credit of \$10 per ton for the first 75 million metric tons of carbon dioxide captured and transported from an industrial source for use in enhanced oil recovery and \$20 credit per ton for carbon dioxide captured and transported from an industrial source for permanent storage underground
- ✓ Consumers may claim a tax credit of \$2,500 to \$7,500 for the purchase of a plug-in electric car or light truck, depending on the capacity of the battery. The credit is available against the AMT
- ✓ Employers are allowed to provide employees who commute to work by bicycle limited fringe benefits to offset the costs, such as storage
- ✓ The provision allowing taxpayers to immediately write off 50 percent of the cost of facilities that produce cellulosic biofuels is expanded to include production of other cellulosic biofuels in addition to cellulosic ethanol
- ✓ The \$1-per-gallon production tax credit for biodiesel and the 10-cents-

provisions; more changes likely as balance

per-gallon credit for small biodiesel producers are extended through 2009. The \$1-per-gallon production tax credit for diesel fuel created from biomass is also extended. Biodiesel imported and sold for export is not eligible for the credit effective May 15, 2008

- ✓ The 30 percent credit for alternative refueling property, such as natural gas or E85 pumps, is extended through 2010. Electric vehicle recharging property is added to the types of property eligible for the credit. The credit for hydrogen refueling property is unchanged
- ✓ The tax credit for energy-efficient existing homes is extended for 2009 and is expanded to include energy-efficient biomass fuel stoves as a new class of energy-efficient property eligible for a consumer tax credit of \$300
- ✓ The law allowing taxpayers to deduct the cost of energy-efficient property installed in commercial buildings is extended through 2013
- ✓ The provision allowing contractors to receive a credit for the construction of energy-efficient new homes is extended through 2009
- ✓ The provision allowing manufacturers to receive a tax credit for the production of energy-efficient appliances is extended through 2010, and the credit's standards and amounts are increased
- ✓ The depreciable life of smart meters and smart grid systems is reduced from 20 years to 10 years
- ✓ Taxpayers can claim accelerated depreciation for purchases of equipment used to collect, distribute or recycle a variety of commodities

The energy changes are offset by mandatory basis reporting to IRS by brokers on transactions involving publicly traded securities acquired after 2010; freezing the Code Section 199 manufacturing deduction at 6 percent (the deduction had been scheduled to increase to 9 percent in 2010 under the old law)

for domestic manufacturing activities of major U.S. oil and gas companies; extending the *Federal Unemployment Tax Act* surtax through 2010; tightening the rules by which oil and gas companies pay taxes on income earned overseas; and making general fund monies available with increased payments into the oil spill liability trust fund as new drilling is considered.

Mortgage debt relief

The new law assists homeowners who are caught in the current mortgage crisis and trying to keep their homes. For income tax purposes, a discharge of indebtedness or forgiveness or relief of debt is generally taxable, subject to certain exceptions, such as bankruptcy. Under pre-2007 tax law, no special rules applied to discharges of acquisition debt on the taxpayer's principal residence. Under 2007 tax legislation, taxpayers are generally allowed to exclude up to \$2 million of mortgage debt forgiveness on their

principal residence. This relief provision was to expire at the end of 2009, but the new law extends it through 2012.

Executive compensation

Under the new law, when more than \$300 million of a company's assets are purchased by the U.S. Treasury Department through an auction, "golden parachute" payments are banned for top executives hired while the Treasury rescue is in effect and tax provisions kick in to strengthen the tax treatment of remaining executive compensation and severance packages.

Specifically, the deductibility of executive compensation for companies will be cut in half from pre-act levels, and companies will also lose deductions available under pre-act law for excessively large severance packages. Executives receiving severance packages will continue to face a 20 percent excise tax on payments once they reach an excessive threshold, and that tax will be due if the executive leaves

Do you need to tidy up? Put year-

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The holidays are quickly approaching and before you know it 2008 will be over. In anticipation of the new year, now is a good time to do some "financial housekeeping" to take care of those last-minute items and to prepare our financial lives for January 1. Here are some things you can do to get ready for 2009:

Double check your IRA distributions. If you are at least 70½ years old and have to take the Internal Revenue Service mandated annual required minimum distribution from your IRA, make sure the proper amount will

have been withdrawn by December 31. Forgetting to take a required distribution or failing to take the proper amount will result in a 50 percent tax penalty on the amount not withdrawn. The IRA owner does have the option to delay the first required distribution to the year after they turn age 70½; however doing so will result in having to take two distributions the following year. The delayed distribution will need to be taken by April 1 of the year after the IRA owner turns age 70½, and a second by December 31 for the current calendar year. Taking two distributions in the same year will increase the owner's taxable income for that current year.

Look at college savings. Parents con-

of power shifts in federal government

for reasons other than a standard retirement for which he or she is eligible—not just if the company changes hands, as in pre-act law.

Extension of certain other provisions

The following provisions that were set to expire have been extended through 2009:

- ✓ Option to deduct state and local general sales taxes
- ✓ Above-the-line tax deduction for qualified higher education expenses
- ✓ Provision allowing teachers an above-the-line deduction for up to \$250 for educational expenses
- ✓ Provision allowing qualified taxpayers to make tax-free contributions from their IRA plans to qualified charitable organizations
- ✓ Standard deduction for real property taxes for nonitemizers

- ✓ Research tax credit
- ✓ 15-year write off for qualified leasehold, restaurant and retail improvements
- ✓ Favorable Subchapter S basis rules for gifts of appreciated property
- ✓ Qualified zone academy bonds
- ✓ Native American employment credit
- ✓ Accelerated depreciation for business property on Native American reservation
- ✓ Tax credit for certain expenditures for maintaining railroad tracks
- ✓ Seven-year recovery period for certain motorsports racetrack property
- ✓ New markets tax credit
- ✓ Enhanced charitable deduction for qualified computer contributions
- ✓ Tax incentives for investments in the District of Columbia
- ✓ Enhanced charitable deduction for food inventory

- ✓ Enhanced charitable deduction for contributions of book inventory to schools
- ✓ Special expensing rules for certain film and television productions
- ✓ Exception under Subpart F for active financing income

The new legislation offsets the cost of the tax break extensions by eliminating the deferral of tax by hedge fund managers and others. This elimination would apply to deferred compensation income held in offshore accounts and other corporate structures by requiring the hedge fund managers and others to account for it as it accrues. ♦♦♦

end financial housekeeping to work for you

tributing to a 529 college savings plan may be eligible for a state income tax deduction by contributing to either their home state's sponsored 529 plan or another state's sponsored plan by December 31. The tax deduction varies by state, so contact the sponsor of the state's plan or visit its website to determine the maximum deduction allowed to open an account and make contributions.

Consider taking some losses.

Investment losses are not a four-letter word. Now is a great time to consider tax loss harvesting, that is, selling investments at a loss to offset current and potential future year capital gains. With systematic portfolio rebalancing, you can identify investments that have not

lived up to expectations and need to be replaced or spot perfectly good investments that have a current loss because of market conditions and sell those to realize the loss. That loss can be used to eliminate any realized capital gains in that year plus \$3,000 of ordinary income for a married couple. Any remaining loss can be carried over to future tax years to offset capital gains. A word of caution though: purchasing the same security within 30 days before or after selling the investment will disallow realization of the loss under the "30-day wash sale rule."

Be strategic about mutual funds. Say you have appreciated mutual fund shares that are candidates to sell before year end and have been held for more than

12 months in a taxable brokerage, mutual fund or investment account. Selling before the December dividend and/or capital gains distribution will avoid having additional, taxable ordinary income. Selling prior to the ex-dividend date will also exclude your shares from the dividend distribution.

On the flip side, if you want to make year-end mutual fund purchases, wait until after the dividend and/or capital gains distribution, otherwise you will get back money you just invested and owe taxes on it. To determine the ex-dividend date and anticipated payout amount, contact the mutual fund company or visit its website. With this information in

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INDIVIDUAL YEAR-END TAX PLANNING STRATEGIES

- ✓ When gifting income-earning assets to your children in a lower tax bracket, consider the recently revised, and more strict, kiddie tax rules. These rules tax unearned income for kids under age 19 (and most college students under age 23) at parents' tax rates. Also consider that assets in a child's name may affect eligibility for college financial aid.
- ✓ Consider extensive planning with a BKD advisor to take advantage of the 0 percent capital gains rates that are in effect for 2009 for certain situations.
- ✓ If your boat or RV has sleeping, cooking and toilet facilities, it may qualify as a second home, making it interest deductible. If it qualifies, make sure you ask any lenders for the interest

expense associated with the RV. Many times this information is not regularly provided.

- ✓ Stock market declines can lead to a tax trap for people who exercised incentive stock options earlier in the year when the stock price was higher. The gain on the option may have created an AMT liability that is recognized despite the fact that the stock price has since fallen. In effect, you could owe tax on a larger amount than the stock is currently worth. If you are in this situation and don't have the cash to pay the additional tax, consider selling the acquired shares by year end to eliminate the AMT.
- ✓ Consider converting traditional IRAs to Roth IRAs in the current year if income levels allow the qualification to do so. As many stock prices are down, any appreciation of IRAs will be down as well, allowing for decreased tax consequences.
- ✓ Lower-income individuals may claim a tax credit for elective deferral contributions to qualified plans and IRAs.
- ✓ If current income is substantially higher than last year, be careful when you pay your state taxes in order to avoid AMT consequences associated with higher state tax deductions in the following year.
- ✓ When making year-end charitable contributions be sure to receive and retain all appropriate documentation from the organization. Additionally, before you donate appreciated property, consult your BKD advisor for information related to appropriate documentation requirements and any potential consequences associated with the contribution.
- ✓ Consider gifting away assets out of large estates, given the likelihood of a lower appraisal of assets in today's market. In addition, consider gifting a gift

Individual tax rate & schedule

Status	2008 Rates		Estimated 2009 Rates*	
	Rate	Bracket	Rate	Bracket
Single	10%	\$0 - 8,025	10%	\$0 - 8,350
	15%	7,826 - 31,850	15%	8,351 - 33,950
	25%	31,851 - 77,100	25%	33,951 - 82,250
	28%	77,101 - 160,850	28%	82,251 - 171,550
	33%	160,851 - 349,700	33%	171,551 - 372,950
35%	Over 349,700	35%	Over 372,950	
Head of Household	10%	\$0 - 11,450	10%	\$0 - 11,950
	15%	11,451 - 42,650	15%	11,951 - 45,500
	25%	42,651 - 112,650	25%	45,501 - 117,450
	28%	112,651 - 182,400	28%	117,451 - 190,200
	33%	182,401 - 357,700	33%	190,201 - 372,950
35%	Over 357,700	35%	Over 372,950	
Married Filing Jointly & Surviving Spouses	10%	\$0 - 16,050	10%	\$0 - 16,700
	15%	16,051 - 65,100	15%	16,701 - 67,900
	25%	65,101 - 131,450	25%	67,901 - 137,050
	28%	131,451 - 200,300	28%	137,051 - 208,850
	33%	200,301 - 357,700	33%	208,851 - 372,950
35%	Over 357,700	35%	Over 372,950	
Married Filing Separately	10%	\$0 - 8,025	10%	\$0 - 8,350
	15%	8,026 - 32,550	15%	8,351 - 33,950
	25%	32,551 - 65,725	25%	33,951 - 68,525
	28%	65,726 - 100,150	28%	68,526 - 104,425
	33%	100,151 - 178,850	33%	104,426 - 186,475
35%	Over 178,850	35%	Over 186,475	
Trust	15%	\$0 - 2,200	15%	\$0 - 2,300
	25%	2,201 - 5,150	25%	2,301 - 5,350
	28%	5,151 - 7,850	28%	5,351 - 18,200
	33%	7,851 - 10,700	33%	8,201 - 11,150
	35%	Over 10,700	35%	Over 11,150

Long-term capital gains and dividends are subject to a maximum tax rate of 15% (0% for individual 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.

on December 31, 2008, and January 1, 2009, in order to use one appraisal for support of both gifts. This will save an additional price of an appraisal.

- ✓ If you are typically unable to itemize or are subject to phase-out limits for high income taxpayers, time your miscellaneous itemized deductions, medical expenses and other various itemized deductions in order to group these expenses into one year rather than spreading them out over multiple years.
- ✓ Real estate professionals should consider the advantages of owning an interest in low income housing groups in order to take advantage of the potential losses from real estate operations and the associated credits which can now offset both the regular tax and the AMT.
- ✓ If you are supporting your parents or relatives who have limited income streams, investigate whether or not you can claim additional dependency exemptions.
- ✓ Consider passive activity rules that allow grouping of activities based on certain criteria. BKD advisors can assist in helping you meet the grouping

criteria and possibly take advantage of potential losses generated by once passive entities related to other active activities.

- ✓ Track your participation hours in each business and make sure you review the hours during the year with your BKD tax advisor in order to determine which areas need be increased/decreased before year end in order to avoid limitations on losses from passive activities. ♦♦♦

Retirement plan contribution limits

Individuals age 50 and older can make elective catch-up contributions to their retirement accounts. The catch-up amounts are in addition to the existing contribution limits, making the maximum allowed elective deferral retirement contributions.

	2008	2009
401(k), 403(b), 457 & SAR-SEP Plans – younger than age 50	\$15,500	\$16,500
401(k), 403(b), 457 & SAR-SEP Plans – age 50 & older	\$20,500	\$22,000
Traditional & Roth IRAs – younger than age 50	\$5,000	\$5,000
Traditional & Roth IRAs – age 50 & older	\$6,000	\$6,000
SIMPLE Plans – younger than 50	\$10,500	\$11,500
SIMPLE Plans – age 50 & older	\$13,000	\$14,000

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 employees' pension accounts. The total sum of an employee's combined pension contributions can't exceed \$46,000 for 2008 and \$49,000 for 2009. 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 \$195,000 in 2009 from \$185,000 in 2008.

Kiddie tax

	2008	2009
Child's earnings limit to be exempt from Kiddie Tax	\$1,800	\$1,900

Gift exclusions

	2008	2009
Annual gift tax exclusion	\$12,000	\$13,000

BUSINESS YEAR-END TAX PLANNING STRATEGIES

- ✓ C corporations that significantly overpaid estimated taxes may use an expedited procedure to get cash back from the IRS as quickly as possible.
- ✓ To claim a current tax benefit from a partnership or S corporation loss, you must have adequate basis. If you anticipate a loss from your S corporation or partnership, you should consult with your BKD tax advisor regarding basis limitations.
- ✓ If you anticipate a loss from your business in the current year and anticipate profits in future years, you should consider accelerating income or deferring deductions in the current year. This will help equalize your taxable income and allow you to take consistent advantage of lower tax brackets.
- ✓ Accrue and deduct employer matching and profit-sharing plan contributions.
- ✓ Ensure the expanded 2008 Section 179 and reinstated bonus depreciation rules are explored during any end of the year capital budgeting meetings.
- ✓ Review methods of accounting for income and deduction items for opportunities to defer tax, *e.g.*, prepaid expenses, accrual vs. cash accounting, inventory methods, etc.
- ✓ C corporations should monitor double taxation through potential year-end bonuses to owners; however, remember to pay those bonuses before year-end.
- ✓ Businesses can accelerate depreciation deductions for significant real property acquisitions with a cost segregation study by BKD.
- ✓ Perform a study on other fixed assets to ensure they are being depreciated utilizing the correct method and life, especially assets utilized in retail and distributive trades or businesses, personal and professional service businesses.
- ✓ Consider foregoing bonus depreciation in order to advance unused research credits, AMT credits, and trapped foreign tax credits.
- ✓ Consider establishing a retirement plan before December 31, 2008. These could include a Simplified Employee Pension Individual Retirement Account (SEP IRA), traditional IRA, or a Roth IRA, among many others. Please consult your BKD advisor to consider the best fit for your circumstances.
- ✓ Consider looking into a personal and real property study to determine if your property is being over assessed or assessed when it should not be. Property taxes vary greatly by state, so please consult your local BKD office for further guidance.
- ✓ Consider disposing of unused or scrapped property that may remain on fixed asset schedules. This can accelerate deductions of remaining tax basis and reduce related property taxes.
- ✓ Think about a sales and use tax study to make sure your company is taking advantage of special exceptions the law provides as well as making sure your company is in compliance with ever-changing sales and use tax law.
- ✓ Consider a tax-basis inventory analysis to reduce inventory and correspondingly reduce taxable income. This might be even more valuable recently, as the IRS has emphasized inventory capitalization rules during examination.
- ✓ Closely held corporations whose income is largely from investment activities, including rental activities, interest, dividends and royalties, should consider the personal holding company rules. Personal holding company status could lead to unexpected double taxation. Corporations can consider electing S corporation status combined with paying out any corporation earnings and profits of the C corporation in order to avoid future double taxation. In addition, paying out earnings and profits now as qualified dividends can help assure taking advantage of the current favorable dividend rates in an ever-changing tax atmosphere.
- ✓ Consider an employee study to ensure your company is taking full advantage of potential employee credits such as the work opportunity credit and the various credits surrounding empowerment or enterprise zones.
- ✓ Consider a research and development (R&D) study to take advantage of potential R&D credits. Typically, wages and related employee expenses are the majority of R&D expenses.
- ✓ Have you taken advantage of the alternative fuel excise tax credit for forklifts operated on propane or natural gas? The potential tax savings is 50 cents per gallon of fuel.
- ✓ Calendar year accrual method taxpayers may attribute a full day of payroll to the previous taxable year by changing the employee holiday compensation policy to vest the New Years Day holiday on December 31 of the previous year.
- ✓ Accrual basis taxpayers should consider BKD assistance to consider if all relevant and material liabilities are being accrued to take full advantage of accelerating the deduction into the applicable year owed. ♦♦♦

Standard mileage rates

	Before 7/1/2008 Per Mile	After 6/30/08 Per Mile
Business	50.5¢	58.5¢
Charitable	14¢	14¢
Medical & Moving	19¢	27¢

Be sure to provide pre- and post- June 30 mileage information to your BKD advisor.

Travel rates

New simplified per diem travel rates became effective October 1, 2008. Employers can give employees these per diem allowances instead of reimbursing actual business travel expenses. Use of the per diem rates greatly simplifies recordkeeping requirements needed to substantiate deductions for business travel.

	Beginning October 2007	Beginning October 2008
Lodging, meals & incidentals - "high-cost localities"	\$237 per day	\$256 per day
Lodging, meals & incidentals - other localities	\$152 per day	\$158 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

A payor must treat meal and incidental expense allowances as a food and beverage expense generally subject to the 50% deduction limit.

Guidelines for deducting certain meals & entertainment expenses

While most meal and entertainment expenses are only 50 percent deductible, such costs for recreational, social or similar activities primarily for the benefit of employees who are not highly compensated employees are generally 100 percent deductible. Examples include food and beverages provided by the employer at a company picnic.

In addition to potential 100 percent deductible meal and entertainment expenses, the deductible percentage of the cost of food and beverages consumed while away from home by individuals

subject to the hours of service limitations of the Department of Transportation increases to 80 percent deductible for 2008 (up from 75 percent in 2007). Some examples of individuals subject to the hours of service limitations of the Department of Transportation are as follows:

- ✓ Air transportation employees (pilots, crew, etc.)
- ✓ Interstate truck operators and bus drivers
- ✓ Certain railroad employees and merchant mariners ♦♦♦

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. The report must be filed on or before June 30 of the following year.

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 percent 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. ♦♦♦

Health Savings Account contributions & how they affect federal tax deductions

Health Savings Accounts (HSA) are becoming more popular as a way to save taxes with a high deductible health insurance plan. When an S corporation makes an HSA contribution on behalf of an eligible employee who also is a more-than-2-percent shareholder, it can be treated as either a generally tax-free corporate cash distribution

to that shareholder-employee or a wage payment to that person.

If wage treatment applies, the HSA contribution amount is generally subject to Federal Income Tax (FIT) withholding and Federal Insurance Contributions Act (FICA) tax, but the amount of the contributions is deductible by the corporation. However, in general, if employer payments are made

for medical or hospitalization expenses under a plan for employees and their dependents, the HSA contribution amount treated as wages is not subject to FICA tax (FIT withholding still applies). Under either treatment, the shareholder-employee then claims an above-the-line deduction for the HSA contribution amount on the front page of Form 1040. ♦♦♦

Avoid penalties by timely filing Form 5471

The IRS has issued guidance encouraging taxpayers to submit delinquent Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, before January 1, 2009. After December 31, 2008, the IRS will begin to automatically assert penalties on late filed Form 1120, *U.S. Corporation Income Tax Return*, with Form 5471 attached. The penalty begins at \$10,000 for each annual accounting period to which Form 5471 is not timely remitted to the IRS with the associated Form 1120.

Although the IRS has not historically focused on penalties for late filed Form 1120 with Form 5471 attached, the increased number of Form 1120 being filed electronically has enabled the IRS to quickly determine which returns are filed late and therefore potentially subject to penalty. In order to avoid the penalty in the future, ensure that Form 1120 with Form 5471 attached are filed on time and by the 1120's extended due date. To correct any delinquently filed Form 1120 with Form 5471 attached, please consult your BKD advisor immediately. ♦♦♦

Health savings accounts

	2008 Self Only Coverage	2008 Family Coverage	2009 Self Only Coverage	2009 Family Coverage
High deductible health plan	\$1,100	\$2,200	\$1,150	\$2,300
Deductible contributions	\$2,900	\$5,800	\$3,000	\$5,950
Maximum out-of-pocket expense	\$5,600	\$11,200	\$5,800	\$11,600

Out-of-pocket expenses do not include the cost of insurance premiums. Catch-up contributions for an individual and spouse who have reached age 55 before the close of the tax year may make additional contributions up to \$900. For a limited time, a one-time transfer from an individual retirement account, health flexible spending account, or a health reimbursement arrangement can be made to an HSA.

Employment tax payment & reporting for disregarded entities

Beginning with wages paid in 2009, Internal Revenue Service regulations require “disregarded entities” to pay their own employment taxes and file their own tax reports. An employer identification number (EIN) will be required to file the necessary reports. Disregarded entities include single-member LLCs and Qualified Subchapter S subsidiaries (Q-Subs).

Regulations now treat a disregarded entity as a separate unit for purposes of employment taxes and related reporting requirements. The separate entity is

treated as a corporation for purposes of employment taxes and must make timely deposits of these employment taxes, file employment tax returns and issue W-2 statements to employees. This treatment is effective for wages paid on or after January 1, 2009.

The regulations also treat disregarded entities as separate entities for certain excise taxes, effective for liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008. ♦♦♦

Depreciation of certain vehicles

	Qualifying for First-year Bonus Depreciation	Not Qualifying for First-year Bonus Depreciation
Autos		
First year depreciation	\$10,960	\$2,960
Second year depreciation	\$4,800	\$4,800
Third year depreciation	\$2,850	\$2,850
Each succeeding year depreciation	\$1,775	\$1,775
Trucks, Vans & SUVs		
First year depreciation	\$11,160	\$3,160
Second year depreciation	\$5,100	\$5,100
Third year depreciation	\$3,050	\$3,050
Each succeeding year depreciation	\$1,875	\$1,875

FIN 48 proposed to affect nonpublic companies for periods after December 15, 2008

Financial Accounting Standards Board (FASB) interpretation of number 48 (FIN 48) was scheduled to become effective for all nonpublic entities whose financial statement period began after December 15, 2007. On October 15, 2008, the FASB proposed another one-year deferral of the effective date of FIN 48 for nonpublic companies. Thus, once the 30-day comment period

passes, FIN 48 will apply to nonpublic companies for periods beginning after December 15, 2008. The deferral represents a great opportunity to address tax positions for nonpublic clients during 2008 and 2009 in order to avoid unwanted financial statement disclosures concerning tax issues that do not have a greater than 50 percent likelihood of success on the issue's merits. ♦♦♦

2008 depreciation limits for business vehicles

The Internal Revenue Service has released the inflation-adjusted depreciation limits for business autos, light trucks and vans (including minivans) placed in service in 2008. Generally, the maximum annual depreciation deduction limits for these vehicles are close to what they were for vehicles that were placed in service last year; however, the dollar limits for the first and second years for business autos, light trucks and vans are \$100 lower than last year's figures. Moreover, for passenger automobiles, light trucks, and vans (heavy trucks, vans and SUVs built on a truck chassis and rated at more than 6,000 pounds gross, loaded vehicle weight are exempt from these limits) whose original use begins with the taxpayer and the vehicle is placed in service during 2008, the *Economic Stimulus Act of 2008* increases the otherwise applicable first-year limit by \$8,000, which makes the purchase of such vehicles in 2008 favorable for tax purposes. ♦♦♦

Deterioration in credit conditions affects e

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Second quarter economic growth was reported at a revised 2.8 percent, continuing to defy expectations of a slowdown. Despite the turmoil in the financial and housing industries, most other economic sectors grew nicely, fueled by rapid increases in U.S. exports. However, conditions changed greatly during the third quarter, as the credit crisis unfolded at an accelerated pace.

The Federal Reserve Bank (the Fed) was very active in the third quarter, as the condition of several large U.S. financial institutions deteriorated rapidly. In early September, the U.S. Treasury assumed control of both Fannie Mae and Freddie Mac as these entities succumbed to mortgage losses. These two government sponsored enterprises (GSEs) hold or guarantee about half of all U.S. mortgages, so even a small uptick in defaults causes severe consequences to their capital base.

Soon after, Lehman Brothers also surrendered to credit losses, filing for bankruptcy protection. In the same week, AIG, one of the country's largest insurers, was forced to seek an \$85 billion loan from the Fed to avoid bankruptcy, also due to losses on subprime related securities.

As concerns evolved to crisis for these major U.S. financial institutions, the U.S. Treasury and Federal Reserve Bank were compelled to develop a more comprehensive plan to stabilize the financial system. In late September they proposed the Troubled Asset Relief Program (TARP) to create a \$700 billion dollar fund that would buy these distressed mortgage securities from banks. After much debate, Congress eventually approved the pro-

gram; however, the fund is not expected to be up and running until the middle of the fourth quarter.

In the meantime, the government took several other measures designed to improve credit availability. It has increased the funds available through credit facilities to banks and brokers, developed a purchasing program for commercial paper to improve liquidity in this market, and the Treasury is considering direct capital investment in banks in order to shore up their balance sheets and improve lending conditions.

In summary, economic conditions deteriorated significantly in the month of September, primarily due to the escalation of circumstances in the financial sector. The availability of credit is crucial to economic growth. Without it, the prospect for a deep recession will increase, and employment conditions will worsen. To help keep this predicament from spreading to other parts of the economy, the Fed and Treasury are acting diligently to restore confidence and the flow of capital in our financial system. Their success in freeing capital flows will, in large part, determine the extent of the deterioration in economic conditions in coming months.

Stock markets decline globally

Stock markets around the world reacted in a rapid and extremely negative way to September's intensification of credit problems. Every U.S. economic sector sold off in September, with the broad S&P 500 index declining 9.08 percent. Global equities also declined across the board, with many international markets posting results worse than U.S. stocks. The major index returns for the third quarter and year-to-date are as follows:

Equity Index	3Q 2008	YTD 2008
S&P 500	-2.73%	-11.91%
S&P Mid-Cap 400	5.43%	-3.90%
Russell 2000	.58%	-9.37%
MSCI EAFE	-2.25%	-10.96%

So far in 2008, nine of the 10 economic sectors have posted double-digit declines, with only Consumer Staples stocks delivering positive results in the quarter, although down 5 percent for the year. What began as a sector-specific phenomenon of losses in the financial sector has now progressed to concern that a global recession will result. As evidence of this, financial sector shares were essentially flat in the third quarter while energy and materials stocks, whose shares had been driven up on worldwide commodity demand, were the worst performers with declines of more than 20 percent.

International stocks, after several years of out-performance vs. U.S. stocks, have posted sub-par results in 2008. The weakening dollar drove most of the excess return posted by international stocks through the end of 2007. The dollar has actually strengthened against other developed country currencies in 2008, but so far this year has been neutral to overall diversified international market returns.

Bonds performance also reflects challenging credit conditions

In conjunction with the escalating concerns in the stock market, nearly every area of the bond market came under pressure during the quarter as well. The flight-to-safety reaction pushed the benchmark 10-year Treasury note yield down to 3.82 percent from about 4.00 percent at the beginning of the quarter, causing Treasury bonds to be one of the few havens that provided positive re-

. . . put year-end financial housekeeping to work for you

. . . continue from page 5

hand, you can then strategically plan your sales/purchases to minimize taxable income from the transaction.

Simplify and consolidate. Simplifying your financial life and consolidating accounts can lessen the drudgery of recordkeeping and make management easier. If you have multiple brokerage accounts with the same owner or IRAs with the same owner, consolidating these down to one or two accounts of each type will reduce the amount of account statements, voting proxies and investment prospectuses received in the mail. It will also make it easier to identify any overlap and redundancy in investment holdings, which can put a crimp in the effectiveness of any portfolio strategy.

Get organized. To make filing this year's tax return smoother, why not begin organizing tax records now? Set aside a file folder titled "2008 Taxes" so when the December year-end investment account statements, interest and dividend records (1099), payroll and withholding statements (W-2) start rolling in, you will have a place set aside to store them until it is time to provide them to your tax preparer. Other information to file includes records of deductible expenses such as property taxes, business expenses, charitable contributions, mortgage interest statements, etc.

So there you have it, several simple tasks to prepare for the end of the calendar year and set yourself up for the next. ♦♦♦

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