

TAX NOTES & PERSPECTIVES

HIGHLIGHTS OF THE 2008 TAX ACTS

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Recently enacted legislation contains a number of tax changes; some will provide favorable tax breaks, while other provisions will result in higher tax liabilities. Our tax specialists are available to discuss how these changes may impact you.

Incentives for Business Owners

These incentives will expire at the end of 2008:

Bonus Depreciation

The Economic Stimulus Act of 2008 provides for accelerated depreciation by allowing a bonus first-year depreciation deduction of 50% of the adjusted basis of qualified property placed in service during calendar year 2008. In addition to the 50% deduction, the taxpayer can depreciate the remaining 50% of the adjusted basis. This generally includes most tangible personal property used in a business, such as equipment, vehicles, computers, and office equipment.

Enhanced Section 179 Deduction The threshold for the Section 179 depreciation deduction has increased significantly for

calendar year 2008 only. Small and medium sized businesses will be able to deduct more of the cost of certain types of property as an expense against income, instead of capitalizing and depreciating it. The maximum Section 179 deduction increases to \$250,000 (up from \$128,000 before the new law). The allowed 179 deduction will phase out once the business's purchases during the year exceed \$800,000 (up from \$510,000).

Extension of Popular Tax Breaks for Individuals

The following tax breaks have been extended through 12/31/2009:

- State and local sales tax deduction
- Higher education tuition deduction
- Teacher's classroom expense deduction
- Tax free IRA distributions for charitable purposes
- Accelerated leasehold and restaurant depreciation
- Research tax credit

Changes to Alternative Minimum Tax (AMT)

Several changes to the AMT are in place for 2008:

- Higher exemption levels
- AMT refundable credit is now recoverable in two years with no income phase-out
- Many personal credits will continue to offset the AMT in 2008.
- Residential energy credits can now offset AMT.

Changes for Owners of Vacation or Second Homes

Under current law, a taxpayer may exclude from income up to \$250,000 of gain (\$500,000 for married couples) from the sale of a home owned and used by the taxpayer as a principal residence for at least 2 of the 5 years prior to the sale.

Prior law permitted taxpayers to convert a vacation or rental home to their principal residence, live in it for two years, sell it and take the full exclusion available for principal residences.

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TAX LAW CHANGES MAY IMPACT TAX PLANNING

Tax Changes Proposed by President-Elect Obama

President-Elect Obama has proposed several tax increases for taxpayers earning over \$250,000. These include increasing the top two income tax brackets to 36% and 39.6% and increasing the top qualified dividend and capital gains rate from 15% to 20%.

Consider taking advantage of current lower rates using the following tax strategies:

Sell Long-Term Capital Gain Property- Consider selling capital assets, including stock, held at least one year by December 31, 2008 to lock in a 15% rate.

Pay Qualified Dividends in 2008- Closely held corporations should consider paying dividends in 2008 to lock in the current maximum rate of 15% at the shareholder level.

Deferral or Acceleration of Income- Under President-Elect Obama's tax proposals, taxpayers with taxable income exceeding \$250,000 stand a good chance of seeing regular income tax rates and self-employment tax rise in the future. If that were to happen in 2009, it may pay to accelerate income from 2009 to 2008. If a taxpayer expects to be in a lower or similar bracket in 2009, it may pay to defer taxable income from this year to next. For example, if you are self-employed and a cash-method taxpayer, you can postpone taxable income by waiting to send out some client invoices until next year.

TAX PLANNING IN A DOWN MARKET

Current market conditions may require changes to taxpayers' year-end tax strategies.

Mutual Fund Sales Prior to Year-End

Mutual funds typically make capital gain distributions near the end of the year. Even if your investment is down in value for the year or if you are a new investor in a particular mutual fund, these capital gain distributions will be taxable to you in 2008. Mutual fund investors should consider selling these funds prior to capital gain distributions, or should consider offsetting the capital gain distributions by recognizing other losses in their portfolios.

Hedge Fund Capital Gains

Although many hedge funds may be reporting economic declines in the current market, these funds may still pass through significant capital gains to their owners during 2008. This results from hedge fund managers selling off long held appreciated assets to satisfy requests for fund redemptions. Taxpayers should contact fund managers to determine expected flow through income for 2008, so they can incorporate expected gains in their year end planning.

Consider 'Wash Sale' Rules When Selling Stock

For some taxpayers, selling securities at a loss to offset earlier gains can be a good idea. If you have realized gains from sales of securities earlier in the year, take a close look at your portfolio with a view to selling some of the losers—those shares that now show a paper loss. However, care should be taken to avoid triggering the 'wash sale' rules.

These rules prohibit deducting the loss if "substantially identical" securities are purchased with 30 days before or after the sale. For those investors wanting to remain in the same market niche, it is possible to maintain the balance of your portfolio by re-purchasing similar securities. Purchasing securities in the same industry is not considered "substantially identical." For example, sell stock in one software company and buy stock in another software company or sell stock in the banking industry and repurchase a different stock in the banking industry. If holding the same security is important, make sure the repurchase occurs more than 30 days before or after the loss sale to avoid the 'wash sale' rules.

Under 'wash sale' rules, mutual fund owners should be careful of dividend reinvestment plans since the reinvestment is considered a purchase of "substantially identical" securities and the loss would be disallowed.

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ADDITIONAL PLANNING STRATEGIES (CONTINUED)

Roth IRA Conversion

Unlike traditional IRAs, distributions from Roth IRAs generally are not subject to income taxes. A traditional IRA can be converted to a Roth IRA if (1) the taxpayer's modified adjusted gross income does not exceed \$100,000, and (2) the taxpayer isn't a married individual filing a separate return. The distribution from the traditional IRA is taxable, but the 10% premature distribution penalty doesn't apply. The depressed condition of the market makes it an opportune time to convert traditional IRAs into Roth IRAs for those taxpayers who are eligible to do so.

Zero Percent Tax Bracket

For 2008 through 2010, the federal income tax rate on long-term capital gains and qualified dividends is 0% when the income would otherwise fall within the 10% or 15% regular federal income tax brackets. This low rate has an impact not only on lower-bracket individuals but also, surprisingly, on some whose taxable income is well in excess of 15% tax bracket. The amount of income taxed at 0% depends on the interplay between an individual's filing status, his taxable income, and how much of that taxable income consists of long-term capital gains and qualifying dividend income.

While your income may be too high to benefit from the 0% tax rate, you may have children or grandchildren who will be in one of the bottom two tax brackets. If those individuals aren't subject to Kiddie Tax, consider giving them some appreciated stock which they can sell tax free under this provision.

Changes in the Estate Tax Exemption

In 2009, the federal estate tax exemption will increase to \$3,500,000 per individual. Please note that the lifetime gift tax exemption will remain at \$1,000,000 per individual and the Washington State estate tax exemption will remain at \$2,000,000 per individual. These differences in exemptions may require modifications to your estate plan.

Annual Exclusion Increase

The gift tax annual exclusion will increase to \$13,000 in 2009, up from \$12,000 in 2008. This higher amount should be incorporated into your 2009 gift tax planning.

Bunching Itemized Deductions

If you are generally close to the 7.5% floor for the deduction of medical expenses or the 2% floor for the deduction of miscellaneous expenses, 'bunching' (pre-paying next year's expenses this year) medical and miscellaneous expenses may help you exceed those minimum thresholds.

Leverage Standard Deduction by Bunching Deductions

Are your 2008 itemized deductions likely to be just under, or just over, this year's standard deduction amount? If so, consider the strategy of bunching together itemized deductions every other year, while claiming the standard deduction in the intervening years.

ALTERNATIVE MOTOR VEHICLE TAX CREDIT

The IRS has acknowledged the certifications by manufacturers that certain advanced lean-burn technology vehicles qualify for the alternative motor vehicle tax credit. Before, only hybrid vehicles, fuel cell vehicles and alternative fuel vehicles had been certified, but now certain advanced lean-burn technology vehicles, which generally run on diesel fuel have been certified. The qualifying vehicles and their credit amounts are:

- 2009 Volkswagen Jetta 2.0L TDI Sedan manual or automatic — \$1,300
- 2009 Volkswagen Jetta 2.0L TDI SportWagen manual or automatic — \$1,300
- Mercedes GL 320 BLUE TEC — \$1,800
- Mercedes R 320 Blue TEC — \$1,550
- Mercedes ML 320 Blue TEC — \$900

ELDER CARE AND LONG TERM CARE INSURANCE

People over 65 represent the fastest growing segment of the U.S. population. Adult children face a difficult challenge in helping parents make the right choices.

Financial advisors have developed detailed strategies for dealing with aging parents which include a combination of open family discussions, long-term care insurance, and pro-active management of parents' assets. Careful planning can help to mitigate much of the emotional and financial stress that caring for an aging parent or family member entails. There are many resources available today to help with these tasks. These include:

Daily Money Manager – these individuals go through mail, pay bills, balance the checkbook, and keep track of medical bills and Medicare forms for an hourly fee. American Association of Daily Money Managers can provide referrals.

Geriatric Care Manager – Private consultants to help guide families through the health care and long-term

health care systems. They can help assess the individual's situation and develop a plan. They can even continue to monitor the care the family member is receiving. Elder care attorneys can provide referrals. (On-line resources are available; see links on our website.)

Long term care insurance policies cover traditional costs of long-term healthcare. The estimated cost of a one year's stay in an assisted living facility is nearly \$36,000. Home health care averages \$19/hour and one year in a private room at a nursing home is \$78,000 and in high cost areas can be as much as \$135,000 year. These amounts are expected to triple over the next 20 years. **

Coverage varies widely depending on the policy. Some policies may only cover nursing home care while others offer coverage for a whole range of care, including care provided by informal caregivers, such as friends or family. Insurance experts indicate that the middle and upper middle class can benefit most from long-term care insurance, as they could see their savings devastated by long-term care expenses.

** Source: MetLife Mature Market Institute

IDENTITY THEFT THROUGH TAX SCAMS

The Internal Revenue Service cautions taxpayers about a new wave of scams using the IRS name in identity theft e-mails, or phishing. In 2008 so far, taxpayers have reported about 1,600 phishing incidents to the IRS. Most scams consist of e-mails requesting detailed personal information. Taxpayers should note that the IRS generally does not send e-mails, discuss tax account matters with taxpayers in e-mails, and does not request security-related personal information, such as PIN numbers, from taxpayers.

Refund e-Mail Scam Several variations of the refund scam exist. An e-mail claiming to come from the IRS falsely informs the recipient that they are eligible for a tax refund for a specific amount. The bogus e-mail instructs the recipient to click on a link to access a refund claim form. The form requests personal information that the scammers can use to access a bank or credit card account.

Substitute Form 1040 Fax Scam This scam consists of a faxed cover letter and form. The letter is addressed "Dear Valued Tax Payer (sic)" and appears to be signed by an IRS employee. It says that the IRS is updating its files and recipients who supply the

requested information will receive a nominal tax refund. It also states that those who fail to immediately return the completed form risk additional tax and withholding.

Company Report Scam This e-mail appears to come from an IRS.gov e-mail address, addresses recipients by name and references the company the recipient works for. These personalized details may convince the recipient that the e-mail is legitimate. The e-mail says that the IRS has a report on the company and asks the recipient to review a copy by clicking on a link to download the report. However, when the link is clicked, malware is downloaded to the recipient's computer.

How Scams Work The goal of a scam is to trick people into revealing personal and financial information, such as Social Security, bank account or credit card numbers, which the scammers use to commit identity theft.

What to Do To access the IRS Web site, type www.irs.gov into the Internet address window, rather than clicking on a link or opening an attachment, either of which may download malicious code or send the recipient to a phony Web site. Those who have received a questionable e-mail may forward it to the following address: phishing@irs.gov.

2008 TAX LAW CHANGES (CONT'D FROM PAGE 1)

For sales and exchanges after December 31, 2008, the home sale exclusion won't apply to the extent gain is allocable to periods of nonqualified use. Nonqualified use is any period (after December 31, 2008) during which the property is not used as the principal residence.

Nonqualified use does not include: 1) any portion of the 5-year period which is after the last date that the property is used as the principal residence of the taxpayer, 2) any period (up to 10 years) during which the taxpayer is serving on qualified official extended military duty or 3) any period of temporary absence (up to 2 years) due to change of employment, health conditions, or other unforeseen circumstances specified by the IRS.

New Credit for First Time Homebuyers

The single largest provision in the \$15.1 billion package of housing tax incentives in the recently enacted Housing Assistance Tax Act of 2008 is a measure allowing individuals buying their first home to take a tax credit of up to \$7,500 of the purchase price.

Qualified homebuyers can subtract the credit amount from their federal income tax when they buy a home and even get a refund if the credit exceeds the tax. However, they are required to pay the credit back over 15 years. The result is that the credit resembles an interest-free loan that must be repaid to the government. The credit is phased out for higher income taxpayers.

TAX AUDITS ON THE RISE

If you received an audit notice this year, you weren't alone. The number of IRS audits increased notably between 2006 and 2007, particularly for higher income individual taxpayers.

Individuals

The IRS examined 9% of all individual returns filed for 2007, an increase of 7% over the number of returns audited in 2006. 61% of these audits were through correspondence.

Audits of higher income individuals increased more than the average. Most notably, 1 out of 11 of the

2007 returns with income of \$1 million or more were audited, an increase of 84% over 2006.

Businesses

The IRS continued efforts to review more returns of flow-through entities – partnerships and S Corporations. IRS examined 10% of each of these types of returns, an increase of roughly 25% over 2006. IRS examined 15% of the 2007 returns filed for mid-market corporations (those with assets between \$10 million and \$50 million dollars), an increase of 6% over 2006.

QUALIFIED CONSERVATION CONTRIBUTIONS

A conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. The donee must be prohibited from making certain transfers and the conservation purpose must be protected in perpetuity.

Conservation purposes include protecting a natural habitat, preserving historically important land area or a certified historic structure.

Landowners may have several reasons to favor a conservation easement. They may wish to ensure that property is left in an undeveloped state even after their death. Landowners also use qualified conservation easements for financial and estate planning purposes. The easements allow landowners

to reduce the fair market value of their property. Four benefits may result:

- 1) upon their death, the estate taxes on the property are reduced,
- 2) a federal income tax deduction can be taken for the value of the easement,
- 3) current property tax assessments may be lower, and
- 4) several states also have state specific tax breaks or credits.

Recent tax law changes may encourage timely action if you are considering a conservation contribution. For qualified conservation contributions made prior to December 31, 2009, donations are limited to 50% of adjusted gross income (instead of 30%) and the carry forward period is 15 years (instead of 5).



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Learn more about the range of tax consulting services we offer, our people, and our firm. Use the links to access tax forms, financial information, past newsletters and more.

KING & OLIASON NEWS

We are pleased to welcome three tax professionals to our team in 2008.

Rick Starkenburg joined King & Oliason as a principal, with expertise in planning for wealth transfer; estate and trust income tax; charitable giving; formation and operation of family limited liability companies; and business valuation. He has more than fifteen years experience with Northwest public accounting firms serving the tax needs of individuals, trusts, partnerships, corporations and private foundations.

Andrea Kristof has over 25 years experience in accounting, tax, financial management and financial consulting for small businesses. Her varied experience includes four years of public accounting work. Andrea serves on the board of a local athletic club. She often commutes to work on her bike, enjoying the scenic Seattle waterfront along the way.

Yukiko Hatheway worked with regional and local accounting firms for seven years before joining King & Oliason last February. Yukiko was born in Tokyo, and grew up in London. She has a B.A. in Accounting from Eastern Washington University and is a member of the Nichibei Women's Network, an association for those involved in Japanese-American culture and business. Yukiko appreciates the work-life balance she has found here at King & Oliason, allowing her to spend more quality time with her family.

In October we said goodbye to **Pat Wentz**. Pat retired from King & Oliason after six years working on the complex tax returns of multi-national business clients. We wish her well in her retirement.



Protecting Your Personal Information

At King & Oliason, our duty to protect your personal information is taken very seriously. Our e-mail procedures ensure that information sent to you electronically cannot be accessed by others. Email attachments will arrive with password protection. Typically, the password will be a portion of your social security number. Your password will not be explicitly stated in the email, but you will be able to determine the password from the information provided. We are always open to discussing any questions or concerns you have regarding protection of your personal information.