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CERTIFIED PUBLIC ACCOUNTANTS
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WHAT'S NEW FOR THE 2008 FILING SEASON?

Once again, it's been a very busy year for changes in our income tax laws. First of all, there are a number of provisions that were passed prior to 2008 that are just now coming into effect. Secondly, The Economic Stimulus Act of 2008 was passed on February 13, 2008. Third, the Food, Conservation, and Energy Security Act of 2008 went into effect May 22, 2008. Fourth, the Heroes Earnings Assistance and Relief Act of 2008 went into effect on February 13, 2008. Fifth, the Housing Assistance Tax Act of 2008 was signed by President Bush on July 30, 2008. Finally, the Individual AMT Relief in the 2008 Financial Bailout and Tax Package was enacted October 3, 2008. As if that were not enough, in addition to the Federal changes, there have been a number of changes relating to Kansas Income Tax. Although the changes are voluminous, this newsletter will attempt to boil down the changes that have the greatest chance of affecting you, our client.

EXTENSIONS IN BRIEF

The following provisions that were applicable in prior years, but set to expire, have been extended-

Deduction for State & Local Sales taxes in lieu of Income Taxes through 2009

Deduction for qualified tuition and related expenses through 2009

Deduction up to $250 for certain expenditures incurred by elementary and secondary school teachers through 2009

Extension through 2009 of the rule allowing tax free distributions from IRA's for charitable purposes

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FORECLOSURE & CANCELLATION OF DEBT

Sometimes we see a taxpayer who has had debt forgiven for one reason or another. Generally, the taxpayer receives a 1099C in January of the following year, and is required to pay tax on the amount forgiven unless he declared bankruptcy or was insolvent immediately prior to the cancellation. A new law permits taxpayers to exclude from gross income debt cancellation where the debt was incurred to buy, build, or substantially improve the taxpayer's principle residence.

If you are involved in a situation where you expect a 1099C, the first step is to make certain you agree with the amount. Try to get that agreed to at the time, so you aren't surprised by the amount in January. The second step is to involve us, so that you aren't surprised by the tax impact in April.

LOW INCOME HOUSING CREDIT

These credits are sold to investors by developers who have developed qualified low income housing projects. The new law is intended to make it easier to qualify projects and it increases the allowable volume for 2008-2009. More importantly, it allows the credit to offset AMT liability for properties qualifying after December 31, 2007. The AMT has been a problem for many who invested in such projects in the past.

MORTGAGE INSURANCE PREMIUM DEDUCTION EXTENDED

Taxpayers were entitled to deduct premiums paid on qualified mortgage insurance on principal or second residences if the insurance was issued after December 31, 2006. The deduction was subject to income phaseouts and was originally only available for the 2007 tax year. This deduction is extended for tax years 2008 through 2010 for mortgage insurance contracts issued between January 1, 2007 and December 31, 2010.

FIRST TIME HOMEBUYERS CREDIT

The Housing Assistance Act of 2008 provides for a refundable tax credit for first time homebuyers. The credit is 10% of the purchase price of the home, limited to $7,500 ($3,750 if married filing separately). This credit is to be repaid in equal installments over 15 years with no interest charged. So it's not really free money, it's just an interest free loan. If the taxpayer sells the home or ceases to use it as a principal residence, any remaining credit not yet repaid is due on the tax return for the year of the sale or cessation of use as a principal residence, with limited exceptions.

A person is considered a first time homebuyer for this provision if the taxpayer (and spouse) had no ownership interest in a principal residence during the three year period before the new home is purchased. The credit applies for qualified home purchases on or after April 9, 2008 and before July 1, 2009. However, a special election allows the taxpayer to treat a residence purchased after December 2008, as purchased on December 31, 2008, so that the taxpayer can claim the credit on their 2008 return. The date of purchase is the date when title closes. The credit is not allowed for property acquired from related parties. Two unmarried parties can split a purchase and allocate the credit between them. The credit phases out for individual taxpayers with modified adjusted gross incomes between $75,000 and $95,000 ($150,000 - $170,000 for joint filers) for the year of purchase.

ADDITIONAL DEDUCTION FOR STATE AND LOCAL REAL PROPERTY TAXES

Taxpayers previously chose itemized deductions or the standard deduction, whichever was the best. Previously, real estate tax deductions were only allowed as an itemized deduction. Under the new law, those who do not itemize can increase the amount of their standard deduction by the amount of real property tax paid during the year, limited to $500 ($1,000 for a married couple filing jointly). This deduction is for 2008 only.

REDUCED HOME SALE EXCLUSION

IRC §121 allows taxpayers to exclude up to $500,000 of gain (MFJ) or $250,000 of gain (Single Filers) on returns when they sell their principal residence. They are required to live in the property at least two of the last five years with certain exceptions. Gains from the sale of a principal residence will no longer be excluded from taxable income for periods that the home was not used as a qualifying residence. This new rule will apply to home sales after December 31, 2008, and it will deal only with non-residential use after December 31, 2008. This provision is illustrated as follows: Taxpayer buys a property January 1, 2009 for $400,000 and rents it for two years, claiming $20,000 of depreciation. On January 1, 2011 the taxpayer begins to use the property as a principal residence. The taxpayer then moves out of the home January 1, 2013 and sells it for $700,000 on January 1, 2014. The first two years are non-qualifying use. Each of the next three years are considered qualifying use. The last year of the five year period when the house was vacant is not considered non-qualified use. Of the $300,000 gain, 2/5 is not eligible for the home sale exclusion, and the $20,000 of depreciation must be recaptured. In total, the taxable gain is $140,000 (($300,000 x 40%) + $20,000).

PENALTIES

Penalties are a fact of life, but each year the penalties taxpayers and preparers are exposed to become more and more severe. For individuals, failing to file a tax return by the due date results in a penalty of 5% for the first month and an additional 5% for each additional month or partial month. The maximum penalty is 25%. Under the new law, the minimum late filing penalty is increased to the lesser of 100% of the net amount of tax due or $135 if the returns is not filed within 60 days of the filing deadline.

Partnerships and S-Corporations that file late will now be penalized $85 per partner per month for up to 12 months. A two partner partnership or S-Corp can now be subject to a penalty of $2,040 for filing late.

The most terrifying penalty currently out there surprisingly relates to W-2's. Failure to timely file W-2's can potentially subject taxpayers to a $50 per W-2 information return penalty and even worse a civil penalty totaling 10% of the wages reported on the W-2's. For example, taxpayers could be subject to a $50,000 penalty on only ½ million dollars of wages. This is particularly horrifying given that the IRS and Social Security Administration are often wrong in their claims that the W-2's were not timely filed. In the past, our firm has been able to successfully get these penalties abated, but it often took three to four letters and ultimately a call to the IRS Taxpayer Advocate Office. Due to changes in IRS procedure, the Taxpayer Advocate Office can no longer abate penalties. Additionally, a new IRS position is that late filing penalties for W-2's will no longer be waived without hard proof of timely filing. As such, for the coming year we will strongly recommend that our clients either mail the W-2's via certified mail or electronically file the W-2's. We intend to offer our clients a convenience service whereby we will e-file or mail the W-2's certified mail to provide documentation of timely filing.

KIDDIE TAX

The age of dependents subject to the kiddie tax increases for tax years beginning after May 25, 2007. The kiddie tax applies to dependents who have taxable investment income exceeding $1,800. The new law extends the age limit to taxpayers age 18 and full time students under age 24 if they do not provide more than half of their support with earned income.

CREDIT FOR QUALIFIED PLUGIN ELECTRIC DRIVE MOTOR VEHICLES

The new law allows for a credit of between $2,500 and $7,500 for qualified vehicles with a gross vehicle weight rating of 10,000 pounds or less. The credit is subject to limitations based on the number of qualifying vehicles sold. The Chevrolet Volt (forthcoming) is projected to be eligible for the full $7,500 credit.

529 PLANS

According to the College Savings Plan Network, as quoted by Edward Jones, "more than $105 billion has been invested in 529 plans." Generally, these amounts have been invested by parents and grandparents to fund future college expenses. While there is no Federal tax deduction for such contributions, there may be a Kansas tax deduction and future earnings grow tax free within the plan.

Some people were using such contributions to avoid the $12,000 limit of gifts. New anti-abuse rules will now apply to 529 plan contributions.

EXTENDED TIME PERIOD FOR SURVIVING SPOUSES TO SELL PRICIPAL RESIDENCE

Beginning on January 1, 2008, an unmarried surviving spouse is entitled to the $500,000 exclusion that applies to joint return filers if the sale of the principal residence occurs within two years of the date of death.

STIMULUS REBATES

Many of you did not qualify for the rebate checks for various reasons, the most common reason is due to making too much money in 2007. If you did not receive a check, you have a second chance in 2008. Also, if you had a child born in 2008, you may receive an additional rebate. All of this is because the rebates were technically an advance refund of 2008 taxes. The first rebate checks were based on 2007 data. The second calculation will be based on 2008 actual data, giving you a second chance. Luckily, it's a one way street. Failure to qualify for the rebate in 2008 will not cause a taxpayer to give up the rebate already received based on 2007 data.

MAXIMUM TAX RATE ON QUALIFIED DIVIDENDS AND NET CAPITAL GAIN REDUCED

For tax years beginning after 2007, the 5% maximum tax rate on qualified dividends and net capital gain (the excess of net long-term capital gain over net short-term capital loss) is reduced to 0%. This zero percent rate applies when the amount of the Adjusted Net Capital Gain is equal to or less than the ceiling for the 15% tax bracket. In other words if your income not including capital gains and qualified dividend income is below the cap for the 15% bracket, the tax rate on the qualified dividends and capital gains is zero. The 15% bracket ceilings are $65,100 for marrieds, $32,550 for singles, and $43,650 for heads of household. This reduction applies for both regular tax and AMT. The 15% maximum tax rate on qualified dividends and net capital gain has not changed.

CODE SEC. 179

This provision was enacted in 1986 to allow small business taxpayers an immediate tax deduction for up to $10,000 of capital equipment purchases. The property had to be qualifying property (generally new tangible personal property used in a business other than a rental). The law has been expanded several times since then, generally to encourage business to purchase capital equipment.

For 2008, the amount of Code Sec. 179 deductions has been expanded to $250,000. This maximum amount starts being reduced dollar for dollar for businesses that purchase over $800,000 of qualifying property in 2008, thereby greatly expanding the number of small businesses that would qualify.

As before, if the property stops being used more than 50% for business purposes, the taxpayer has to "recapture" the amount expensed over the amount that could have been depreciated using normal depreciation rules.

BONUS DEPRECIATION

Businesses who purchase over $800,000 of qualifying equipment , or those who can't use Code Sec. 179 due to losses or or other reasons, may want to use the bonus depreciation provision which also is limited to equipment purchased and put into use during the calendar year of 2008. The bonus depreciation is a a 50% deduction for purchases of new tangible personal property used in the taxpayers trade or business. Equipment used in a rental activity does not qualify. Purchase of used property is not eligible. Water utility property and qualified leasehold property are potentially eligible, but may require research on our part to apply those provisions to your specific case.

Depreciation and Code Sec. 179 deductions have been limited for autos, vans, and light trucks. The 2008 bonus depreciation provisions allow for 2008 deductions up to $10,960 for autos and $11,160 for vans and light trucks (under 6,000 pounds Gross Vehicle Weight). Again, the vehicle must be new, and used actively in a trade or business.

AMT RELIEF

Two of the changes affecting AMT will impact millions of taxpayers. The first change is an increase in the exemption amounts that are subtracted from an individual's "alternative minimum taxable income" to determine the taxable amount (if any). The exemption amounts for 2008 are $69,950 for joint filers, $46,200 for single filers, and $34,975 for married taxpayers filing separate returns. Although the 2008 exemption amounts represent only modest increases from the 2007 tax year, they are substantially higher than the exemption amounts originally scheduled to apply in 2008: $45,000 for joint filers, $33,750 for single filers, and $22,750 for married taxpayers filing separate returns.

The second broadly applicable AMT change permits taxpayers to use all their "nonrefundable personal credits" (e.g. the dependent care credit) in full to offset both the regular tax and the AMT in 2008. Before this change, which represents a one-year extension of a rule that had expired in 2007, most of the nonrefundable personal credits could not be used to offset the AMT.

Other changes in the new law are aimed at a narrower but nevertheless substantial group of taxpayers. These are the many employees who paid AMT as a result of exercising incentive stock options (ISO's), then later suffered losses on selling the stock after its value had declined sharply. Although the tax incurred on exercising an ISO generates a credit that taxpayers can use to offset future tax from a profitable sale, the credit is wasted if the stock is sold at a loss. The scenario is often called the "phantom income" problem because tax is paid on gains that never materialize. These changes are rather complicated and are beyond the scope of this newsletter. If you believe you may be impacted, please contact us so we can explain these changes further.

CHARITABLE CONTRIBUTIONS

A recent court case reminds us that rules override common sense. The law for contributions (oversimplified) is that contributions are to be substantiated by either a bank record or a receipt, letter or written communication from the donee. For contributions of $250 or more, the deduction must be substantiated by a contemporaneous written acknowledgment from the donee organization which shows the donee name, contribution date, amount, and a statement regarding the value of goods and services provided. Any noncash contributions over $500 must be documented with form 8283. Noncash contributions over $5,000 require an appraisal by a qualified appraiser. Household items and clothing must be in "good used condition" or better. The donation of an automobile will be limited to the selling price of the donee if they sell the vehicle.

The court case denied $6,885 of charitable contributions from an individual to a church even though they had canceled checks and a late date statement from the church. The denial was because the checks were over $250 and they didn't have the contemporaneous letter from the church.

MISCELLANEOUS

- The FICA wage base is $102,000 for 2008. The wage base increases to $106,800 for 2009.
- The Standard Mileage Rate for Business use is 50.5 cents per mile from January 1, 2008 through July 30, 2008.
- The rate is 58.5 cents per mile for the remainder of 2008.
- Medical and moving mileage are 19 cents for the first half of 2008 and 27 cents for the second half.
- Charitable mileage is 14 cents per mile for all of 2008.
- Beginning January 1, 2009 the rates are 55 cents for business, 24 cents for medical or moving, and 14 cents for charitable miles.
- For those of you between age 62 and your normal retirement age, you will lose social security benefits when yourearned income exceeds $13,560 for 2008. The limit increases to $14,160 for 2009.
- For 2009 the annual exclusion for gifts rises to $13,000 from the current level of $12,000.

WHO PAYS THE MOST?

According to the Joint Economic Committee of the United States Congress, here are the facts from the IRS summary of 2006 income tax returns.

Percentiles Ranked by AGI	Adjusted Gross Income Threshold on Percentiles	Percentage of Federal Personal Income Tax Paid
Top 1%	$388,806	39.89%
Top 5 %	$153,542	60.14%
Top 10%	$108,904	70.79%
Top 25%	$64,702	86.27%
Top 50%	$31,987	97.01%
Bottom 50%	< $31,987	2.99%

LOSSES ARE NOT ALWAYS DEDUCTIBLE

A recent case, Eder vs Commissioner, TC Summary 2008-12 dealt with a case where the IRS disallowed the loss claimed by Mr. Eder. Mr. Eder was employed full time by Abbott Laboratories as an engineer. While employed at Abbott, he become an independent distributor for Reliv International, a network marketing company that sells health care products.

Mr. Eder ordered products from Reliv and attempted to resell them. However, be believed the more lucrative part of the business was to sponsor others in the Reliv program, which would enable him to earn commissions on their sales.

Mr. Eder promoted his business in several ways. While commuting to his job at Abbott, he would stop at commuter train stations or shopping malls and place "opportunity of a life time" cards on car windshields Mr. Eder also sent direct mail to about 48 prospects in his area each month. He followed that mailing with a second and third postcard and sometimes telephoned some of those prospects. On occasion, he would meet with a prospect at the local library to give them Reliv materials.

Mr. Eder was for the most part unsuccessful. None of the prospects ever became Reliv distributors except his son and brother, who only became distributors to obtain discounts on Reliv products. Robert had not prepared a business plan nor calculated a break-even point. He maintained no organized record keeping system. He incurred losses ranging from $2,700 to $12,000 from 1997 through 2005. Mr. Eder was a long time user of Reliv products. The court felt that the ability to obtain products at a discount was a significant motivating factor for Mr. Eder's business.

Morrow & Company comment:

Most businesses do not prepare formal projections nor document carefully the calculation of a break-even point. Most would be unable to document unsuccessful marketing efforts. The court, however, held theses factors more important than the efforts expended by Mr. Eder to promote his business. As a side note, the court noted that Mr. Eder only spent several hours per week on his Reliv business while earning substantial income from his full time employment. We believe this was not a factor that should have had any bearing on whether the Reliv activity was engaged in for profit. The case does show that the IRS may challenge losses, and that courts rely heavily on taxpayer documentation to overcome IRS challenges.

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