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NEWSLETTER
VOLUME 2, ISSUE 3

Welcome to Craft, Noble and Company's e-news update - your quarterly brief on the most up-to-date tax talk and advice.

During November: It's wise to estimate your 2008 income tax liability and review your options for minimizing your 2008 taxes. Year-end tax planning is always a smart thing to do, but this year it becomes even more important. We are coming up on the sunset year for the 2001 tax law, a new President in 2009, and almost certainly a major tax revision in the next year or two.

Call Craft, Noble and Company to schedule your year-end review to minimize year-end tax implications where possible.

YEAR-END, KEY TAX EXTENSIONS

President Bush signed the *Emergency Economic Stabilization Act of 2008* into law on October 3, hoping this plan would bring stability to the financial markets. The new legislation includes a wide range of provisions affecting financial institutions and individuals. For instance, it authorizes the government to spend $700 billion for troubled financial assets, curbs excessive compensation arrangements for executives of financial firms, raises the FDIC compensation arrangements to $250,00 per account through December 31, 2009, and provides relief for certain homeowners.

Although these provisions have been well-publicized, less attention has been paid to the $100 billion in tax breaks added to the package late in negotiations. The changes generally extend a series of recently expired tax provisions through 2009, and include:

AMT relief. The new law "patches" the alternative minimum tax (AMT) again by raising the exemption amounts for 2008 to $46,200 for single filers and $69,950 for joint filers. The patch also allows you to offset AMT liability with nonrefundable personal credits.

Tuition deduction. The new law reinstates the above-the-line deduction for qualified higher education expenses paid for yourself, your spouse, or a dependent. The deduction is $4,000 for single filers with adjusted gross income (AGI) of $65,000 or less and joint filers with an AGI of $130,000 or less. It drops to $2,000 for an AGI up to $80,000 for single filers and $160,000 for joint filers. No deduction is allowed over these thresholds.

Sales tax deduction. In lieu of deducting state and local income taxes, you can elect to deduct sales tax paid during the year. The sales tax deduction may be based on amounts in an IRS table plus actual amounts paid for certain big-ticket items like cars, or you can keep actual receipts for taxes paid.

Teacher's deduction. Teachers and other educators may claim an above-the-line deduction for up to $250 of unreimbursed classroom expenses. This covers books, supplies, equipment, and software.

Charitable IRA rollovers. Under the new law, those age 701/2 or over can still transfer up to $100,000 directly from an IRA to a qualified charity without paying any tax. This provision is reinstated through 2009.

Nonitemizer's deduction. The new law extends the special property tax deduction for nonitemizers previously available only in 2008. The deduction is actual property tax paid, up to a $500 for single filers and $1,000 for joint filers.

Business tax breaks. Among other provisions for business owners, the new law extends the research tax credit (with certain modifications), the fast 15-year write-off for restaurant and leasehold improvements, and enhanced charitable deductions for donations of food, books, and computers.

DON'T LOSE OUT ON A BIG 2008 TAX BREAK

Year-end is fast approaching, but it's not too late to reduce your 2008 taxes. Consider the following possibilities for actions you can take to cut your 2008 tax liability.

Capital gains. There is a new zero tax rate on long-term capital gains and qualified dividends for taxpayers in the regular 10% and 15% tax brackets. If you're single with taxable income under $32,551 or married filing jointly with income under $65,101, the zero rate applies to you.

IRA contributions. Contributions for Roth and traditional IRAs have been increase to $5,000 for 2008. And those age 50 or older by the end of the year can add an additional $1,000 as a "catch up" contribution, making their total contribution $6,000.

Kiddie tax. The kiddie tax now applies to children with more than $1,800 of unearned income if they are under age 19 (under age 24 for full-time students). If you have dependent children with investment income, they could be subject to this tax. Now is the time to review their income sources and consider moving them into investments that are more kiddie tax friendly.

If you're planning to purchase **business equipment,** be aware of these two depreciation rules: You can expense $250,000 work of new and used equipment purchased for your business this year, and you can take 50% bonus depreciation on new equipment purchases.

You can use both breaks this year, and the two benefits can even be combined on the same purchase. For example, you can use the expensing option on a piece of equipment and apply bonus depreciation to the remaining cost if the property qualifies.

Off-the-shelf computer software qualifies for both tax breaks.

As you plan your acquisitions, remember that both 50% bonus depreciation and the increased expensing election are available only for 2008. Also, the expensing benefit phases out once your total equipment purchases for 2008 exceed $800,000.

Stock losses. With the stock market in turmoil, be aware that you can sell stocks at a loss and use that loss to offset gains on other stock sales. Additionally, if your losses outstrip your gains, you can deduct up to $3,000 of those losses to offset other income.

For details in best utilizing these tax breaks, give Craft, Noble and Company a call.

TAXABLE WAGE EXTENSIONS AND INCREASES IN '09

***Federal Unemployment Tax Act* (FUTA) surtax extended.** It imposes a 6.2% tax on the first $7,000 of wages paid annually to employees. Years ago, a .2% surtax was added as a "temporary" measure, set to expire after 2008. The *Emergency Economic Stabilization Act of 2008* extends the surtax through 2009. The extension of the surtax will, according to the Treasury Department, "support the continued solvency of the federal unemployment trust fund."

The amount of wages subject to social security tax will increase next year to $106,800, up from $102,000 for 2008. The Social Security Administration estimates that 11 million taxpayers will pay higher taxes as a result.

Applying the 6.2% tax rate to the higher wage base will bring the maximum social security tax for 2009 to $6,621.60, up from $6,324 for 2008. The Medicare tax rate of 1.45% continues to apply to all wages.

Self-employed individuals pay both the employer and employee share of social security and Medicare taxes, but they are allowed a tax deduction for 50% of the taxes paid.

Also adjusted for inflation, the social security benefits pad in 2009 will increase 5.8%. Working retirees who are drawing benefits prior to reaching full retirement age will lose one dollar in benefits for every $2 above $14,160.

Have a question about how this may effect you? Contact Craft, Noble and Company today.

SPOT PROBLEM ACCOUNTS EARLY

If you extend credit to your customers, some losses are inevitable. So unless you are willing to forgo the credit part of your sales, you have to figure out ways to control your bad debt losses.

Once you have extended credit to a customer, you have a stake in continuing the relationship even if you suspect there might be trouble a-brewing. You don't want to crack down on a good customer too hard too soon; yet you don't want to be "taken" by a debtor who has become unable or unwilling to pay. The problem is distinguishing between slow pay (which is bad enough) and no pay.

What you need is an early warning system to detect a credit problem in the making, so you can stop additional sales to that customer and begin collection procedures in earnest. Here are some of the telltale signs that point to an account that is turning sour:

- The debtor has begun paying erratically, settling up on smaller invoices while larger ones just get older, at the same time disputing specifications or terms.
- The debtor fails to return your phone calls or shows unusual annoyance at your inquiries.
- Your requests for information, such as updated financial statements, are ignored.
- The debtor places jumbo orders and presses you for a higher credit limit.

Any one of these hints of trouble can be the handwriting on the wall. Two or more and it's time to crack down. Take a firm stand; turn up the heat on your collection efforts with this debtor, and make no more sales unless they're cash on delivery. For advice of this and similar issues, please contact Craft Noble.

PARTNERSHIP EXTENSIONS SHORTENED IN '09

Partnerships are "pass-through" entities that file Form 1065 reporting partnership income but paying no income tax. Instead the income "passes through" to partners who pay tax on their share of the partnership's income on their individual tax returns.

The filing deadline for Form 1065 for partnerships on a calendar-year is April 15th of the following year. For tax returns due after December 31st, the extension period will change and be shortened from six to five months - giving partnerships until September 15, 2009.

INCREASED SCRUTINY FROM THE IRS

According to the *Journal of Accountancy,* the S corporation is the most popular form of business ownership in the country, swelling to around four million entities. The primary reason for their growth is that S corporations avoid that double taxation that applies to regular C corporations while still offering protection from personal liability.

However, as the popularity of S corporations continues to rise, they are facing greater scrutiny from the IRS. In particular, the IRS has focused its attention on three issues:

- Shareholder-owner compensation. The basic tax rule is that compensation paid to shareholder-employees must be reasonable in amount. Historically, the IRS has questioned compensation amounts paid to C corporation owners that seemed unreasonably high. With an S corporation, a high-tax bracket owner may establish a compensation amount that is extremely low, or even zero, while increasing other pass-through income (i.e., dividends.) By doing so, the owner avoids employment taxes on these payments.

The IRS recognizes the tax benefits of this strategy. Therefore, it may object to compensation that appears to be low relative to corporate profits

Suggestion: Have compensation reviewed before the end of the year. If appropriate, the S corporation may pay bonuses to shareholder-employees. In any event, document the reasons for compensation amounts.

- Shareholder basis. Generally, a shareholder's "tax basis" for deducting corporate losses may be increased by contributing additional capital to the company.

The IRS may challenge basis adjustments resulting from loans by third parties to the company. Furthermore, it has consistently maintained that a shareholder's guarantee of an S corporation debt does not increase basis.

Suggestion: Loans should be made directly from the shareholder to the S corporation. A written note, based on reasonable terms, can serve as proof that a bona fide loan exists.

- Fringe benefits. An S corporation may provide tax-free fringe benefits, like health insurance or employer-paid group-term life insurance coverage (up to $50,000), to its employees. However, if an employee owning 2% or more of the company receives fringe benefits, he or she is generally taxed on the value. To avoid abuses, the IRS may examine fringe benefit packages.

Note that there are several exceptions to the general rule. For example, certain "working condition" fringe benefits are tax-free to 2%-or-more shareholders.

Suggestion: Consider restricting benefits for owners to those that are essential or that result in minimal or no taxation.

In summary, S corporation owners must be careful to observe all the technicalities in the tax law. For assistance, contact the Craft Noble office.

TEACH YOUR CHILDREN ABOUT MONEY

If you haven't already started teaching your children about money and finances, you're neglecting an important part of their education. Consider these suggestions:

- Teach children how to live below their means. Children learn by example, and you can be their best teacher. Teach them to think first and spend later. Impulsive spending increases your children's chances for getting in over their heads with consumer debt.

- **Illustrate the power of compounding.** Here's an example. If your child invests $1,000 from a summer job at a 6% return, the investment will double in 12 years, grow to over $4,000 in 25 years, and exceed $10,000 in 40 years — all this from a single $1,000 investment.

- **Fund a Roth with summer earnings.** If your child has a summer job, consider setting up a Roth IRA. The funds can be withdrawn to cover college expenses or left to grow for retirement. If your daughter invests $5,000 in a Roth at age 16, and the fund earns a 6% return, by age 65 that $5,000 will have grown to over $86,000 tax-free. If she continues to invest $5,000 every year to age 65 with a 6% return, the balance will exceed $1,400,000.

- **Match savings.** Consider matching every dollar your child puts into savings. It may prepare him or her for later participation in an employer's 401(k) plan.

If you want your children to be money-smart, take the necessary steps to educate them while they're young.

Craft, Noble and Company helps clients realize the benefits of planning. While the day-to-day financial outlook is less than optimistic, the long run can be for those who can adjust their horizon.