

# Advantage

4th Quarter, 2006

## YEAR-END TAX PLANNING

Although the end of the year is fast approaching, there is still time to implement tax planning strategies for 2006. While some tax minimization strategies can be completed after year-end, most require completion by December 31, 2006.

Year-end tax planning needs to be adjusted each year due to changes in tax rules, as well as fluctuations and modifications in your own personal financial and tax status. For 2006, there are new planning strategies resulting from the two tax acts that Congress passed during 2006, as well as the phase-in and expiration of some provisions of prior years' tax acts.

Taking the time now to review your 2006 tax situation gives you a chance to take advantage of many year-end tax savings opportunities. This article highlights possible changing circumstances, but there are many others that might also apply to your particular situation. Please contact us if you would like to discuss year-end tax planning strategies and ideas to potentially

reduce your 2006 tax liability. We are here to help you and we would be pleased to schedule a meeting within the next few weeks while there is still time to implement tax strategies prior to year-end.

The following events may have tax implications and need to be planned for accordingly. This is not meant to be an all-inclusive list, but rather some common items that come to our attention on a regular basis. If there is an event or transaction that occurred during the year and you are uncertain of its impact, please do not hesitate to call us.

- Change in filing status (i.e. marriage, divorce or death of a spouse).
- Significant change in investment income.
- Large dollar amounts in stock sales.
- Distributions from retirement accounts and partnerships.
- Sale of a business or business property.
- Change in employment income (i.e. subcontractor vs. employee).

- Dramatic change in itemized deductions (i.e. medical expenses, taxes, mortgage interest or contributions).

- Deviation from the estimated tax payments we previously provided to you.

## CHANGES IN THE TAX LAW

To follow are some newly enacted tax law changes and revisions from prior years' tax laws:

**Higher Kiddie Tax Age** – Now 18 years old, was previously 14.

**Roth Conversions from IRAs** – Income limits of \$100,000, starts in the year 2010.

**Charitable Contributions** – Starting in 2007, regardless of the amount, proof will be required (i.e. cancelled check or letter from charitable organization).

Clothing and household items must be in at least "good condition" to be deducted as of August 17, 2006.

Conservation easements can be

donated with a deduction of up to 50% of the adjusted gross income for 2006 and 2007 only.

**Residential Energy Credit** – Up to \$500, for certain non-business energy products installed.

**Military and Public Service Personnel** – If called to active duty between September 11, 2001 and December 31, 2007 you can take early distributions from IRAs, 401(k)s and similar plans penalty-free. The individual has a two year period following active duty to recontribute those amounts to avoid income taxes on recontributed amounts.

**Dividends and Capital Gains** – The lower rate is extended through 2010. Starting in 2008, if the taxpayer's rate is in the 10-15% bracket, the dividend and capital gain rate will be zero.

**Business Expensing of New Assets** – For 2006 the purchase of up to \$108,000 of equipment can be expensed. The \$108,000 threshold is reduced if the acquisition exceeds \$430,000. Those amounts are indexed for inflation through 2010.

## AVOIDING AN AUDIT

Each year there are a number of taxpayers who are audited by the IRS. There are some individuals who are randomly audited by the IRS; however, the majority of audits are requested for a specific reason. Having your personal finances or businesses audited by the IRS is a process that many individuals try to avoid and there are a number of fairly easy pre-

cautions that should be taken to avoid a potential audit.

There are several reasons why the IRS can request an audit. An audit request is often made when a tax return contains information that raises a "red flag" to the officials at the IRS.

The following are some examples of red flags:

- Greater than average itemized deductions.
- Greater than average or continued Schedule C losses.
- Income greater than \$150,000.
- Any unmatched records – such as missing W-2s or 1099s.
- A return missing the alternative minimum tax form, any required schedules, or sufficient explanation of complex transactions.
- Self-employed individuals whose bank records do not seem consistent with comparable businesses.

There are several steps to follow in order to avoid an audit. The first is to file a complete and accurate tax return. Next, be sure to include appropriate and detailed explanations of any unusual transactions and finally, engage a quality tax professional to assist in any dealings with the IRS.

This newsletter is intended for general reference purposes only. It is not a substitute for specific, professional accounting and tax advice.

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## CONTRIBUTION LIMITS

In order to increase retirement savings, the Economic Growth & Tax Relief Reconciliation Act of 2001 contains provisions for increases in the 2006 maximum annual contribution amounts to retirement and, education savings accounts.

To follow is a summary of the employee contribution limits for 2006:

**Roth and Traditional IRAs** — \$4,000 for 2006 until April 15, 2007, plus \$1,000 catch-up if you are age 50 or over; and \$4,000 for 2007, plus \$1,000 catch-up if you are age 50 or over.

**SEP IRAs** — 25% of your wages (or up to 20% of your Schedule C income) up to a maximum of \$44,000 for 2006. Contributions can be made for 2006, up until your tax filing deadline, including extensions.

**SIMPLE IRAs** — \$10,000 salary deferral plus \$2,500 catch-up if you are age 50 or over for 2006, (2.192% if you are self-employed). Salary deferral contributions for the self-employed (in addition to the employer contribu-

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tion) can be made up until your tax filing deadline for 2006, including extensions. The \$10,000 is subject to adjustment for cost-of-living increases, but no adjustment was made for 2006.

**Profit Sharing/401(k)s** — \$15,000 in salary deferral for 2006, plus catch-up deferral of \$5,000 if you are age 50 or over, plus 25% of your wages (or 20% of your Schedule C income) up to a maximum of \$44,000 for 2006. Salary deferral contributions for the self-employed (in addition to the employer profit sharing contributions) can be made, up until your tax filing deadline for 2006, including extensions.

**Coverdell ESAs** — \$2,000 per year, until the child is age 18.

**Health Savings Accounts** — \$2,700 for individual coverage for 2006. \$5,450 for family coverage for 2006, plus \$700 catch-up for 2006 if you are over age 55.

### 2007 MILEAGE RATES

The Internal Revenue has issued the 2007 optional standard mileage rates used to calculate the deductible costs of operating an automobile for business, charitable, medical or moving purposes.

- 48.5 cents per mile for business miles driven.
- 20 cents per mile driven for medical or moving purposes.
- 14 cents per mile driven in service to a charitable organization.

## **DOING BUSINESS INTERNATIONALLY: RESOURCES & INFORMATION**

As you most likely know by now, **Marien + Company, LLC** is a member of MGI, a worldwide association of independent accounting and consulting firms ([www.MGIWorld.com](http://www.MGIWorld.com)).

One of the benefits of membership in MGI is access to resources and information about conducting business in a foreign country. Over the years, MGI member firms have compiled guidelines to assist their clients in dealing with all of the issues associated with international transactions.

The "DOING BUSINESS IN..." booklets provide a comprehensive library of tax and business information.

For each country, topics covered include:

- Country overview
- Business environment
- Business entities
- Foreign investment and trade
- Banking and finance
- Audit and accounting
- Taxation

The following is a list of the countries that are included in the "DOING BUSINESS IN..." booklet series:

### European Countries

Austria  
Belgium  
Denmark  
Finland  
France  
Hungary  
Italy  
Malta  
The Netherlands

Poland  
Switzerland  
Spain  
Turkey  
United Kingdom

### Middle East

Cyprus  
Egypt  
Qatar  
United Arab Emirates

### Australasia / Pacific

Australia  
New Zealand

### Latin America

Uruguay

### Africa

Ghana  
South Africa  
Tunisia

### Far East and Asia

India  
Malaysia  
Singapore  
Sri Lanka  
Thailand

We would welcome the opportunity to meet with you to provide additional information about our association with MGI and to discuss how we can help you meet your national and international business goals and objectives.

Please contact Tom Marien with any questions related to international service needs.

## **TAX CONSEQUENCES OF LENDING MONEY TO FAMILY OR FRIENDS**

Loans to family and friends usually fit into one of the following classifications:

124 New London Turnpike, Norwich, CT 06360

Phone: 860.886.1750 Fax: 860.886.0280

[www.MarienCPAs.com](http://www.MarienCPAs.com)



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- **Gift loan** — Any below-market loan in which the forgone interest is in the nature of a gift.
- **Demand loan** — Any loan payable in full at any time upon demand by the lender.
- **Term loan** — Any loan that is not a demand loan.

If you make a gift or demand loan, the difference between the interest calculated at the AFR (rates published by the IRS or applicable Federal rates) and the actual interest charged on the loan is treated as additional taxable income to you. The same amount is treated as a gift from you to the borrower. The calculation is made on December 31 of each year the loan is outstanding.

For below-market term loans, you're treated as if you made a gift. The

amount of the gift is the difference between the amount of the loan and the present value (using the AFR) of all the scheduled payments you'll receive. In addition, you must report the same amount as interest income over the term of the loan using the original issue discount rules.

In essence, with below-market loans, the tax law forces income tax reporting as if you had received interest at the AFR. Then you're treated as if you made a gift to the borrower equal to the "discount" you gave in the lower interest rate. There are certain exceptions to these rules.

None of these exceptions applies if one of the main purposes of the interest rate arrangement is the avoidance of federal tax.

The tax rules regarding monies lent to

family and friends can be confusing and can involve complex calculations. It's always a good idea to consult with your tax advisor before entering into such loan arrangements.

We would welcome the opportunity to meet with you to provide additional information about loan arrangements and to discuss how we can help you meet your financial goals and objectives. Please contact Tom Marien with any wealth advisory questions.

*The ability to discipline yourself to delay gratification in the short term in order to enjoy greater rewards in the long term is the indispensable prerequisite for success.*

- Brian Tracy