

Advantage

3rd Quarter, 2007

2007 YEAR-END TAX PLANNING

The sooner you begin your year-end tax planning, the more time you will have to take advantage of tax minimization strategies. Before acting on any of the ideas in this article, you should seek the advice of a tax professional.

PERSONAL TAXES

Alternative Minimum Tax

Avoiding the Alternative Minimum Tax (AMT) consequences is becoming increasingly more difficult. Paid in addition to normal federal taxes, the AMT is an additional tax which can be triggered by the following events:

- A large capital gain
- Interest on a mortgage not used to buy, build, or expand your home
- The exercising of employee stock options
- Tax-exempt interest on certain municipal bonds
- A large number of dependency exemptions

You can minimize your AMT by planning to exercise stock options or recognizing a large capital gain into a non-AMT year. Alternatively, you might push income into an AMT year if your income tax rate is in excess of 28%.

Timing of Income

You can delay income and minimize taxes by timing the recognition of income for tax purposes. For example:

- Requesting your employer to delay paying year-end bonus or last quarter commissions until after the first of the year.
- Invest in CDs that mature in 2008.

Alternatively, if you think your tax rate will be higher in 2008, you can request to accelerate a 2008 bonus or commission payment into 2007. You can also make a withdrawal from your IRA earlier than planned if you are over age 59 1/2.

Income Shifting

For 2007, the amount you can transfer to a child or family member without paying federal gift tax consequences is \$12,000 (per person). Married couples can transfer \$24,000.

A child can have only a limited amount of unearned income before the so-called "kiddie tax" kicks in. Under the kiddie tax rule, a child's unearned income in excess of \$1,700 is taxed at the parent's highest marginal rate.

In 2007, the tax applies to children under age 18. In 2008 and later, it will apply to children 18 years old and under and full-time students under age 24, whose

earned income doesn't exceed half of their support.

Investments

Planning the timing of selling investments can minimize your tax liability.

Short-term gains can be taxed as high as 35%, while long-term gains can be taxed as low as 5% to 15%. Capital losses are fully deductible against capital gains.

Dividends are normally taxed at a maximum rate of 15%, making dividend-paying stock attractive for tax purposes.

Before selling securities resulting in a gain, you may want to wait more than one year to take advantage of the long-term gain tax treatment.

If you will be retiring in 2008 and project that you will be in the 15% tax bracket, you may wish to defer selling securities that will result in a gain until 2008. In 2008, the rate for such sales drops to 0% for taxpayers in the 10% and 15% tax bracket.

Retirement Planning

Contributing to an individual retirement account (IRA), an employer-sponsored retirement plan, or a retirement plan for the self-employed, can reduce your taxes.

The following are the contribution amounts for 2007.

Type of Plan	Under Age 50	Age 50 or Older
Traditional Roth/IRA	\$4,000	\$5,000
401(k), 403(b), 457, SEP	\$15,500	\$20,500
Simple IRA	\$10,500	\$13,000

You have until April 15, 2008 to contribute to an IRA for 2007.

Personal Deductions & Credits

In 2007, each personal exemption you claim reduces your taxable income by as much as \$3,400. The deduction begins to be phased out with adjusted gross income over \$156,400 if you are single and \$234,600 if you are married and filing jointly.

In 2007, the basic standard deduction is \$5,350 for singles and \$10,700 for married couples filing jointly.

Home mortgage interest up to \$100,000 of mortgage debt may be deductible regardless of how you used the loan proceeds. You may also be able to deduct mortgage insurance premiums.

Interest paid to purchase taxable investments may also be deductible.

Starting in 2007, contributed items must be in good condition to claim a deduction for contributions of clothing and household items.

Cash contributions are now required to have a bank record or receipt from the charitable organization in order to be deductible.

You may be able to deduct college tuition and related expenses up to \$4,000.

Unless extended, the tuition deduction expires in 2007.

In 2007 you may be eligible for certain tax credits as follows:

- Child-related credits of \$1,000 for each qualifying child under age 19 on 12/31/07.
- Employment related child or dependent-care expenses up to a maximum of \$6,000.
- Tax credits for purchase of hybrid vehicles.
- A tax credit of up to \$500 for the cost of certain energy-efficient improvements on your home.
- Tax credit for certain tuition expenses. The maximum credit is \$2,000.

BUSINESS TAXES

Business Income

If your business is structured as a C corporation, you may have some tax minimization strategies available pertaining to distribution of earnings. Amounts paid as dividends are not deductible by the corporation and are taxable income to the recipient. However, the maximum tax rate on dividends is 15% through 2010. Compensation, as long as it is reasonable, is deductible by the company, and is taxable at ordinary rates, but only taxed once. Analyzing the best method of distributing earnings will assist you in obtaining a more favorable tax treatment. Some of the options to shift income to attain a more favorable tax treatment are:

- If you use the cash method of accounting, you may wish to delay past due notices until 2008. Accrual basis taxpayers can hold off shipping products until 2008.
- Make year-end shipments FOB distribution to delay the transfer of title and recognition of income to 2008.

Alternative Minimum Tax (AMT)

Corporations can also be liable for the AMT. The AMT exemption amount for corporations is \$40,000 with AMT income taxed at a flat 20% rate. Small corporations that meet a gross receipts test are exempt from the AMT. Generally, in order to be exempt, average annual gross receipts for the last 3 years can't be in excess of \$7.5 million.

BUSINESS DEDUCTIONS AND CREDITS

Asset Purchases

Year-end purchases of business assets may achieve significant tax savings. An exception applies when the total cost of assets placed in service during the last quarter of the tax year exceeds 40% of the year's total purchases.

Your business may also elect under Section 179 of the tax code to currently deduct the cost of qualifying assets instead of depreciating them. For 2007, the maximum amount that may be deducted is \$125,000. There are some exceptions to this rule.

Start-up costs

If you started a new business in 2007 and incurred expenses before the business commenced operation, \$5,000 of those types of expense can be deducted as long as the business officially started before year-end 2007.

Retirement Plan Contribution

Another way to lower business taxes is to contribute as much as possible to your company's retirement plan.

- You may wish to consider modifying your 401(k) plan before year-end to allow discretionary profit-sharing contributions.
- In some cases, you may be able to declare a profit sharing contribution

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in 2007 and fund it in 2008 if you file for an extension to file your tax return.

- If you expect a net operating loss for 2007 that can be carried back to offset taxable income from a prior year, you may want to consider increasing the loss by accelerating deductions in 2007.

Business Tax Credits

There are a number of tax credits to take advantage of. The following is an example of some of the credits available to businesses:

- **Disabled access**—50% of eligible expenditures, but not more than \$10,250.
- **Employer-provided Child Care**—25% of expense to buy, build, rehabilitate, or expand property that will be used as part of an employee's child care facility up to a maximum credit of \$150,000 per year.
- **Investment**—10% (or more) of the costs of rehabilitating a building placed in service prior to 1936 or installing solar, geothermal, or fuel cell equipment.
- **Work opportunity**— a percentage of first-year wages paid to members of certain groups.

The information in this article is not intended to be, nor should it be treated as tax, legal, or accounting advice. Additional issues, circumstances, etc. could exist that would offset the tax treatment of a specific transaction or planning strategy. You should seek advice from a tax advisor before acting on any information presented. This information is not intended to be an all-inclusive article about tax planning and advice or avoiding tax penalties.

Please feel free to contact Tom Marien with any questions concerning this article or about any of your tax and financial planning needs.

NEW IRS REQUIREMENTS FOR VERY SMALL NON-PROFITS

In the past many small non-profits were not required to file an annual information return (Form 990) with the Internal Revenue Service because their gross income (all receipts before expenses) was less than \$25,000.

The rules have changed for tax periods beginning after December 31, 2006. Small non-profits will now be required to file electronically on a form called a Form 990-N, also known as the e-postcard. This will be required to be filed annually.

Every small non-profit in the IRS data bank should be receiving a letter from the IRS. The electronic filing system is still being developed. When it is completed, information will be available at www.irs.gov/eo. If the non-profit fails to file the information return for 3 consecutive years, their tax-exempt status will be revoked automatically.

"Do not anticipate trouble, or worry about what may never happen. Keep in the Sunlight."

...Benjamin Franklin

DOING BUSINESS IN MEXICO

Mexico has made considerable efforts to reform its economy and open it to free trade through NAFTA and the EU-Mexico Free Trade agreement. In 2001, Mexico became Latin America's largest economy.

Economic Regions

For business purposes, Mexico can be divided into 3 economic regions: the North, Central, and South.

The Northern region has taken on many

of the customary business approaches found in the USA. Most of the "maquiladoras" (factories) are located in the Northern part of Mexico. The Central area has values similar to the Mid-West in the USA. This area is experiencing rapid growth due to state and local governments promoting foreign investment. The Southern area has less commercial business and the lowest level of infrastructure.

Business Culture

The Mexicans often use family and personal networks for conducting business. In Mexico, business is about relationships and people. It is important to socialize with business associates and attend their family events like weddings, birthdays, and anniversaries.

The extent of formality in the conduct of business can depend on the industry concerned. For example, in some cases, large business transactions will be consummated without a contract. Conversely, in other cases with small transactions, the paperwork can be complex and a signed contract is required. When doing business in Mexico, it is always recommended to close a business transaction with a signed contract.

Business Legal Structure

There are various types of business legal structures in Mexico:

The Sociedad Anonima (S.A.) is a limited liability corporation with fixed capital. It must have at least two shareholders and a minimum capital of 50,000 pesos (approximately \$4,500). Shareholder liability is limited to capital.

Sociedad Anonima de Capital Variable (S.A. de C.V.) is a limited liability company with variable capital. This is the most popular with foreign investors. It has similar features as the S.A., but changes in capital are allowed with approval.

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Other forms of legal business structures are:

- Sociedad de Responsabilidad Limitada (S. de R.L.) —Limited Liability Partnership
- Sociedad de Nombre Colectivo, (S. en N.C.)—General Partnership
- Sociedad en Comandita, (S. en C.S.)—Partnership of Limited and General Investors

Taxes

The national tax authority in Mexico is called the “Hacienda.” This is similar to the Internal Revenue Service. The Mexican tax system is primarily at the federal level with a payroll tax at the state level.

Business Etiquette

Mexicans dress formally for business meetings with suits and ties.

Breakfast is the meal where most business takes place. It’s not unusual for breakfast business meetings to take place in good restaurants with much pa-

perwork brought to the meeting. A business lunch is more of a socializing-networking time and normally takes place between 2 and 4pm. Lunch is the main meal of the day. Dinner in Mexico starts around 9pm and typically, business is not discussed.

Mexican businesses tend to be very hierarchical. Status and position are important in Mexico. If a Mexican firm’s top managers are present at a meeting, they will expect the same from the other company. They will feel insulted if subordinates are sent to meet with them. Typically, senior people in Mexican businesses are the decision-makers.

In Mexico, people have three names: their first name, then paternal name and maternal name. When writing, they will use all three, but verbally, they will use the first two.

Understanding Mexico’s business culture, laws, and social customs takes

time. Doing business in Mexico is different—not more difficult.

For additional information about doing business in Mexico or in other countries, contact Tom Marien.

“RAISING THE BAR” CLASSES

In July and August, we held our “Raising the Bar” series of classes for municipal finance personnel. The new auditing standards will require us to consider issuing a management letter if we propose material adjustments to the client’s records. This series reviewed in detail bookkeeping procedures for the most common accounts that require adjustments. Each week there was an excellent turnout of enthusiastic participants.

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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