

ANSPACH FINANCIAL GROUP

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FALL NEWSLETTER

SEPTEMBER, 2006

New Tax Legislation Targets Retirement

The Pension Protection Act of 2006 was signed into law by President Bush on August 17. A massive tax bill intended to reform the private pension system, it provides a multitude of other tax changes that have implications for tax planning in 2006 and beyond. While the bulk of the legislation is designed to force employers to shore up their pension plans, it also contains provisions to help workers who save for retirement through contributory plans like IRAs and 401(k)s. Another significant component of the new tax law aims to tighten the charitable contribution rules and provide new incentives for charitable giving.

We're devoting a significant portion of this newsletter to highlight various provisions of the new law to help you identify which areas may impact your own situation and adjust your tax planning accordingly. As with all large tax reform packages, there is likely to be subsequent clarification of some of the new rules or procedures introduced in this legislation. We will provide updates on new developments in our "end-of-year" newsletter which will be mailed out in mid-November.

Pension & Retirement Plan Reform

One of the major themes of the Pension Protection Act of 2006 is that there should be more transparency so that workers, regulators and investors can better track the financial health of traditional pension and retirement plans. As we have seen far too often in recent years, workers relying on these plans for retirement have been shocked to discover that what they thought was secure had become worth only a fraction of the value they expected.

While there are basic provisions that cover all plans (such as a start-up credit for new employer plans), many of the reforms are specific to one of the two major types of company-sponsored plans.

Defined benefit pension plans

These are the traditional employer-funded private pension plans that promise workers a specific

monthly benefit when they retire. Designed to ensure that employers fund the plans to meet their obligations to their employees and retirees, the reforms shore up the pension insurance system (PBGC) in several key ways. It requires companies which underfund their plans to pay additional premiums. It extends the requirement that companies which terminate their pensions must provide extra funding for the system. It closes loopholes that allow underfunded plans to skip pension payments. It raises caps on the amount that employers can put into their pension plans so they can add more money during good times and build up a cushion that can keep pensions solvent in lean times.

Defined contribution plans

The most prevalent of company-sponsored plans

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Special points of interest:

- New federal tax legislation offers retirement tax breaks and tightens rules for charitable contributions.
- Beginning in 2008 all taxpayers can convert traditional IRA to Roth IRA.
- State agency wants Californians to pay use tax on internet and out-of-state purchases.

Charitable Reforms & Incentives

The Pension Protection Act contains a package of provisions that aim to curb abuse in the charitable sector. Under the new law, taxpayers must keep records for all cash donations in the form of a receipt, cancelled check or credit card statement. No longer will a deduction be allowed for cash put in the church collection basket or small amounts given to Salvation Army bell ringers. There are new restrictions on the valuation of

donated clothing or household items (a long perceived area of abuse). The non-cash items are required to be in "good used condition or better". Since this terminology is not defined in the Act, it is anticipated that IRS audits of returns that list donated property will require filers to confirm the worth of their gifts.

The 2006 Act also provides a new incentive for charitable giving by allowing tax-free distributions from

IRA accounts that are qualified charitable contributions. An otherwise taxable distribution from a traditional IRA or Roth IRA will be excluded from income as long as the donor has reached the age of 70½ and the contribution is made directly from the IRA trustee to the qualifying charity. The maximum allowable for the exclusion each year is \$100,000, and this provision is currently effective for tax years 2006 and 2007 only.

Pension & Retirement Plan Reform

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such as 401(k) plans, these are retirement savings accounts funded mainly by employee contributions.

The reform is designed to make it easier for workers to participate in these plans. It will remove barriers that prevent companies from automatically enrolling their employees in these savings plans, and it will require that employees have more information about the performance of their accounts, their right to change investment options, and the importance of maintaining a diversified portfolio.

Most importantly, the bill expands access to high quality, professional investment advice and includes tough fiduciary and disclosure safeguards to ensure that advice provided to employees is solely in their best interest. The same companies that administer plans will now be allowed to offer specific advice to participants about investing in their own accounts. The advice must be based on a computer model that has been certified as bias-free by an independent third party in order to prevent companies from recommending their own high-fee funds.

Though technically not classified as qualified plans, other employer-sponsored plans such as SEPs and SIMPLEs are governed by the newly expanded disclosure rules and investment advice reforms.

Individual Retirement Accounts (IRAs)

Effective beginning in 2007 the income limits for deductible IRA contributions for active participants in an employer-sponsored plan will be indexed for inflation. Similarly the income limits for allowable Roth IRA contributions will be indexed to inflation. This will result in more taxpayers being eligible for deductible IRA contributions and/or Roth IRA account contributions.

In 2008 the AGI limits will be removed for taxpayers who want to convert a traditional IRA to a Roth IRA.

Currently only those whose adjusted gross income is less than \$100,000 are allowed the Roth IRA conversion.

Other provisions include:

- Taxpayers can have federal refunds deposited directly into an IRA account beginning in 2007.
- The Retirement Savings Tax Credit is made permanent and will be adjusted for inflation beginning in 2007.
- Tax-free distributions from IRAs will be allowed for charitable purposes (see details in enclosed article about charitable reforms & incentives).

General Retirement Plan Provisions

The following provisions are effective beginning in 2007:

- Distributions from qualified plans will be allowed after age 62 for employees who have not separated from service. A pro rata distribution will be allowed for part-time employees over age 59½ who have reduced to 80% or less of full time.
- Non-spouse beneficiaries will be able to roll over assets inherited from a qualified retirement plan into an IRA, affording them the same tax treatment that was previously only available to a surviving spouse. This will mean more flexible retirement and estate planning for non-spouse beneficiaries, such as domestic partners.

Beginning in 2008 the Act allows distributions from qualified retirement plans, tax sheltered annuities and governmental (457) plans to be rolled over directly into a Roth IRA, subject to the usual rules applicable to rollovers from traditional IRAs to Roth IRAs. This will bypass the current requirement to first rollover from an employer's plan into a traditional IRA and then into a Roth IRA.

State of CA Goes After Use Tax

The State of California is aggressively pursuing collection of use tax from consumers. Use tax is like sales tax, but you pay it directly to the state rather than to the retailer. Use tax generally applies to out-of-state purchases that would be subject to sales tax if they were purchased in California. Most commonly, these include purchases made through the internet, from catalogues, or from shopping trips outside of the state. It also applies to purchases of RVs, boats or planes purchased in a state with no sales tax and brought into California within the following 12 months.

(Automobiles purchased out-of-state are subject to a separate set of rules administered by the Dept. of Motor Vehicles.)

The imposition of use tax also protects California merchants from a competitive disadvantage from

out-of-state vendors who are not required to charge a sales tax on interstate merchandise sales.

Use tax is not new, nor is the self-reporting requirement. What is fairly new is the ease of reporting use tax liability on your California income tax return. You can also pay it by filing Form BOE-401-DS with the state.

We are now required by law to ask about use tax liabilities, and we've incorporated this item into the questionnaire in the tax organizer.

Collection has also become a greater priority for California primarily due to the loss of revenue resulting from the increase in internet purchases. A new state program plans to follow up on about 180,000 out-of-state cigarette and tobacco receipts to let taxpayers know they owe state excise and sales taxes on those purchases. This program

is expected to generate more than \$33 million in revenue during the current fiscal year. A new team will be stationed at state border inspections stations to detect and identify property subject to unpaid use tax.

Most Californians are not used to keeping track of their purchases subject to use tax, and it is not always easy to determine what is and what is not subject to use tax. As always, we are available to answer your questions.

Family Gifts—Simple, But Not So Simple

Family members, most commonly parents and grandparents, often wish to gift money or property to other family members for a variety of reasons. These gifts can be more complicated than simply writing a check or transferring title of real estate or stocks. There are often gift tax and estate tax issues to consider. Others have concerns about the control of the gift and participation of the recipient in learning about finances.

Here are the basics. The annual gift exclusion is currently \$12,000 per person. That means that anyone can give to any one person up to \$12,000 (cash or value of property) in a calendar year without any reporting requirements. Remember, gifts to individuals are not deductible by the giver or includible in income by the recipient. The lifetime gift exclusion is \$1,000,000. That means gifts in excess of the \$12,000 per person each year can reach \$1,000,000 before any gift tax is due. There is a reporting requirement for these gifts in excess of the annual exclusion, but no tax due until they exceed the \$1,000,000 limit.

Gifts may be made directly to an individual, to a custodial account (if the recipient is a minor), to a trust, to an education savings account or to a retirement account, to name the most common gift vehicles. To qualify as a completed gift, the giver must give up control of the gift to the recipient, although the giver may serve as custodian or trustee.

Gifts that do not count against either the annual or lifetime exclusion are tuition payments made directly to educational institutions and medical payments paid directly to medical providers. A special rule applies to 529 education savings accounts whereby up to five years worth of annual gift exclusion can be used in a single year. For example, \$60,000 could be contributed to the 529 plan on behalf of an individual in 2006 without impacting the lifetime exclusion, there is and no requirement to report it. The giver must then wait until 2011 to make any additional gifts to that person in order to avoid the requirement to file gift tax returns and use a portion of the lifetime exclusion limit.

This is yet another area of complexity that raises many questions. Please consult with us prior to your gifting to assure you achieve the outcome you intend.

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At Anspach Financial Group, we are committed to providing valuable and personalized services to each of our clients. We strive to solve complex tax and related issues by combining technical expertise with creative planning and problem solving. The experience, professional credentials and personal attention of our partners provide our clients with superior services at reasonable cost.

Tax Calendar

Tax Due Dates

- September 15** Third quarter estimated tax payments due.
Final filing due date for calendar year corporation returns on extension.
(All information required to complete the tax returns must be in our office immediately to meet this deadline.)
- October 16** Final filing due date for individual, partnership and fiduciary returns on extension. *
- January 15** Fourth quarter estimated tax payments due.

Anspach Financial Group Deadline Dates *

- September 11** Deadline to provide all required information for the preparation of individual, partnership and fiduciary returns to guarantee completion by October 16, the extended due date.

We have a large number of tax returns on extension and need tax return information from those clients as soon as possible. The elimination of the interim deadlines and our vacation schedules will make preparing "last minute" tax returns extremely difficult.