

ANSPACH FINANCIAL GROUP

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FALL NEWSLETTER

SEPTEMBER, 2007

Tax Planning Season Is Upon Us

Many are under the impression that tax offices go into a brief hibernation mode after the October 15th final tax filing deadline, but that certainly is not the case at Anspach Financial Group. This is the time of year when we can do our best work helping clients find and take advantage of opportunities to enhance their financial health. Too often during the long tax filing period, we see clients we wish had consulted us the previous year when we could have recommended a different course of action that could have resulted in a more favorable outcome. Often it's just a matter of timing, when either the postponement or acceleration of an action into a different tax year could have made a considerable difference in the tax liability.

We're devoting this issue to the identification of some of the timeliest opportunities that you may want to employ before the end of the year, or make preparations to put into place early in the next tax year. As you know, the tax laws are complex (they're literally written in code) and their application is not equal. There are income limitations, deduction floors, ceilings, sunsets and countless additional colorful terms that can be used to limit your individual eligibility for a particular credit or incentive. That's what we are here for - to help you identify and implement available strategies that are appropriate for you. So, before you run out and start selecting colors for that hybrid car you've been looking for an excuse to buy, give us a call and let's work through the numbers.

Roth IRA Gift to Child or Grandchild

If your child or grandchild has earned income from full-time, part-time or summer jobs, you may want to consider a Roth IRA contribution on their behalf. The Roth account contribution can be as much as the child earns, up to a maximum of \$4,000 for tax year 2007 (\$5,000 in 2008).

These young earners are generally not inclined to fund a retirement plan with their first paychecks, but ironically, they are of the age group to best benefit from this powerful savings vehicle. A 16-year old with \$4,000 in a Roth IRA account that earns 7% a year will have an account worth more than \$117,000 at age 65. Of course the account will be worth considerably more if additional contributions are made for subsequent tax years.

The best part of the story is that this money can be taken out of the account tax-free after the account-

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Special points of interest:

- It may not be too early to start planning for the new Roth IRA conversion rules beginning in 2010.
- There is still time in 2007 to make purchases that may qualify for certain energy credits and hybrid vehicle credits.

For a basic history and explanation of the AMT, please refer to the June 2006 issue of our newsletter available on our Website. Link to "newsletters" where you will find archived copies of all past issues.

Higher Tax Rate for Children's Custodial Accounts

You may want to consider taking gains in custodial accounts this year because of an unfavorable tax law change beginning next year. Under current law, a child's unearned income over \$1,700 is taxed at the parents' rate until the child turns 18. Beginning in 2008 this "Kiddie Tax" will be expanded to apply to 18-year olds as well as to student dependents under 24 years of age. Students will continue to qualify as dependents while enrolled in school at least five months of the year taking a minimum of 12 units.

The remaining months of 2007 comprise a window of opportunity to recognize gains in the custodial accounts of this new age group to be subject to the Kiddie Tax, and pay tax at the child's tax rate. The cash from the gains can be placed in a 529 plan where payouts for college are tax free.

Still Singing the AMT Blues

The Alternative Minimum Tax (AMT) continues to be a source of frustration, confusion, and even anger among taxpayers. It is difficult to understand; even more difficult to avoid. This brief article is an attempt to demystify the calculation of the AMT.

If you have paid AMT in the past, find Form 6251 in your copy of the tax return. If you have not yet been subject to AMT but want to walk through this illustration, you can find the form on the IRS Website at www.irs.gov. We will focus on a few lines that cause most taxpayers into AMT. Here we go.

Line 1 is the starting point - this is your AGI (adjusted gross income) less itemized deductions.

Line 3 is the single largest trouble maker - state income taxes, real property taxes and personal property taxes that are not deductible for AMT purposes.

Line 5 presents another problem, but mostly for taxpayers who have large employee business expenses or large investment expenses.

Lines 6-27 will have small numbers, if any, for a vast majority of taxpayers. If you have a large number on any of these lines, we have most likely discussed this.

Line 28 is your taxable income in the AMT system.

Line 29 is your exemption which depends on filing status and income level. As you can see, the exemption amounts phase-out as income increases.

Line 31 is the tax calculated in the AMT system.

Line 34 is the tax calculated in the regular tax system.

Line 35 is the AMT (the excess of the tax calculated in the AMT system over the regular tax).

Keep in mind that the cause of the ever invasive AMT is the lowering of the regular tax rates without similar reductions in the AMT calculation. As regular tax rates have been lowered and AMT rates have remained relatively constant, more and more taxpayers have become all too familiar with AMT.

Recent information indicates that what has become an annual event will repeat itself again this year. End of year action by Congress is expected to keep the AMT exemption levels at least as high as 2006. The uncertainty of the exemption amount until the end of the year makes current year tax planning extremely difficult for anyone who may be impacted by the Alternative Minimum Tax. We hope our elected representatives will forge a more permanent solution to this increasingly pervasive problem in the near (very near) future.

Roth IRA Gift to Child or Grandchild

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holder has reached age 59 1/2. Since the Roth contributions are made with "after-tax" money, they can be taken out at any age tax-free and are thus available to go towards a first home purchase. Distributions of earnings prior to age 59 1/2 are taxable and subject to early distribution penalties.

This gift facilitates a financial education opportunity for the young adult recipient. They will need to sign the documents to establish the account with an IRA custodian and name a beneficiary. You can assist them in selecting and monitoring the investments. But even more importantly, you can help them see the power of saving for their own future.

Save Taxes by Hiring Your Kids

If you are a business owner, there are potential tax savings available when you employ your children. The wages paid must be for legitimate services performed by the child, and they must be reasonable compensation for those services to qualify as deductible business expenses. The potential tax savings are twofold:

Income Taxes

You can shift some of your income to your child who will likely be taxed at a lower rate than you. A child has a standard deduction up to \$5,350 (indexed each year) for earned income, so you can pay them \$5,350 in wages tax-free. A typical business owner may save close to \$2,000 in taxes with no cost to the child.

Social Security Taxes

If your business is not incorporated, you can save on Social Security taxes if the child you employ is under age 18. They are specifically exempt from these taxes if employed by parents who are sole proprietors or the sole partners in a partnership.

There is an additional opportunity to fund retirement accounts for the child. If you have a company retirement plan and your child meets the eligibility requirements, you can shelter income by contributing to their plan account. If you don't have a plan in place, or if they do not qualify to participate, you can shelter from tax up to an additional \$4,000 in wages (2007 IRA limit) by funding a deductible IRA account in the child's name.

Get Ready For New Roth Conversion Rules

The premise is sound - convert retirement account funds into a Roth IRA account, pay taxes now and grow accounts for tax-free distribution later. The problem is that many of our clients aren't eligible to make these Roth conversions because they make too much money (more than \$100,000). This will change in 2010 when the income limitation rule will be lifted, and anyone with an IRA account can convert it to a Roth IRA and pay the taxes ratably over the following two years in 2011 and 2012.

What if you don't have an IRA? You may not be eligible to contribute to an IRA because you participate in an employer-sponsored retirement plan. However, anyone is eligible to contribute to a non-deductible IRA account up to the annual limits (\$4,000 in 2007, increasing to \$5,000 in 2008, plus \$1,000 catch-up for those over age 50). Your contributions to these accounts aren't deductible, but the earnings accumulate in your IRA account tax-deferred.

Take an example of how this works. Assume a taxpayer makes contributions of \$4,000 per year for four years to his non-deductible IRA account. When he converts this account to a Roth IRA his \$16,000 has earned \$1,000. If he has no other IRA accounts, the cost of converting the \$17,000 account will only be the taxes on the \$1,000 in earnings.

The tax bill on the conversion will be higher if he has additional IRA accounts since the non-deductible contributions must be prorated over the value of all IRAs. In this example suppose our taxpayer has a rollover IRA account that is worth \$100,000 at the time of the Roth IRA conversion. He would have to add the value of the two accounts (\$117,000) to determine the taxable amount, and in this case he would pay tax on \$14,674 in the year of conversion. Of course he would now have tax basis in the IRA account that he didn't convert, and subsequent distributions from that account will be taxed proportionately upon withdrawal.

This is a complex area of tax planning, but we can help you determine what planning strategies may be appropriate for your unique situation.

Hybrid Auto and Energy Credits Still Available

You may still be able to receive a tax credit for purchasing or leasing a qualified hybrid vehicle. Partial credits are available for Toyota and Lexus hybrids, while full credits are still available for Honda, Ford, GM and Nissan hybrids through the end of September. Mazda has also entered the hybrid market with its 2008 Tribute.

Be careful to consider that this is not a credit against the Alternative Minimum Tax (AMT). If you are already in AMT, you will not receive a hybrid credit.

Go to the IRS Website, www.irs.gov, for the most recent information on these credits and search "qualified hybrid vehicles".

There is still time to take advantage of the residential and commercial energy credits that are set to expire at the end of this year. The residential credits are available for expenditures on a principal residence that include insulation, exterior doors and windows, qualifying solar systems and qualifying hot water heaters. Like the hybrid credit, these are not credits against AMT.

Legislation has been proposed that would extend the expiring energy credits for a few more years. There is also a proposal to allow the hybrid credit to offset AMT and larger solar energy credits.

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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 and staff provide our clients with superior services at reasonable cost.

Calendar

Tax Due Dates

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| September 17 | Final filing due date for calendar year corporation returns on extension
Third quarter estimated tax payments due |
| October 15 | Final filing due date for individual, partnership and fiduciary returns on extension |
| December 10 | Due date for 1st installment property tax payment |

Anspach Financial Group Deadline Dates *

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| August 24 | Deadline for providing all required information for the preparation of 2006 calendar year corporation returns to guarantee completion by September 17, the extended due date |
| September 21 | Deadline for providing all required information for the preparation of individual, partnership and fiduciary returns to guarantee completion by October 15, the extended due date |

*These deadlines are based on the large number of tax returns that we have on extension. It is important not only that we have sufficient time to prepare accurate returns, but also that you have time to review the completed returns before the final filing date. Please make arrangements to get your 2006 tax information to us as soon as you possibly can.