As this year enters the home stretch, there is still time to plan to reduce your 2006 federal income taxes. Adding to existing tax-saving strategies are some new ones presented by recent tax legislation. On the other hand, the uncertain fate of several popular tax breaks that expired at the end of 2005 could make 2006 year-end planning more difficult.

Tried and True Strategies

Here are some proven strategies that may help you reduce your taxes once again this year. Of course, before applying any of these strategies to your personal situation, consult with one of our tax professionals.

Deductible Interest. Consider making your January 2007 mortgage payment (which includes December's interest) in late December 2006, so that the mortgage interest will be deductible on your 2006 return (applicable only if you itemize deductions on your income-tax return).

Medical and Miscellaneous Itemized Expenses. Your deductions are limited to the amounts that exceed 7.5% of adjusted gross income for medical expenses and 2% of adjusted gross income for miscellaneous expenses. Bunching two years of your or your family’s unreimbursed medical or miscellaneous itemized expenses (such as certain job-related expenses and investment expenses) into one year may allow you to surpass the deduction floors and help you gain an itemized deduction for part of your expenses.

Charitable Contributions. If you are planning to make a charitable donation in early 2007, consider a 2006 year-end donation instead. Contributions charged on your credit card in 2006 count as 2006 deductions, even if you don’t receive or pay the credit card bill until 2007.

Taxes. If you pay quarterly estimated state income taxes, consider paying your last 2006 estimate by December 31, so that the taxes will be deductible on this year's tax return. Employees who have state income taxes withheld from their pay may wish to increase the amount withheld from their remaining 2006 paychecks to cover any projected underpayment.

However, if you are a high earner facing a limitation on your itemized deductions or if you expect to be in a much higher tax bracket in 2007, accelerating these payments into 2006 may not be your best course of action. In addition, if you claim high deductions in 2006, you may be subject to the alternative minimum tax. See us for more details.

Income Deferral. Review any opportunities you may have to push taxable income into a later tax year. Deferral strategies are especially effective if you expect to be in the same or a lower tax bracket in the year in which you will be reporting the income on your tax return. Any of these strategies may help cut your 2006 taxes:

- Ask your employer to defer paying your 2006 year-end bonus until early 2007.
- Maximize 2006 contributions to any tax-deferred retirement savings plan in which you participate, such as a 401(k) plan or a 403(b) tax-sheltered annuity. If you are age 50 or older, you may be able to make additional “catch up” contributions to your plan.
- If you are self-employed and use the cash method of accounting for income-tax purposes, time late 2006 customer billings so that payment won’t be received until 2007.

Self-employed business owners who do not already have a tax-deferred retirement plan should consider starting one before year-end. Options to examine include a so-called “solo 401(k)” plan, a Simplified Employee Pension (SEP) plan, or a SIMPLE plan.

continued on page 6
Each year usually brings several changes in the federal tax laws that affect individual taxpayers. Some are recurring—for instance, the inflation-based increases in the income-tax brackets. Others are due to new laws passed in the previous year. And still others are the result of delayed effective dates for laws enacted in years past.

For tax year 2006, there are a number of changes that may have an impact on your planning and your income-tax return to be filed in 2007. Here is a brief rundown of the more important changes.

**PERSONAL EXEMPTION PHASEOUT**

If your adjusted gross income (AGI) exceeds a certain threshold amount, the $3,300 personal exemption amount you can claim for yourself and your dependents begins to be phased out. The 2006 threshold amounts are: $225,750 for married joint filers, $188,150 for a head of household, $150,500 for unmarried filers, and $122,875 for married-separate filers.

The 2006 change: Due to a 2001 law, for 2006 this personal exemption phaseout is reduced so that it will be only two thirds of the normal phaseout.

Example: Assume a married couple with three children has 2006 joint AGI that triggers the personal exemption phaseout. Normally, with their AGI, the amount they could claim as personal exemptions would be reduced by $3,300. But, due to this new provision, their personal exemptions will only be reduced by $2,200.

**ITEMIZED DEDUCTION REDUCTION**

Similarly, your itemized deductions (for example, state/local taxes and mortgage interest paid) are reduced starting when your AGI exceeds $150,500 ($75,250 for married separate filers). As with the personal exemption phaseout, for 2006 the reduction in itemized deductions is scaled back so that you will lose only two thirds of the normal amount.

**RETIREMENT PLAN LIMITS**

Certain retirement plan limits increase for years beginning after 2005.

- For 401(k), 403(b), salary reduction SEP, and 457 deferred compensation plans, the deferral limit rises from $14,000 to $15,000.
- For those same plans, the catch-up contribution limit (for those at least age 50) rises from $4,000 to $5,000.
- The IRA catch-up contribution limit increases from $500 to $1,000.
- The SIMPLE plan catch-up contribution limit rises from $2,000 to $2,500.

In addition, starting in 2006, 401(k) and 403(b) plans can (but do not have to) allow plan participants to make after-tax Roth contributions, with no income restrictions. (In contrast, higher-income taxpayers cannot contribute to Roth IRAs.) If all requirements are met, earnings on the Roth contributions will avoid tax when distributed.

If you are an active participant in a retirement plan at work and contribute to an IRA, you are not allowed a tax deduction for your IRA contribution if your modified AGI exceeds a certain amount. In 2006, this amount increases for married joint filers and qualifying surviving spouses to $85,000 from $80,000 in 2005.

**RESIDENTIAL ENERGY CREDITS**

Two new residential energy credits are available for certain energy savings expenses, starting in 2006.

The nonbusiness energy property credit allows you to claim a lifetime tax credit (i.e., a direct offset against tax) of up to $500 for making qualifying energy saving improvements to your home. The residential energy efficient property credit allows an annual tax credit of up to 30% of the amount paid during the year for qualifying energy efficient property such as photovoltaic (solar power) property, solar water heating systems, or fuel cell property. Both credits are available through 2007. Several requirements and limits apply.

**ALTERNATIVE MOTOR VEHICLE CREDIT**

If you buy a hybrid or lean burn vehicle in 2006, you may be entitled to a credit of up to $3,400 (depending on how fuel-efficient the vehicle is). This credit replaces tax deductions available for certain vehicles placed in service before 2006.

**ESTATE TAXES**

The top federal estate-tax rate has dropped to 46% (from 47%) for 2006. The exemption equivalent amount of estate value that is free from the estate tax has increased to $2 million from $1.5 million.

**EXPIRED PROVISIONS**

Several favorable tax provisions expired at the end of 2005. Currently, Congress is considering some of these items for reinstatement.

- Decreased AMT exemption amount. Higher exemption amounts used in computing the alternative minimum tax expired at the end of last year, so the old lower exemption amounts are in effect for 2006 (unless Congress reinstates the higher amounts).
- Educator expenses. This above-the-line deduction for certain educator’s expenses is no longer allowable.

**NEED TAX HELP?**

These changes and others may have an impact on your 2006 planning. Our tax professionals can help you look at your 2006 tax picture now with an eye on the tax law changes that will affect your tax bill come April 2007. The earlier you plan, the easier it will be to cut your 2006 taxes.
The word “disaster” brings to mind earthquakes, hurricanes, fires, floods and, more recently, terrorist attacks. But it can also mean losing a key person to massive heart failure, or to a major competitor, or even discovering that someone has stolen your network servers.

While these types of disasters don’t inspire blockbuster movies, there’s a much greater chance that a smaller scale event could some day impact your businesses productivity and even its ability to survive. A good disaster plan will cover all the bases, from power outages to a tsunami.

Here are some guidelines to help you create a disaster plan that is most suited for your particular business.

**Worst case scenarios**

The first step is to brainstorm on likely disasters or emergencies to prepare for. You’ll need input from everyone with management and supervisory responsibilities in your business. Include every major and minor event that could interrupt firm operations, from natural disasters to power outages to employee fraud.

Once you have a list, it’s time to decide on courses of action for each disaster. Determine who needs to do what and when they need to do it. For example, if the CEO gets hit by a bus or the whole management team is wiped out in a plane crash, who takes over? These events have happened to companies before. Who has access to the files? Who else can sign checks? What happens to the line of credit at the bank?

On a larger scale, if the company’s building is uninhabitable due to a flood, earthquake or fire, where can you set up shop? How would you notify clients, employees or vendors? Who will have the necessary information to make this happen?

**Critical steps to neutralize effects**

While having plans in place to deal with emergency situations is crucial, there is much you can do ahead of time that will neutralize potential crises. The following checklist will help lessen the impact of most emergency situations:

**Review your insurance policies.**
Determine what’s really covered and, more important, what’s not. For example, if your firm is located on a floodplain, you may need a separate flood insurance policy.

**Keep duplicate files.**
Client files and contact information, time and billing records, and other critical records should all be copied and stored off-site.

**Prepare a communication plan.**
Develop a coordinated approach for contacting clients to let them know you’re still in business and attending to their needs. You also need a plan for communicating with employees. Provide a number to call in case of emergency so they can find out where to report for work and how to contact others. Other options are to post a notice on a secure area of your Web site or even do an old-fashioned phone chain.

**Arrange for continuing critical processes.**
In spite of disasters, your vendors and employees will expect to be paid for past work and services. So create a plan to allow emergency payroll and accounts payable processing.

**Planning now could save you later**
Creating a disaster plan entails a great deal of time and effort. But not having one could put your company out of business. Before you decide to put it off, consider: How many people and their families depend on your company for their financial well being? Isn’t that reason enough to make the effort before it’s too late?
After much debate, the Pension Protection Act of 2006 has become law. The new law contains many significant changes to the federal laws governing traditional defined benefit pension plans, as well as defined contribution plans (such as 401(k) salary deferral plans and profit sharing plans) and Individual Retirement Accounts. The Act will have an impact on almost every employer sponsoring a retirement plan and every employee participating in a plan.

The new law also contains provisions that change some important rules for income-tax charitable contribution deductions and exempt charitable organizations.

This summary is intended to familiarize you with the new law. However, since many of the changes are complex, you’ll want professional guidance before acting on any of the law’s provisions.

**Defined Benefit Plans**

The Pension Protection Act (the “Act”) overhauls the rules affecting defined benefit pension plans. The changes are generally effective for the 2008 plan year (with some exceptions). The new law:

- Reforms funding requirements for single- and multiemployer plans.
- Increases the tax deduction limits for defined benefit plan sponsors, under certain conditions.
- Changes the rules for calculating lump-sum distributions from defined benefit plans.
- Provides special funding relief for specific industries, including airlines.
- Restricts benefit payouts with respect to underfunded plans and imposes significant tax penalties on executives whose employers set aside or reserve assets in a nonqualified deferred compensation plan when the employer’s defined benefit plan is considered to be “at risk” or the plan sponsor is in bankruptcy.

The Act also affects so-called “cash-balance plans” and other hybrid retirement plans. For example, the Act imposes requirements on conversions of defined benefit plans to hybrid plans, generally effective for conversions occurring after June 29, 2005.

**Pension Rules’ “Sunset” Reversed**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) overhauled many retirement plan and IRA rules. Many of the changes were set to expire after 2010, while at least one was due to “sunset” (expire) at the end of 2006. Under the Act, the EGTRRA provisions relating to retirement plans and IRAs become permanent.

**Section 529 Plans**

Certain changes made in EGTRRA regarding the tax treatment of qualified tuition programs (so-called “529 plans”) were scheduled to “sunset” after 2010, including the provision that qualified withdrawals from qualified tuition accounts are exempt from income tax. The Act makes these changes permanent.

**Other Pension Provisions**

- **Automatic enrollment.** For plan years beginning on or after January 1, 2008, the Act provides several incentives for sponsoring employers to adopt automatic enrollment in their 401(k) plans.
- **Investment advice.** The Act permits retirement plan service providers who offer investments to the plan (“fiduciary advisers”) to recommend their own funds without violating fiduciary rules, if certain requirements are met. The new rules are generally applicable beginning in 2007.
- **New participant disclosure rules.** Among several changes: Defined contribution plans must provide benefit statements at least quarterly to participants who can direct their own investments and annually to participants who cannot. Special requirements apply to the content of the statements for participant-directed plans. The new requirements generally go into effect for plan years beginning after 2006.
- **DB(k) Plans.** For plan years beginning in 2010 and later, an “eligible combined plan” will allow 401(k) deferrals to be made to a defined benefit pension plan. Several requirements apply.
- **Direct rollovers.** Starting in 2008, participants will be able to make direct rollovers of distributions from their qualified plans (e.g., 401(k) plans), 403(b) tax-sheltered annuity plans, and governmental 457 deferred compensation plans to Roth IRAs. The conversion will be taxable, but all future earnings on the Roth IRA will be tax free, if all requirements are met.
- **Inherited benefits.** Beginning in 2007, non-spouse
beneficiaries of a decedent’s balance in a qualified plan (such as a 401(k) plan) may roll over the inherited amounts to their own IRAs. Previously, only surviving spouses could do this.

• In-service distributions. For distributions in plan years beginning after 2006, defined benefit plans can make in-service distributions to participants age 62 or older seeking to phase into retirement.

• After-tax amounts. Beginning in 2007, the portability of after-tax retirement plan contributions is expanded. The new law allows direct rollovers of after-tax contributions between different types of employer plans (from a 401(k) plan to a 403(b) tax-sheltered annuity, for instance).

• Tax refunds to IRAs. Starting in 2007, taxpayers can have all or part of their federal income-tax refunds directly deposited into an IRA, within applicable limits.

• Saver’s Credit. The income limits applicable to the Saver’s Credit (a tax credit for lower-income individuals who save for retirement) will be adjusted for inflation. The law also makes the credit permanent.

• IRA income limits. The income-related limits that apply to deductible contributions to traditional IRAs and after-tax contributions to Roth IRAs are made subject to inflation indexing.

• Hardship withdrawals. Hardship withdrawals will be permitted for hardships of a person who is a participant's beneficiary under the plan, even if that beneficiary is not a spouse or dependent. Similar rules will apply to unforeseeable financial emergencies for beneficiaries of 457(b)/409A deferred compensation arrangements.

Charitable Contribution Provisions
The new law also makes several changes applicable to charitable contribution deductions and charitable organizations, including:

• An income-tax exclusion for otherwise taxable distributions of up to $100,000 paid to a qualified charity from a traditional IRA or Roth IRA, provided the IRA owner is at least 70½. This change would apply for 2006 and 2007.

• An increase — from 30% to 50% of a taxpayer’s “contribution base” (modified adjusted gross income) — in the charitable contribution deduction limit for qualified conservation contributions. The deduction limit rises to 100% of the contribution base for eligible farmers and ranchers who specify that the donated land remain available for agriculture or livestock production. This change also would apply for 2006 and 2007.

• Effective for contributions made after August 17, 2006, disallowance of deductions for charitable contributions of clothing and household items that are not in good used (or better) condition.

• A requirement that monetary contributions of any amount made after 2006 be supported with a bank record or a receipt from the charitable organization showing (1) the name of the charity, (2) the contribution date, and (3) the contribution amount.

• A tightening of the rules governing charitable donations of partial interests in tangible personal property (artwork, for example). Among the new rules: The charity would have to receive complete ownership of the item within ten years or at the death of the donor, whichever occurs first. This rule is effective for contributions made after August 17, 2006.

• The doubling of excise taxes applicable to certain prohibited activities by charities, social welfare organizations, private foundations, and managers of tax-exempt organizations.

Summary
The Pension Protection Act of 2006 is one of the most significant pension laws passed during the last 30 years. It is designed to preserve the pensions of millions of American workers and make it easier for employees to contribute to, invest in, and transfer their retirement savings plan accounts. It will also require sponsoring employers to meet more requirements. From a charitable-giving perspective, the law provides new opportunities — and responsibilities.

If you have questions about how the new law applies to your business or personal situation, please let us know.

The Pension Protection Act of 2006 is designed to preserve the pensions of millions of American workers, and make it easier to contribute to, invest in, and transfer their retirement savings plan accounts.
Investment Strategies. If you have investments with “paper losses” and you are thinking about selling any of these poor performers before the end of the year, remember that capital losses offset the capital gains you may have realized. Any net loss is deductible against up to $3,000 of ordinary income per year.

Consider selling appreciated stock or other investments on which you have “paper gains” before year-end to absorb any capital losses that exceed $3,000. If this is not desirable, any unused capital losses may be carried forward for deduction in future years, subject to limitations.

Remember, too, that the maximum tax rate on 2006 qualifying dividends and net long-term capital gains is 15%. Ordinary income tax rates range as high as 35%.

New Strategies

Prepare for a Roth Conversion. Earlier this year, a new law removed the income limit for high earners who want to convert their traditional Individual Retirement Account to a Roth IRA. But this change isn’t effective until 2010.

If the income limit applies to you and you are interested in a Roth IRA, you might want to consider making contributions to a traditional IRA now with the intent of converting that IRA to a Roth IRA in 2010. Even if you cannot make deductible IRA contributions (due to you or your spouse being an active participant in an employer-sponsored retirement plan and exceeding certain income limits), you can make nondeductible contributions to a traditional IRA now. On conversion in 2010, only the IRA earnings on the nondeductible contributions would be taxed, and any Roth IRA earnings from then on would be nontaxable (assuming tax law rules are met). See us for more details.

Charitable Gifts of Clothing or Household Items. New rules apply to contributions of clothing and household items made after August 17, 2006. In general, the items must be in “good used or better” condition. However, you can still deduct the value of an item that isn’t in good or better condition if the value of the donation is more than $500 and you include a qualified appraisal with your tax return.

Kiddie Tax. To minimize income shifting from parents to their young children in lower tax brackets, the tax law requires children who have more than a small amount of unearned income ($1,700 in 2006) to pay tax on that excess income at their parents’ marginal tax rate. A new law increases the age of children to whom this “kiddie tax” applies. Effective for 2006, the kiddie tax applies to children under age 18 (formerly, age 14). Due to this change, higher-income parents should consider investing any assets put aside for their under-age-18 children in investments that generate little or no current taxable income (such as U.S. savings bonds, municipal bonds, or growth stock index funds).

Energy Tax Breaks. Tax credits are available for energy efficient and alternative energy home improvements. Among the items for which credits are available: energy efficient exterior windows and doors, furnaces and central air conditioning units, and solar water heaters. Also, credits are available for the purchase of certain hybrid and alternative fuel vehicles.

Uncertain Tax Breaks

As we write this, Congress is still debating extending to 2006 certain tax breaks that expired at the end of 2005. Among those breaks: the itemized deduction for state and local sales taxes, the above-the-line deduction for the teacher’s out-of-pocket expenses for supplies used in the classroom, and the above-the-line deduction for higher education expenses. Be prepared in your planning if these items are not extended.

For More Details

Want to learn more about these and other strategies that might cut your 2006 tax bill? Talk to us. Our tax planning know-how can benefit you.
BUYING A HYBRID? SAVE THE ENVIRONMENT AND TAXES
By Andrew J. Wilder, CPA

With news headlines shouting about rising gasoline prices and global warming concerns, it’s no small wonder that many people are looking at — and buying — hybrid motor vehicles. And while these vehicles are touted as environmentally friendly, you should be aware that they could be friendly to your tax bill as well.

WHAT THEY ARE

Hybrid motor vehicles are passenger automobiles or light trucks (weighing 8,500 lbs. or less) that are propelled by both a gasoline engine and an electric motor that, usually, is recharged when the vehicle is operated.

Hybrids come in many shapes, sizes, and brands, and many popular gasoline-only vehicles are or soon will be offered as hybrids.

INCOME-TAX CREDIT ALLOWED

The purchase of a new hybrid motor vehicle comes with a significant tax advantage.

If you buy and use a new hybrid motor vehicle on or after January 1, 2006, you are entitled to a tax credit (i.e., a direct offset against federal income tax) of $400 to $3,400, depending on the fuel efficiency of the vehicle.

Example: Jane buys a qualifying hybrid passenger vehicle in 2006. Based on the vehicle model and fuel efficiency, Jane is entitled to a tax credit of $2,000. She can subtract the credit dollar-for-dollar against her federal income-tax bill for 2006.

The exact amount of the credit depends on the total weight of the vehicle, the fuel economy, and the lifetime fuel savings. The vehicle manufacturer should be able to provide this information. In essence, the more gasoline the vehicle saves, the higher the credit.

The tax law says the credit will expire at the end of 2010. However, for popular hybrid models, the credit will expire much earlier. Why? Because once a manufacturer sells 60,000 qualifying hybrid motor vehicles, the tax credit will be phased out over the next five calendar quarters for hybrid vehicles sold by that manufacturer.

Some other facts you should know about the credit:
• The vehicle owner receives the credit. So, a car leasing company that leases qualifying hybrids to customers would qualify for the credit.
• The credit must be claimed in the year the vehicle is placed in service. So, if you sign a purchase contract in late 2006, but the car is not delivered and put to use until early 2007, you may only claim the credit in 2007.
• The vehicle must be used mainly in the U.S. to qualify.
• Vehicles bought for resale do not qualify.
• No credit is allowed for any portion of the vehicle’s cost that is taken into account when making the Section 179 expensing election allowed for property purchased for use in a trade or business.
• Complex alternative minimum tax (AMT) rules apply.

CAN WE HELP?

The qualified hybrid motor vehicle tax credit can provide an added incentive for those who want to buy and use a vehicle that conserves energy. However, the rules are tricky. Whether you have already bought a qualifying hybrid or are considering a purchase in the future, our firm is ready and willing to help you determine any tax benefit to which you might be entitled.

Note that other tax credits are available for qualifying vehicles — such as fuel cell vehicles and advance lean-burn technology vehicles — placed in service in 2006 through 2010. And a separate credit is available for 10% of the cost of a qualified electric vehicle placed in service before 2007.

Note, too, that, prior to 2006, buying a hybrid vehicle could have resulted in a tax deduction of up to $2,000. Unlike a tax credit, a deduction reduces the income subject to tax, and generally is not as beneficial as a credit. If you bought a hybrid vehicle in 2005, see us for more details.

For more information on these and other income-tax incentives for alternative energy vehicles, contact our firm today.

Note that other tax credits are available for qualifying vehicles — such as fuel cell vehicles and advance lean-burn technology vehicles — placed in service in 2006 through 2010.
The federal government stopped collecting a 3 percent excise tax on long-distance telephone services beginning July 31 and will issue approximately $13 billion in refunds to taxpayers subject to the tax since 2003, according to Treasury Secretary John Snow. The Internal Revenue Service stated the agency will simply stop collecting the tax and, in doing so, adhere to five U.S. circuit court decisions that ruled current long distance telephone services are not subject to the tax defined and imposed by Internal Revenue Code Sections 4251 and 4252.

IRS Refund Process

Refunds, including interest, will be provided to taxpayers for excise taxes paid on long-distance services billed to them after Feb. 28, 2003, and before Aug. 1, 2006, the IRS notice said. Taxpayers will claim the refunds in their 2006 tax returns, which will typically be filed during 2007.

The IRS will allow taxpayers to elect a safe harbor amount or claim the actual tax paid. The safe harbor amount is still under consideration and will be announced in later guidance. In order to save taxpayers from spending time digging through old telephone bills, the IRS is designing a straightforward process that taxpayers may use when they file their tax returns next year. According to Commissioner of Internal Revenue Mark Everson, “Claiming a refund will be simple and fair.” Taxpayers not claiming the safe harbor amount will have to substantiate their requested refund amount with documentation.

Tax Forms to Change

The series of Forms 1040 and 1120, as well as Forms 990-T, 1041, and 1065, will be changed for tax year 2006 to include a line for requesting the refund or overpayment amount. Persons not otherwise required to file federal income tax returns will file a new form, Form 1040EZ-T, to request their payment. Code Section 7701 partnerships may request a credit or refund of federal excise taxes paid on nontaxable service on Form 1065, U.S. Return of Partnership Income. Estates and trusts qualify for the refund as well. If interest is claimed on any refunded amount, taxpayers must declare the interest as income for the taxable year in which the interest is received or accrued. Limitation statutes do not allow refunds for amounts paid on long-distance telephone services billed to taxpayers before March 1, 2003.