



2007 YEAR-END TAX PLANNING

The final quarter of the year is an excellent time to review some tax planning strategies that may help reduce your overall income tax burden.

While no major federal income tax reforms have been enacted this year, a law change signed in May 2007 could impact those with dependent children or investments in business assets. In addition, year-end planning is advisable for anyone who has had a change in circumstance during the past year. Life changes, including a marriage or divorce, birth or death of a family member, acquisition or sale of a business, promotion or loss of a job, or any other major event may prompt the need for tax planning.

Tax planning is a process that leverages the timing and method of reporting income and deductions to your advantage. The basic philosophy is to defer the payment of tax. Accelerating deductions and postponing recognition of income items typically accomplish this goal, with one important exception: These techniques may not reduce your taxes if you are subject to the alternative minimum tax.

Offered here are several ideas that are grouped by type of taxpayer. Remember that these items may not all be relevant to your specific situation. Therefore, it is a good idea to check with us before taking any significant steps.

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INDIVIDUAL INCOME TAX CONSIDERATIONS

- **Salary and Bonus Deferral** – If your employer will defer payments into January 2008, those salary and bonus amounts will not be taxed on your return until next year. (It may still be possible for your employer to claim a deduction on its 2007 tax return.)

- **Stock and Bond Sales** – Gains and losses are determined on the trade date. For 2007, the last trading day is Dec. 28. Consider deferring the sale of stock with gains until January to postpone recognition. Likewise, sell those stocks with losses before the end of the year to reduce any other gains you may have accumulated.

Keep in mind that only \$3,000 of combined net losses from capital transactions can be deducted on the 2007 return. The balance of any losses will carry over to next year.

You also need to be mindful of the length of time that you have held the investment – favorable long-term capital gain rates are applicable when you have held the property for more than one year. Don't spoil that favorable long-term capital gain rate with a short-term capital loss. If you do sell some stocks at a loss, be careful not to repurchase the same security within 30 days of the sale date or the loss may be disallowed.

- **Deductible Expenses** – Charge deductible expenditures on credit cards to get a deduction in 2007 even if payment of the charge will not be made until next year.
- **Charitable Donations** – Beginning in 2007, charitable contributions must be substantiated with bank records or receipts – the “miscellaneous” cash contribution will no longer be allowed without a receipt.

Consider making charitable donations with appreciated stock owned more than one year. The donation will be measured by the fair market value, and there is no tax on the difference between your cost and the fair market value. (If the fair market value is less than your cost, then sell the item to recognize the loss and contribute the cash proceeds.)

If you are over age 70½, consider distributing up to \$100,000 of your IRA balance to qualified charities. For 2007 you won't recognize the distribution as income (or get the deduction), but it will count toward your required minimum distribution.

- **Retirement Contributions** – Look to contributing the maximum amount to retirement arrangements – whether employer sponsored or an IRA. If you have not been able to contribute to a Roth IRA because of income limitations, consider nondeductible IRAs. In 2010, there will be no income limitation for Roth conversions.
- **Flexible Spending Accounts** – For calendar year plans, flexible spending account balances may be used through March 15, 2008, instead of Dec. 31, 2007, without losing the account balance. (Make sure that your employer has amended its plan to allow this.)
- **Passive Activity** – Dispose of a passive activity with suspended losses. When a passive activity has suspended losses, those losses become deductible in the year the activity is sold.

- **Medical Expenses** – Medical expenses are deductible if they exceed a limitation based on adjusted gross income. Medical expenses include transportation, medical insurance premiums, certain long-term care premiums, prescription drugs and some medically prescribed programs such as weight loss. (If you pay more than one-half of the support of a parent or child, regardless of their qualification as a dependent, and you pay their medical expenses, it is deductible on your tax return.)

You may want to reschedule and pay for procedures this year to get the benefit of a 2007 medical deduction – or reschedule to next year for a 2008 deduction. If you have a “high-deductible” health insurance plan, you may be in a position to set up a health savings account and get a deduction for contributions.

- **Partnerships and S Corporations with Losses** – Review your tax basis in partnerships or S corporations that may have a current-year loss. If the tax basis is insufficient to claim the loss, you may need to make a contribution to the capital of the business.
- **Installment Sales** – Consider an installment sale of property rather than collecting all proceeds this year.
- **Tax Liability** – Review your tax liability position and determine whether to reduce your payroll tax withholding or adjust any estimated tax payments. You don't want to be in a position in which you will be penalized for underpaying taxes, nor do you want to give the government an interest-free loan.
- **Expanded “Kiddie Tax”** – For 2007, a dependent child under age 18 may be subject to tax at the child's parents' highest marginal rate on the child's unearned income in excess of \$1,700. Beginning in 2008, the kiddie tax will be further expanded to include a dependent who is under 19 years of age (or 24 years if a full-time student), thus subjecting the dependent to the higher tax. This will also impact those who were planning to sell securities in 2008 to avail themselves of the special 0 percent tax on certain low-bracket capital gains. If your children are between 18 and 24 this year, they can still take advantage of the 5 percent rate on capital gains available to taxpayers in the two lowest tax brackets.
- **Section 529 Plan** – Consider using a Section 529 plan for college funding. Many taxpayers set up “Uniform Gift to Minor Act” accounts for their children to help pay for college. The income on these accounts is taxed to the children; however, unearned income over \$1,700 is taxable at the parents' higher tax rate (see above). Convert these accounts to 529 plans to avoid the tax on the earnings – so long as the amounts are used for education.
- **Hybrid Vehicle** – If you purchase and take possession of a qualified hybrid motor vehicle in 2007, you may get a tax credit. Caution, if you are subject to the alternative minimum tax, you will not get to use this credit.

TAX CONSIDERATIONS FOR THE SELF-EMPLOYED

- **Late December invoices** sent out by a cash-basis method business will not normally be collected until January.
- **Establish a retirement plan** before the end of the year. The deduction is allowed on this year's return as long as the plan is funded before you file the return next year. (See retirement plan limit chart, pg 4.) Only a SEP plan can be established and funded after the end of the year.
- **Establish a medical insurance plan** or convert to or establish a high-deductible health plan.
- **Minor children employed** to perform administrative tasks can avoid Social Security taxes on the wages. This also shifts income to a lower bracket. The children may establish Roth IRAs to gain significant nontaxable benefits for the future.
- **Meal and entertainment expenditures** should be reviewed to make sure you have proper substantiation.

TAX CONSIDERATIONS FOR BUSINESS ENTITIES

- ✓ **New Equipment** – Acquire and place new equipment into service before the end of the year to take advantage of the immediate deduction of up to \$125,000. Limitations may apply if total expenditures exceed \$500,000.
- ✓ **Inventory** – If higher costs are anticipated, consider adopting the LIFO inventory method.
- ✓ **Domestic Production Activity** – Evaluate the deduction for domestic production activities, which is up to 6 percent of qualified amounts.
- ✓ **Retirement Plan** – Establish a retirement plan before the end of the year. The deduction is allowed on this year's return as long as the plan is funded before you file the return next year. (See retirement plan limit chart pg. 4.) Only a SEP plan can be established and funded after the end of the year.
- ✓ **Additional Benefits** – Offer additional benefits such as a Roth option to existing 401(k) plans.
- ✓ **Depreciated Business Assets** – Trade in fully depreciated business assets instead of selling at a gain. If a trade-in value is less than net book value, sell instead of trading to get the benefit of the loss.
- ✓ **Estimated Tax** – Consider the status of any final estimated tax payment requirements. A penalty for underpayment of taxes can be costly.

GIFT AND ESTATE TAX

If your estate is large enough to be subject to the estate tax, the rates are higher than the income tax rates. The top estate tax rate is 45 percent. It makes sense to ensure that the largest possible amount ends up with your heirs and not with the federal or state government through taxes.

The federal annual exclusion for gifts is \$12,000 to any individual. If you are married and your spouse consents, the effective annual exclusion can be \$24,000 per donee. This provides a good opportunity to transfer income-producing or low tax basis assets to heirs who may also be in a lower income tax bracket. In addition to the annual per-person exclusion, up to \$1 million may be transferred without a federal tax.

If you are making gifts to limit or reduce future estate tax and you have reached the annual exclusion, be aware that payments of tuition and medical expense for an individual are not subject to gift tax. There is an unlimited exclusion of amounts paid directly to educational organizations for tuition (not books, fees, etc.) and healthcare providers for medical expenses.

RETIREMENT PLAN LIMITS

The maximum compensation to be taken into account for plan limits is \$225,000 for 2007.

Type of Plan	Contribution Limit	Additional Catch-up Contribution for Age 50 and Older
IRA	\$4,000	\$1,000
SIMPLE	\$10,500	\$2,500
401(k)	\$15,500	\$5,000
SEP IRA	\$45,000	--

REMEMBER THAT WE ARE HERE TO HELP YOU.

Give us a call to review your year-end strategies and plans for the next year.

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To ensure compliance with requirements imposed by the IRS, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties assessed under the Internal Revenue Code.

ALTERNATIVE MINIMUM TAX THE BEST LAID PLANS OF MICE AND MEN ...

Each year, we have seen more individuals subjected to the alternative minimum tax (AMT). The tax was once considered a tax on the wealthy. By virtue of its construction, the AMT is catching more and more individuals. Those who happen to have significant deductions are most susceptible. Those living in a state with a relatively high personal income tax rate and high real estate taxes, and those with large families, are vulnerable. The AMT makes year-end planning difficult and potentially dangerous if done in a vacuum.

Reducing regular tax liability through deductions, deferral and overall rate reductions has increased exposure to AMT liability. All planning must consider multiple years to be truly effective. While a credit for prior-year AMT may be available against regular income tax in a subsequent year, there is no guarantee that the AMT will ever be recovered.