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The Navigator

Important Markers To Guide Your Way

October 2006

Welcome to our October issue of The Navigator. In this issue you will find information on Year-end tax planning for the balance of 2006. Our firm combines expertise and experience to assure that each business and individual receives close and personal attention. We feel it is important to continually keep you informed by keeping you abreast of changing tax laws and financial trends as well as sharing our financial knowledge with you. We will answer all of your questions, as they impact both your tax and financial situations. We welcome you to contact us anytime.

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The Alliant Team

Overview of Tax Saving Moves for the rest of 2006

This month's Navigator is oriented towards the time-honored approach of deferring income and accelerating deductions to minimize 2006 taxes. For individuals, deferring income also may help minimize or avoid AGI-based phase outs of various tax breaks. As always, however, year-end tax planning doesn't occur in a vacuum. It must take account of each taxpayer's particular situation and planning goals, with the aim of minimizing taxes to the greatest extent possible. While most taxpayers will come out ahead by following the traditional approach, others with special circumstances will do better by accelerating income and deferring deductions. Most traditional techniques for deferring income and accelerating expenses can be reversed to achieve the opposite effect. For instance, a cash method professional who wants to accelerate income can do so by speeding up the billing and collection process instead of deferring income by slowing it down. Or, a cash-method taxpayer who sells property in 2006 can accelerate income by electing out of the installment method.

Inflation adjustments to rate brackets, exemption amounts, etc.
In 2007, individuals will benefit from inflation adjustments in the thresholds for applying the income tax rates, the personal exemption and standard deduction amounts, and the adjusted gross income levels at which itemized deductions and personal exemptions are phased out.
The inflation-adjusted amounts effectively increase the range of taxable

income covered by the lower rate brackets, the personal exemption and standard deduction amounts, etc.

As a result, many taxpayers will enjoy a modest increase in the amount of income they can receive in 2007 without being pushed into a higher tax bracket. Taxpayers whose pre-tax income remains the same may have more after-tax income.

Capital gains. Long-term capital gains are taxed at a maximum rate of 15% (at 5% if they would otherwise be taxed at a rate below 25% if they were ordinary income).

Low-taxed dividend income. Qualified dividend income received in 2006 is taxed at the same favorable tax rates that apply to net capital gains. Converting investment income taxable at regular rates into qualified dividend income can achieve tax savings and result in higher after-tax income.

IRA and Roth-IRA year-end moves. These include recharacterizing an IRA-to-Roth IRA convention, coping with losses in a retirement account, withdrawing required minimum distributions before year-end to avoid a penalty, and accelerating the first required minimum distribution.

Expensing deduction. For tax years beginning in 2006, the maximum amount of eligible assets that can be expensed (deducted in full) under Code Sec. 179 is $108,000, and the expensing deduction doesn't begin to phase out until expensing-eligible property placed in service during the year exceeds $430,000). (For 2007, the figures are $112,000 and $450,000, respectively. This means that many small and medium sized businesses will be able to currently deduct most if not all their outlays for machinery and equipment. What's more the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

Deduction for qualified production activities income. Taxpayers can claim a deduction, subject to limits, for a specified percentage of the taxpayer's "qualified production activities income" for the tax year (i.e., net income from U.S. manufacturing, production or extraction activities, U.S. film production, U.S. construction activities, and U.S. engineering and architectural services). This deduction generally has the effect of a reduction in the taxpayer's marginal rate and, thus, should be taken into account when making decisions regarding income shifting strategies.

Changes in individual's tax status may call for acceleration of income. Changes in an individual's tax status due, say, to divorce, marriage, or loss of head of household status must be considered.

Alternative minimum tax (AMT). Watch out for the AMT, which applies to both individuals and many corporations. A decision to accelerate an expense or to defer an item of income to reduce taxable income for regular tax purposes may not always save taxes because it may subject the taxpayer to the AMT.

Time value of money. Any decision to save taxes by accelerating income must take into account the fact that this means paying taxes early and losing the use of money that could have been otherwise invested.

Estimated tax. When taxes on deferred or accelerated taxable income must actually be paid depends to a great extent on how the estimated tax rules apply. This can be affected by how much taxable income is shifted.

Obstacles to deferring taxable income. The Code contains a number of rules that hinder the shifting of income and expenses. These include the passive activity loss rules, requirements that certain taxpayers use the accrual method and limitations on the deduction of investment interest.

Charitable contributions. The timing of charitable contributions can have an important impact on year-end tax planning. As a result of recently enacted legislation allowing individual taxpayers who are age 70-1/2 to contribute to charities directly from their IRAs without having the amount of their contribution included in their gross income, some taxpayers may be able to reduce their tax liability even more than they would have if they had received the distribution from their IRA and then contributed the amount distributed to charity.

Energy tax incentives. The Energy Tax Incentives Act of 2006 created tax credits for qualifying energy-saving home improvements made after 2005 and before 2008, and for the purchase of qualifying energy efficient property placed in service after 2005 and before 2008.

Please stay tuned for upcoming details on some of the above items.

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