

ANSPACH FINANCIAL GROUP

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SUMMER NEWSLETTER

JUNE, 2007

Tax Reform—Democrats vs. Republicans

Not surprisingly, the Republicans and Democrats agree on the need for tax reform, but they differ greatly on how to accomplish it. Presently the Bush administration has decided not to pursue tax reform options issued by Bush's tax reform panel. Therefore, the Republicans have abandoned major tax reform for now.

The Democrats have established their priorities for reform in the proposed Fair Flat Tax Act. The major provisions are:

- ◆ Three tax brackets instead of six—15%, 25%, 35%
- ◆ Elimination of the marriage penalty
- ◆ Very large standard deductions—\$30,000 for married filers, \$15,000 for singles
- ◆ Larger earned income credits
- ◆ Elimination of the Alternative Minimum Tax (AMT)
- ◆ Limited deductions for mortgage interest and charitable contributions as a result of the higher standard deductions
- ◆ 10% *refundable* tax credit on state income tax, property tax and sales tax in place of the current allowed itemized deductions
- ◆ Capital gains taxed as ordinary income and no deferral on US savings bond interest
- ◆ Fewer tax-free fringe benefits including elimination of flexible spending plans
- ◆ 35% flat rate for corporations, thus eliminating lower brackets
- ◆ Slower depreciation
- ◆ Elimination of other special tax breaks

This package will definitely not pass as proposed, now, or after 2008 when the Democrats expect to gain control of Congress and the White House. The plan does focus on the Democrats' tax reform goals and is one approach to a permanent solution to the AMT.

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Special points of interest:

- Many taxpayers are not aware that there are special reporting requirements for those who have an interest in foreign bank or investment accounts.
- California Registered Domestic Partners will have to deal with new tax filing rules for 2007.

Timing Is Everything

In 1914 the original Form 1040 was a single page with four pages of instructions. There are now more than 4,000 pages of instructions. Tax rates ranged from 1% to 7%, with most income exempt from tax. Opponents of the 16th Amendment urged a tax rate cap of 10%, but advocates claimed a cap was not necessary since the rate would never exceed 10%. Four years later the rate climbed to 70% to fund World War I. The number of Americans required to file a tax return has risen from 360,000 "rich men" to 135,000,000 workers and investors.

In 1969 the Alternative Minimum Tax (AMT) was enacted as a response to the public outcry when 155 wealthy people paid no income taxes. This year six million filers are subject to the AMT, and next year it will be 26 million if Congress doesn't take action.

2007 is the last year that those over age 70½ can make charitable gifts directly from an IRA or Roth IRA. Amounts up to \$100,000 given to a qualified charitable organization will not be treated as income, the equivalent of a 100% "above the line" charitable deduction. This is an obvious benefit for those who don't itemize. They also benefit taxpayers with higher incomes

whose deductions are limited or subject to phase-outs as well as those whose Social Security benefits are taxed as a result of adding taxable retirement distributions to their income. These charitable gifts can be part of the annual required minimum distribution.

Beginning in 2007 a written receipt or can-

celled check is required for a charitable contribution deduction.

Beginning in 2010 there will be no AGI income limitation (currently \$100,000) for converting a traditional IRA to a Roth IRA. There will be a special opportunity in 2010 only, to spread the income from the conversion over the following two years.

Foreign Bank & Investment Accounts

Any individual, corporation, partnership, estate or trust that has an interest in a "foreign financial account" must report the income from such an account on their US tax return. All US citizens and resident aliens are subject to this requirement, and foreign account disclosure is made on Form 1040, Schedule B, Part III.

Not everyone is aware that there is an additional reporting requirement (separate from the tax return) if the aggregate

value of all foreign accounts exceeds \$10,000 at any time during the calendar year. IRS Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, commonly known as FBAR is due by June 30 of the following year (with no extensions).

The FBAR is a by-product of the Bank Secrecy Act (BSA) enacted in 1970. Congress created the BSA because of concern that financial institutions in tax haven jurisdictions were being used by US persons to hide the pro-

ceeds of illegal activities and evade taxes.

There are complex rules for what constitutes a financial interest in a foreign account, but the most common situations with individuals are generally clear regarding the filing requirement. Because of severe civil and criminal penalties for failure to file the FBAR, we encourage you to consult with us if you think you may be affected by this reporting requirement or need assistance in completion of the form.

Confused About Penalties & Interest?

There is much confusion for taxpayers when they receive a notice from the IRS or a state tax agency that includes charges for interest and penalties. In this article, we will identify and clarify the most common assessments and explain how the amounts

are calculated.

An *underpayment penalty* applies when insufficient taxes are withheld from your wages and/or paid as estimated tax payments during the year. It is assessed as of the original due date of your

tax return (usually April 15) and is based on the current interest rate which is adjusted quarterly. For 2006, the rate was .05258 of the underpayment, which is calculated for each quarter. The required payment to avoid this penalty is 90% of the

Interest & Penalties - continued

total tax liability for the year. There are other "safe harbor" thresholds of which the most common is 100% of the prior year's tax liability (110% if AGI exceeds \$150,000). For example, if your 2005 tax liability is \$10,000 and your 2006 tax liability is \$15,000, the threshold to avoid the underpayment penalty for 2006 is the lower of \$10,000 (100% of prior year's tax) or \$13,500 (90% of current year's tax). If you have \$10,000 or more in withholding taxes from wages and timely paid estimated tax payments, there will be no penalty.

The late payment penalty is assessed when your tax return has been filed or is on extension and your taxes are not paid by the original due date of

the tax return, usually April 15. That penalty is .5% (one half of 1%) per month or part of a month, and it is based on the unpaid balance. For example, if your unpaid balance on April 15 was \$5,000, \$3,000 on May 15, and \$0 on June 15, this penalty would be \$40 (.5% of \$5,000 plus .5% of \$3,000).

The late filing penalty is assessed if your tax return has not been filed by the due date and is not on extension. This penalty is 5% per month, or part of a month, to a maximum of 25%, and it is also based on the unpaid balance. In the above example (assuming no extension was filed) this penalty would be \$400 (the total of 5% of \$5,000 plus 5% of \$3,000).

Interest on unpaid balances after the original due date of your tax return is calculated using the current interest rate which is adjusted quarterly. The annual rate has been 8% for the past 12 months, which is equal to .022% per day on the unpaid balance.

A less common penalty is the charge for a dishonored check, which is 2% of the amount of the check with a minimum penalty of \$15. There are many other penalties such as the 25% substantial underpayment penalty and 100% responsible party payroll trust tax penalty, but they are rare and complex. If you have any questions regarding assessment of penalties and interest, please contact our office.

Franchise Tax Board—Are They Listening?

At a meeting of Enrolled Agents with Selvi Stanislaus, the new Executive Officer of the Franchise Tax Board (FTB), we were encouraged by the openness to change expressed by Ms. Stanislaus. She has made it clear to all FTB employees that they have been charged with listening to and recording complaints and concerns of taxpayers and tax professionals.

In what she refers to as "New Directions of the Franchise Tax Board", the executive officer outlined more efficient and user-friendly procedures in

processing tax returns and collecting taxes. Changes in audit selection and procedures are designed to focus on "tax gap" issues, reduce the timeline for completing audits and identify tax preparers who use questionable methods. In other words, they are attempting to zero in on abusive practices and non-compliant taxpayers. The result should be less contact with honest taxpayers.

In an effort to seek more input from as many sources as possible, there appears to a significant increase in FTB's collaborations with legislators, tax

professionals and other interested parties. Only time will determine the success of this open-minded approach, but we did find Ms. Stanislaus to be credible, sincere and realistic in expressing her aspirations for the second largest state tax agency in the country.

CA Registered Domestic Partners

Beginning in 2007, The State of California will require Registered Domestic Partners (RDPs) to file as married taxpayers. IRS will not recognize this status, so RDPs will most likely be filing as "Single" or "Head of Household" for federal taxes and as "Married" for California taxes. The details and mechanics are still being discussed by the state as they struggle to figure out how this will work. Since RDPs have very rarely had any tax issues as a result of this status, we do not know which of our clients are registered with the state of California as domestic partners. In order for us to keep you informed of developments resulting from this major change, please let us know who you are.

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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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| June 15 | Second quarter estimated tax payments due |
| 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 |

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.