

ANSPACH FINANCIAL GROUP

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YEAR-END NEWSLETTER

DECEMBER, 2006

Big California Tax Changes

Beginning in 2007 California will no longer require income tax withholding based on the sales price of rental, business or investment real estate. This was the equivalent of legal extortion in cases where the required withholding was many times the gain on the sale. The withholding amount will now be an estimate of the actual tax provided by the seller, who will sign an affidavit declaring its accuracy. We expect our clients to contact us to calculate the gain on sales of these properties and provide an accurate estimate for the state tax withholding. We want to help you avoid potential penalties that may result from an underestimate of the tax liability, and we also want to prevent you from making an "interest-free" loan to the State of California by overestimating the amount of tax due on the gain from the sale.

California is going to require that Registered Domestic Partners (RDPs) file as a married couple (married filing jointly or married filing separately) beginning with the 2007 tax year. It is highly improbable that the IRS will conform to this requirement, so California RDPs will most likely have a different filing status for their federal and state income tax returns. The repercussions and questions arising from this are just beginning to emerge and will likely take a good part of the year to sort out.

New and simplified procedures have recently been put into place for termination of CA corporations, limited partnerships, limited liability companies and limited liability partnerships.

Reminders For 2007 Tax Season

- Many online financial services companies such as TD Ameritrade and E*trade do not issue and mail 1099 forms after the close of the tax year. You will need to print your Form 1099 documents for these accounts and provide them to us with your other tax information. You may also be able to print out a statement of gains and losses when you access your account online.
- If the cost basis of any securities sold in 2006 is not available on your year-end tax statements you will need to provide this information or provide us with the data to calculate your cost basis. Please contact us if you need guidance in obtaining the information we need to accurately determine the amount of gain or loss to report on your tax returns.
- We are required to electronically file most income tax returns, so please do not "create" and mail off a return from the copy that we provide for your records. This can seriously delay the processing of your

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Special points of interest:

- California wants Registered Domestic Partners to file returns as married taxpayers.
- IRS provides means for individuals and businesses to claim refund for long distance telephone excise taxes paid.

When Should I Incorporate?

Many unincorporated business owners ask this question. The real question is, "What is the best entity for my business?". This is a simple question that almost always has a complex answer, since everyone's situation is unique. Even given the same set of economic realities and objectives, owners will have different priorities and psychological considerations such as risk tolerance or debt tolerance.

Then, "How do I choose?" is the next question. Should I form a corporation and, if so, should I make an S-Corp. election. Should I form a Limited Liability Company (LLC) and, if so, should I choose to have it taxed as a partnership, corporation or disregarded entity? Should I form a partnership and, if so, should it be a general or limited partnership or perhaps an LLC? There are advantages and disadvantages to every entity, and the ultimate choice is based on far too many factors to cover here.

The most common comparison in our practice, whether you are a sole owner or one of multiple owners, is between the LLC and the S corporation. Both of these are "flow through" entities, which means all of the profits or losses flow through to the owners' personal tax returns. LLC owners have the limited liability protection of a corporation but can be operated less formally. In an S corporation, earnings of an owner in excess of reasonable compensation paid as salary are not subject to employment taxes as are all earnings to managing LLC owners. Corporate loans for which the lender has required personal guarantees from the officers (almost all loans for new corporations) will negate the limitation of liability, which is often the primary reason for incorporation in the first place.

There are many issues such as business continuity, changes in ownership, possibility of going public and favorable tax treatment that must be thoughtfully assessed prior to making an entity choice. If you are considering such a move, please schedule some time for us to help guide you through the labyrinth of possibilities. Fortunately you can change to another entity if your first choice doesn't suit your purposes, although it is a complex and expensive process.

Reminders for 2007 Tax Season

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return. If a paper return is required, we will provide the return and relevant instructions.

- Please provide us with all tax documents (W-2s, 1099s of all types, 1098s for mortgage interest and 1098-T for college tuition paid). We will also need copies of settlement statements on purchases, sales or refinancing of real estate.
- The long distance telephone excise tax is being refunded to taxpayers. Any excise tax shown on your telephone bills between March 1, 2003 and July 31, 2006 is eligible for refund on your 2006 income tax return. Recognizing that most taxpayers will not have those bills, there are safe harbor refunds (you don't have to prove you paid any excise tax) for personal tax returns. The amounts range from \$30 to \$60, depending on the number of exemptions on your tax return. If you are able to determine a higher tax actually paid, that higher amount will be your refund amount. There are no similar safe harbor refunds for businesses, but the IRS just announced a formula for businesses to estimate their federal telephone excise tax refunds as an alternative to gathering up to 41 months of old phone records. We will post this formula on our Web site by the end of December.
- Many will be surprised to discover that the Alternative Motor Vehicle credit for purchasing a hybrid vehicle does not reduce the Alternative Minimum Tax. Yes, that means anyone already in AMT will derive no tax benefit from this highly publicized credit.
- Please provide documentation for any expenses qualifying for the new energy property credits. This documentation includes a Manufacturer's Certification Statement verifying that the product qualifies for the credit. Some of the certifications will be included with the product, but many will require you to print them from the manufacturer's Web site. This credit will not offset the Alternative Minimum Tax.
- If you are operating a business or real estate activity, be sure to let us know early in January if you want us to assist you in the issuance of Forms 1099 for service contractors you have paid in excess of \$600 for the 2006 calendar year.

Self-Employed Retirement Plan Contribution Due Dates

With the increasing popularity of SIMPLE-IRA and 401(k) plans for self-employed business owners has come much confusion about when the plan contributions are due. Almost all self-employed retirement plan participants know that the due date for the *employer* portion of the contributions to a SEP-IRA, SIMPLE-IRA, profit-sharing, money-purchase or 401(k) plan is the due date (plus extensions) of the tax return for the individual or business entity.

The confusion has arisen with SIMPLE-IRA and 401(k) plans since they are primarily “salary deferral” plans and have a component whereby employees and self-employed owners can reduce their salary or taxable income by making these pre-tax contributions to their plan.

Most understand that the deferral amount withheld on behalf of employees must be deposited into their individual accounts within a statutory time period (30 days for SIMPLE-IRA plans and 15 days for 401(k) plans). This prevents employers from inappropriately using the employees’ retirement account contributions. Remember, the employer matching, if any, isn’t due until the due date of the tax return.

The real problem we are seeing is with the self-employed owners themselves. A special rule provides that all income for a self-employed person is deemed earned on the last day of the year. Therefore, the due date for their own deferral contributions is January 15 for a 401(k) plan and January 30 for a SIMPLE-IRA. These deadlines have been upheld by the Tax Court. Compliance in this area is very low, since most self-employed owners believe their entire contribution (deferral, matching and profit-sharing) is not due until the due date of their tax return.

When we think about it, there is no “injured party” if these particular contributions are late. Also, the plan custodians and administrators don’t seem to be concerned about this, and IRS has not been a significant presence in enforcing these rules. However, these due dates are statutory and a crackdown in this area could be damaging to a plan and its participants. We encourage compliance with the deadlines to avoid any potential problems in the future.

In The Courts

- The Limited Liability Company (LLC) fee based on gross receipts has been challenged as unconstitutional by the California Superior Court in San Francisco. This is one we are watching closely.
- The constitutionality of a state taxing out of state municipal bond interest while not taxing its own has been challenged by the Kentucky Supreme Court. IRS will probably appeal this one to the US Supreme Court.

Our Web Site is Live

www.anspachfinancialgroup.com our company Web site is now live. You can find our current as well as archived newsletters on the site. We have provided links for you to access frequently used forms and other useful information. You can also check for frequent tax news updates during tax season or between our newsletter publication dates.

Did You Know?

The amount deducted on US income tax returns for contributed items of clothing and household goods is \$9 billion.

The GDP (Gross Domestic Product) of Paraguay is \$7.2 billion.

IRS Commissioner Mark Everson recently told reporters “If you earn more than \$100,000 or you’re a millionaire, you’re a lot more likely to be audited these days than just a few years ago.”

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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 provide our clients with superior services at reasonable cost.

Calendar

Anspach Financial Group

- December 29—Final business day of 2006
- December 11—Due date for 1st installment property tax payment
- January 2—Tax organizers mailed

Tax Due Dates

- January 15—Fourth quarter estimated tax payments due
- January 31—Due date for Forms 1099 to be sent to recipients
- February 28— Due date for Forms 1099/1096 to be filed with IRS
- March 15—Due date for calendar year corporation tax returns
- April 10—Due date for 2nd installment property tax payment
- April 16—Due date for individual, partnership and calendar year fiduciary tax returns