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Planning Alert
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Charitable Deductions – Important 2007 Provisions to Remember – The tax law contains various provisions regarding charitable contributions, some favorable and some not so favorable. With the first half of 2007 already behind us, we thought this would be a good opportunity to remind you of a couple of the more important provisions as you consider your 2007 charitable giving. Starting with a favorable provision, around this time last year, Congress passed the *Pension Protection Act of 2006* which provided, among other things, limited tax-free distributions up to $100,000 from an IRA to qualified charities with otherwise taxable IRA money. This provision applied to taxpayers that have reached age 70½ and although the donation does not generate a tax deduction, it does equates to a 100% write-off of the contribution and can prove to be a valuable tax benefit in the right circumstances. This provision is scheduled to end this year unless Congress acts to extend it. A couple other changes are considered "anti-taxpayer" because they impose some stricter requirements on both cash and non-cash donations. First, taxpayers will no longer be allowed to deduct contributions of cash, check, or other monetary gifts unless supported by appropriate documentation such as a bank record or written statement from the charity. This means cancelled checks, credit card receipts, or written acknowledgement from the charity (including for cash donations of $250 or more) will be required to substantiate a charitable donation. Lastly, stricter rules apply to non-cash donations of used clothing or household items to charity which we highlighted in our **January 2007 Planning Alert**. For non-cash donations, the used items must be in "good or better" condition in order to qualify for deduction. If the goods are not in a "good or better" condition, then the deduction will be disallowed. As mentioned in the article earlier this year, this determination will likely be a subjective one, but see the **January 2007** article for more details and suggestions for documenting the contribution of "used" items.

Sale of Personal Residence and the "gain exclusion" provisions – As many of you know, a taxpayer can exclude up to $250,000 (single) or $500,000 (married joint) of realized gain on the sale of a principal residence. The exclusion provisions of Sec. 121 can be utilized for a residence owned and occupied by a taxpayer for two out of five years with partial exclusions available for moves made due to change in place of employment, health reasons, or other *unforeseen circumstances*. Under most circumstances, failure to meet the two year requirement or other tests will result in no exclusion of the gain, however a recent letter ruling provided clarification on a specific situation under the "unforeseen circumstance" test. The letter ruling involved two taxpayers that were divorced, had children of their own from a previous marriage, and owned and occupied their own homes (with one taxpayer owning and occupying for less than 2 years). Subsequently, the taxpayers were married and in order to provide a suitable home for their new blended family, each taxpayer sold their respective homes and together purchased a larger home for the new family. Under the provisions of the code, the taxpayer who had not owned the home for 2 years did not qualify for exclusion or partial exclusion on the sale of the home and thus requested the Private Letter Ruling from the IRS. In the ruling, the IRS concluded that the occurrence of *unforeseen circumstances* was the reason for the sale of the primary residence as they had not yet met the soon-to-be spouse at the time the taxpayer purchased the original residence. As a result of the marriage, the suitability of the taxpayer's residence materially changed and both taxpayers needed a larger home that neither owned separately to accommodate the new blended family and the IRS ruled favorably for the taxpayer for a partial exclusion on the sale of the residence. This ruling provides a very fair interpretation of these

standards and certainly one that we feel was within the intent of the law when dealing with the "unforeseen circumstances" test.

__Various Tax Provisions coming to an end in 2007__ – The Tax Code has evolved over the years with various annual tax acts implementing a conglomeration of tax provisions that have been phased-in, phased-out, delayed, expiring, and soon to sunset. The *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) is widely recognized as the Tax Act that created most of these crazy time-sensitive provisions which have resulted in subsequent tax acts that extended or made permanent various EGTRRA provisions. With all the provisions to keep track of and the many phase-in, phase-out, and sunset dates to consider, it's a wonder why the Tax Code has become such a voluminous and burdensome document to follow! As the 2007 tax year progresses and since it is not yet known what actions Congress will take, if any, prior to the scheduled sunset dates, we thought it might be a good idea to highlight some of the more relevant provisions to take advantage of while they are still available. Soon-to-be-expiring *__tax credits__* include the nonbusiness energy property credit (up to $500 for qualified energy efficiency home improvements) and residential energy efficient property credit (up to $2,000 for qualified solar water heating equipment or electricity generating solar photovoltaic property, and qualified fuel cell property). *__Tax deductions__* that might be going away after 2007 include 15 year depreciation on qualified leasehold improvements and restaurant property, the $250 above-the-line educator classroom expense deduction, enhanced charitable deduction by corporate and noncorporate taxpayers for contributions of food inventory (originally enacted for the Gulf Coast hurricane disasters), sales tax deduction (in lieu of state income tax deduction), and the above-the-line deduction for qualified tuition and fees at accredited post-secondary institutions (either $2,000 or $4,000 based on AGI). A couple other provisions scheduled to expire as of December 31, 2007 include the establishment of Archer Medical Savings Account and IRA distributions to charities. Hopefully, Congress will act and extend some of the more beneficial provisions but rest assured we will be keeping an eye open as the year progresses.

__State Taxation of Retirement Benefits__ – Just think, you've been living in California your entire life, working hard to earn a good wage to support your family and build a career that's important to you. During this time, you've become a partner in your business and grown a good retirement account so that you can retire one day and do all those things you've wanted to do. For many people, another common part of the "retirement" picture also involves selling your house and moving to a good retirement location such as Las Vegas or Lake Tahoe where there is plenty of fun, sun, and entertainment to while away the days. Sounds good, doesn't it? Well, until recently, there were some questions as to how good (or bad) this could be specifically as it relates to receiving those hard-earned retirement benefits and how they could be taxed by various states. Not many years ago, serious problems existed with some states that attempted to collect taxes on retirement benefits received by former residents. California and New York were at the top of the list in trying to tax recipients that previously lived in the state but moved out of state after retirement. They felt that since the retirement benefits were earned while you were a resident of that state, they were entitled to tax the recipient upon receipt of the benefits, regardless of where they lived when they received them. In 1996, Congress fixed this problem by enacting Public Law 104-95 that prohibited states from taxing many types of retirement benefits received by former residents. This law applied to mostly garden-variety types of qualified retirement plans where there was an employer-employee relationship but it was not clear on how it applied to nonqualified deferred compensation plans typically set up for partners of a business (since a "partner" is not technically an employee). However, this was clarified by the enactment of Public Law 109-264 in August 2006. This law provides that the protections for benefits paid under the 1996 law extend to any written plan, program, or arrangement that provides for retirement payments of a retired partners service. Great news for retired or soon-to-be retired partners out there!

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