

## Midyear Tax Planning —

# Major Changes to Tax Law Offer Advantages

by David P. Beringer  
Partner

Although the year is half over, we've already seen one major new tax law: The fourth one in a 13-month period was signed in May 2007. We almost certainly will see more changes before the year ends. Despite confusion created by these repetitive law changes, the current federal income tax environment actually is quite favorable.

Now is the time to take advantage of the tax breaks that Congress has provided, before they are taken away. This article presents planning ideas to consider this summer while you have time to think.

Some of the ideas may apply to you, some to family members and others to your business.

### Kiddie Tax alert

Will your child be 18 years of age or older at the end of the year? When the dreaded Kiddie Tax hits part of your child's unearned income (typically from investments), the income gets taxed at your higher marginal rate rather than at your child's lower marginal rate.

For 2007, the Kiddie Tax won't affect a child who is 18 years old or older at the end of the year. Next year, however, the Kiddie Tax can hit part of the unearned income of a child who will be 18 years old or a student who will be age 19 to 23 years as of December 31, 2008 if the child's earned income, such as wages, for the year does not exceed half of

his or her support.

As you can see, your child could be exempt from the Kiddie Tax this year because he or she will be 18 years old or older at the end of the year but not be exempt next year because he or she will be a student age 19 to 23 years without sufficient earned income.

*If this scenario applies to your child, consider having your child trigger some taxable gains and income this year.* That income will be taxed at your child's lower rate. Next year that might not be true, due to the new Kiddie Tax age rules.

Keep in mind that, for this year, the Kiddie Tax hits only unearned income in excess of \$1,700. The threshold for next year probably will be higher due to an inflation adjustment. Also, salaries and wages are not subject to this tax.

### New provisions

Take advantage of favorable new provisions. Several taxpayer-friendly changes kicked in this year. They include a *bigger Section 179 deduction*.

Your business may be able to take advantage of the recently increased Section 179 deduction for its tax year beginning in 2007. The maximum deduction now is a whopping \$125,000 (up from \$112,000).

If you are thinking about purchasing equipment, furniture or other tan-

gible property for use in your business, now may be the perfect time to do so.

### Expiring tax breaks

Take advantage of expiring tax breaks before they become history. As the tax law currently reads, a host of valuable breaks are scheduled to



expire at the end of this year.

While the odds are good that some, or even most, of them will be extended by future legislation, don't bet the farm on it. The prudent course is to take action before year-end to cash in on breaks that are meaningful to you or your business.

What follows is a brief rundown on some of the expiring provisions. (This is not a complete list.)

- *Itemized deduction for state and local sales taxes.* The optional deduction for state and local sales and use taxes (in lieu of deducting state income taxes) will expire at the end of this year unless Congress takes fur-

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ther action. If your California income taxes are low, you may want to make some big-ticket purchases, such as a new car or boat, before year-end to increase your sales tax deduction.

- *Charitable donations from IRAs.* If you've reached age 70 1/2 years, a law change from last year allows you to arrange to distribute up to \$100,000 of otherwise taxable IRA money to specified tax-exempt charities.

These so-called qualified charitable distributions (QCDs) are federal-income-tax-free to you, but you don't get to claim any itemized deductions on your Form 1040. However, the tax-free treatment equates to a 100 percent write-off, and you don't have to itemize your deductions to get it.

This favorable provision will expire at the end of this year unless Congress extends it.

- *Credit for non-business energy expenditures.* The tax credits for up to \$500 given for non-business energy efficiency improvements, such as qualifying exterior windows and doors, insulation and heat pumps, will expire at the end of 2007 unless Congress extends them.

The credit amounts are modest, but they could make it worth your while to make some energy-saving changes to your principal residence. Improvements must be installed by December 31, 2007 to qualify. Make sure you get the credit certificate from the installer.

### Unfavorable changes

Watch for these unfavorable changes. Several anti-taxpayer changes also kicked in this year or in the middle of last year when you might not have noticed. The changes include those that follow.

- *All cash donations to charity must be documented (no exceptions).* You're no longer allowed any write-offs for contributions of cash, checks or other monetary gifts unless you retain either a bank record that supports the donation, such as a canceled check or credit card receipt, or a written state-

ment from the charity that meets tax-law requirements.

For cash donations of \$250 or more, a bank record is not enough. You must obtain a charity-provided



statement that meets tax-law standards.

- *Stricter rules for donated used clothing and household items.* You're no longer allowed to claim deductions for charitable donations of used clothing and household items that are

not in "good used condition or better." The IRS has yet to define this "condition."

The term *household items* means furniture and furnishings, electronics, appliances, linens and the like. Be sure to keep a list and individual or collective photos (to help establish the item's condition) of donated items.

As charities are struggling with changing their acknowledgments to conform to the "condition" standard, be creative and create your own form that says, "These clothing and household items are in good used condition, in compliance with IRS rules." Have the person receiving the items sign and date your form.

### Conclusion

As we said at the beginning of this article, it is intended to give you just a few ideas to get you thinking about tax planning for 2007. Please do not hesitate to call us at 626/577-1440 if you want more details.

## Adjustable Rate Loans – Information Borrowers Need

by Marilyn Noel  
Senior Accountant

Adjustable-rate mortgages (ARM) make up roughly 30 percent of all home mortgages currently being issued. They are still attractive to some borrowers in a period of increased rates, but a recent Federal Reserve study showed that many ARM borrowers know little of the key features of their loans and underestimate the amounts by which their loan payments could jump.

If you are thinking of obtaining an ARM, be prepared to understand and know these key features of your loan:

- Maximum rate that can be charged.
- Maximum the rate can rise at one time.
- Index used to determine rates.
- Original interest rate.
- How often the rate can change.

## Foreign Business Travel — Planning to Maximize Deductions

by Mike Tao  
Manager

When you travel outside the U.S. primarily for business reasons, the general rule is that you must allocate all your travel expenses, including transportation, between business and personal purposes. However, there are two big exceptions, and you often can plan ahead to take advantage of them.

You can deduct 100 percent of your transportation expenses if you meet either of the rules that follow.

- *The one-week rule.* You'll meet this rule if your business trip is a week or less in length, not counting the day you leave but counting the day you return. In this case, you can deduct 100 percent of your transportation costs and 100 percent of your other out-of-pocket expenses for business days (subject to the 50 percent rule for meals).

You cannot deduct out-of-pocket costs incurred on vacation days. The good news: Weekends and holidays falling between business days count as business days. This also applies to an intervening weekday between two

business meeting days.

Standby days, when your physical presence is required for business, also count even if you spend most of your time on personal pursuits during those days.

Finally, business days include the day of your return trip plus days you intended to work but couldn't due to reasons beyond your control.

- *The 25 percent rule.* You can also deduct 100 percent of your transportation expenses for trips that last more than a week, as long as you spend less than 25 percent of your days on vacation.

To qualify under this rule, count the day of departure and day of return as business days. Also count all the other types of business days mentioned under the preceding one-week rule.

Once again, however, you cannot

deduct meals, lodging and other expenses allocable to personal days.

If 100 percent of your transportation expenses are not deductible under the preceding rules, the *business percentage* of your transportation costs is still deductible, assuming the trip is primarily for business.

To calculate the business percentage, divide the days spent principally on business activities by the total number of days outside the country, counting departure and return days. The travel days count as business days, just as the other types of days are considered busi-



ness days for purposes of the one-week rule and 25 percent rule.

You can also deduct the out-of-pocket expenses allocable to your business days, subject to the 50 percent rule for meals.

## AMT Surprise —

## Tax May Affect Municipal Bond Funds

by Don Westenhaver  
Partner

Buying a tax-exempt municipal bond fund remains a popular remedy to lower your tax bill. However, as more and more taxpayers are ensnared by the alternative minimum tax (AMT), and as AMT reform remains a faint hope, investors are discovering that part of the supposed "tax-exempt" interest paid by their muni funds is taxable under federal law if the investor is subject to the AMT.

Under SEC rules, a fund that sells

itself as "tax exempt" can have as much as one-fifth of its holdings in municipal bonds subject to the AMT.

AMT-subject bonds usually are "private-activity" bonds sold to finance government housing, airports, pollution facilities and other local government projects that benefit for-profit companies. Private-activity bonds find their way into fund portfolios because typically they pay higher yields than AAA rated municipal issues.

In reaction to investors' ire, all the major fund companies are offering a

new breed of muni fund that is either completely or nearly free of AMT-subject bonds.

If you're in or approaching the AMT, take the steps that follow.

- View the fund company Web site or contact the fund company to determine your muni fund's AMT exposure.

- Obtain information about AMT-free funds.

- Compare the funds yield, expense ratio and overall performance. After all, it's all about overall after-tax returns, AMT or no AMT.



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The Dow 30 will need to reach 2,011,000 at 12/31/2099 to equal the rate of gain of the 20th century (5.3 percent annually).

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*Publication Seeks Answers —*  
**Why Do Employees Commit Fraud?**

by Kevin Wong  
Senior Accountant

Wiley Publishers recently released its latest edition of *Fraud Auditing and Forensic Accounting* and released a long list of 25 reasons why employees lie, cheat and steal. The list was based on information from authorities in white collar crime (criminologists, auditors, Jeffrey Skilling).

Many of the reasons are well known or use common sense, i.e., lax internal controls, but some are interesting:

- Employees tend to imitate their bosses. If their bosses steal or cheat, then they are likely to do so also.
- Employees are not encouraged to discuss personal or financial problems at work or to seek management's advice and counsel on such matters.
- No one has ever been prosecuted for stealing from the organization.
- The employee feels abused by the employer and wants to get even.

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