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TAX AND BUSINESS ADVISOR

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Tax and Business Alert™

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New Option for Your Retirement Plan Distribution

For many individuals, their employer-sponsored retirement plan (e.g., stock bonus, pension, or profit-sharing plan) represents an integral component of their retirement and estate plans. Therefore, the decisions made when choosing how retirement plan assets will be distributed and taxed during the participant's lifetime, as well as at his or her death, are extremely significant.

It is important to note that following the death of a participant in an employer-sponsored retirement plan, the plan's guidelines often require that the participant's entire benefit be distributed in a lump sum to the designated beneficiary. If that beneficiary is the participant's spouse, the spouse *is not* required to receive the lump sum, but, instead, can choose to roll over the distribution into an IRA and, thereby, defer taxation on the distribution. However, prior to the Pension Protection Act of 2006 (2006 Pension Act), a nonspouse beneficiary was not permitted to roll over distributions from employer-sponsored retirement plans. Thus, nonspouse beneficiaries were required to receive the lump sum distribution and incur an immediate tax liability.

The 2006 Pension Act gave taxpayers an additional option when determining how employer-sponsored retirement plan distributions are made and taxed. Beginning in 2007, the new law permits tax-free rollovers by direct transfers from a deceased person's employer-sponsored retirement plan account into a new IRA established by the nonspouse beneficiary for this purpose. [The same rollover privilege will be available for amounts paid to nonspouse beneficiaries under Section 403(a) and (b) annuities and Section 457 plans.]

This change is a big deal because it allows nonspouse beneficiaries to benefit from the tax-deferral advantages offered by the IRA rollover strategy previously available only to spousal beneficiaries. Please call us for additional information.

The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Tax Calendar

January 16—Individual taxpayers' final 2006 estimated tax payment is due unless the Form 1040 is filed by January 31, 2007, and any tax due is paid with the return.

January 31—Most employers must file Form 941 (Employer's Quarterly Federal Tax Return) to report Medicare, social security, and income taxes withheld in 2006. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until February 12 to file the return. Small employers who have been notified by the IRS should file Form 944 (Employer's Annual Federal Tax Return).

—Give your employees their copies of Form W-2 for 2006. If an employee agreed to receive Form W-2 electronically, have it posted on the website and notify the employee.

—Give annual information statement to recipients of certain payments you made during 2006. You can use the appropriate version of Form 1099 or other information return.

—File Form 940 for 2006. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you deposited the tax for the year in full and on time, you have until February 12 to file the return.

February 28—The government's copy of Form W-2 and Form 1099 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to April 2.

March 15—2006 income tax returns must be filed or extended for calendar-year corporations. If the return is not extended, this is also the last day for calendar-year corporations to make 2006 contributions to pension and profit-sharing plans.

2007 Mileage Rates

Beginning January 1, 2007, the standard mileage rates for the use of a automobile (including vans, pickups, or panel trucks) are (1) 48.5 cents per mile for business miles, (2) 20 cents per mile for medical or moving purposes, and (3) 14 cents per mile for service to a charitable organization.

The 2006 rates were 44.5 cents for business miles and 18 cents for medical and moving. According to the IRS, the increase is due to higher prices for vehicles and fuel during the year ending in October. The charitable rate is unchanged from 2006.

Social Security Changes for 2007

The Social Security Administration recently announced numerous adjustments to Social Security benefit amounts, thresholds, limits, and exclusions. For 2007, Social Security and Supplemental Security Income (SSI) beneficiaries will receive a 3.3% cost of living adjustment. The maximum benefit for workers retiring, after attaining full retirement age, in 2007 will be $2,116/month (up from $2,053/month in 2006).

The wage base for calculating the Social Security portion (OASDI) of the annual payroll tax obligation will be $97,500 in 2007 (up from $94,200 from 2006).

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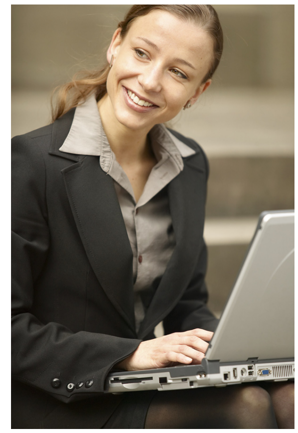
Are You an Investor or Trader for Tax Purposes?

If you purchase and sell investment securities for your own account, you will likely qualify as either an investor or trader for tax purposes. The distinction between trader and investor is important because the tax rules are generally more favorable for traders. Most taxpayers are classified as investors, but in today's setting of discount brokerage and online trading some taxpayers are spending considerable time trading stocks on a regular basis which may qualify them for trader status.

When investors sell shares of stock, they report short-term or long-term capital gains depending upon how long they have held the shares. Any expenses they incur in connection with their stock investing are generally deductible only as miscellaneous itemized deductions subject to a limitation and are not deductible for the alternative minimum tax (AMT). However, most investors receive little or no tax benefit from their investment expenses because of the itemized deduction limitation and the add-back for AMT purposes. Note that any commissions paid in purchasing the securities are capitalized as part of the cost basis while commissions paid at the time of the sale reduce the proceeds.

Unlike investors, securities traders are deemed to be conducting a trade or business, so their trading expenses are generally deductible as ordinary and necessary business expenses. A trader's business expenses include interest paid on margin accounts used in connection with the trading activity. In addition, a trader's business status makes him or her eligible to claim a home office deduction, provided specific requirements are met.

When a trader disposes of a stock, the general rule is that the sale is treated as a short-term or long-term capital gain or loss, depending on how long the stock was held. Thus, traders, like investors, generally report their stock gains and losses as capital gains and losses and, accordingly, are subject to the $3,000 annual limitation that applies to net capital losses and to the wash sale rules. The wash sale rules can be particularly detrimental to traders because they defer the recognition of a stock loss when the taxpayer acquires the same stock within a period beginning 30 days before and ending 30 days after the date of the original sale.



As an alternative, traders can formally elect to mark their stock holdings to market at the end of the tax year. If this election is made, all security gains and losses are treated as ordinary income and all securities on hand at year-end are deemed to be sold at the year-end market value, thereby recognizing unrealized gains and losses. For traders, the primary benefit of making the mark-to-market election is that the $3,000 limitation on net capital losses and the wash sale rules no longer apply. As a result, the trader is no longer allowed to treat trading activity gains and losses as capital asset transactions, but this should have minimal negative impact since traders by definition trade continually and should have few, if any, long-term capital gains.

Because capital gains and losses are specifically excluded from the definition of net earnings from self-employment (SE), earnings from a trading activity are not subject to the SE tax. However, since a trader's net earnings are not SE income, he or she cannot contribute to a retirement plan (e.g., SEP or IRA) based on such income.

There are specific timing requirements for making the mark-to-market election to be treated as a stock trader, and, once in effect, the election applies to that year and all subsequent years. There are benefits from and drawbacks to making such an election, and the advice of a tax professional is warranted. Please call us to discuss this or any other personal or business question in the area of taxation and for advice on how to save on your tax bill.

Accessing Your Home Equity with a Reverse Mortgage

If you have significant equity in your residence, a reverse mortgage might provide a cost-effective source of funds. A reverse mortgage allows homeowners to borrow against the unencumbered value of their home while continuing to live there. In the typical case, the house will be sold at some point (normally after the borrower dies) to pay off the mortgage. Since the loan typically defers all repayment until the house is sold or the borrower dies, lending decisions are usually based primarily on the home's value rather than on the borrower's creditworthiness and ability to make monthly payments.

Reverse mortgages are growing in popularity among senior citizens who use them to pay off delinquent mortgages or home equity loans, or to finance major expenditures such as medical expenses and long-term care expenses.

Reverse mortgages are obtained from private lending institutions, but may be guaranteed by the Department of Housing and Urban Development (HUD) through the Federal Housing Administration (FHA). These FHA-guaranteed reverse mortgages are known as home equity conversion mortgages (HECMs). To qualify for an HECM, the homeowner must be at least 62-years old and must own the home outright or be able to pay off any balance with the reverse mortgage proceeds. To avoid default, the homeowner must maintain the home, pay property taxes, and provide insurance.

The amount the lender will advance depends on the borrower's age, equity in the home, and the interest rate. Generally, the older the homeowner is, and the more equity they have in their home, the higher the advance will be. Lower interest rates equate to larger advances as well. The National Reverse Mortgage Lenders Association provides a calculator to help individuals determine how much they can borrow according to their age, the home's value, and the interest rate. The calculator is at **www.reversemortgage.org.**

Costs. Costs associated with a reverse mortgage include an origination fee, other closing costs (such as escrow fees and a title search), monthly servicing fees, and mortgage insurance premiums. These costs can normally be added to the loan balance.

Sale of the Home. If the house sells for less than the amount due, the lender receives the sales proceeds only. However, if the house sells for more than the loan balance, the homeowner (or the estate) is entitled to the difference.

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