



TAX ALERT

SEPTEMBER 22, 2006

PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006, signed into law last month, primarily affects retirement plans. However, following are some of the important provisions which affect other areas of income taxation:

1. Charitable Gifts of IRAs

Charitable contributions of up to \$100,000 per year can be made from IRAs in 2006 and 2007 for individuals over age 70½ without having to recognize income. The charitable contribution from the IRA must go to a public charity.

Although a charitable contribution deduction is not allowed, the income exclusion is a more favorable outcome. The exclusion results in a lower adjusted gross income mitigating the effect of the statutory limitations. Another advantage of this new law is that these non-taxable charitable gifts satisfy the annual minimum distribution requirement.

2. Non-Spouse Beneficiary Rollovers

Employer sponsored retirement plans often require benefits to be paid in a lump sum or within 5 years of the participant's death to the participant's "designated beneficiary." Under current law, if the beneficiary is a spouse, he or she can roll over the distribution to an IRA, but a non-spouse beneficiary could not use a rollover IRA.

The new law allows non-spouse beneficiaries to utilize IRAs as well, beginning in 2007, which often enables them to defer distributions (and

income taxation) and to control the investment decisions. If the decedent/participant was receiving periodic distributions at the time of his death, the beneficiary must continue to receive distributions in accordance with the current rules.

However, if the decedent/participant was not receiving distributions at the time of his death, the beneficiary can receive distributions over his life expectancy (instead of over 5 years), beginning within 1 year of the decedent/participant's death.

The beneficiaries of plans for participants who die during 2006 should consider waiting until 2007 to receive distributions from the plan, in order to take advantage of the new law. Also, distributions paid directly to the beneficiary do not qualify. Distributions must be made by trustee to trustee transfers. Finally, a new IRA will have to be established to receive the distribution because the IRA must have different distribution rules.

3. Charitable Contribution Reforms

The Act made a number of charitable contribution changes. Following are some of the areas of change:

(a) Contributions of clothing and household items must be in good used condition and have more than minimal value.

(b) In regards to a charitable contribution of tangible personal property, any appreciation at the time of the contribution must be recaptured

if the donee sells the property within three years of the contribution. The donee is required to notify you if this occurs.

(c) A charitable contribution by an S corporation reduces the shareholders' basis by the basis of the property contributed, not by its value.

(d) Additional restrictions and reporting requirements have been placed on contributions of facade easements.

(e) The limitations for deducting qualified conservation contributions of real property have been liberalized.

4. Valuation Penalties

Stricter rules have been adopted for the 20% substantial valuation penalty and the 40% gross valuation misstatement penalty. Reasonable cause is no longer a defense.

SUSPICIOUS E-MAILS AND IDENTITY THEFT

The Internal Revenue Service has issued several consumer warnings on the fraudulent use of the IRS name or logo by scamsters trying to gain access to consumers' financial information in order to steal their identity and assets. When identity theft takes place over the internet, it is called phishing.

Current scams include phony e-mails which claim to come from the IRS and lure the victims into the scam by telling them that they are due a tax refund. E-mails claiming to come from taxrefunds@irs.gov, admin@irs.gov and similar variations directed recipients to claim the refund by using a link to a Web site looking very similar to a genuine IRS Web site. This modified site asked for personal and financial information that the genuine IRS interactive page does not require.

The IRS has now created a new IRS mailbox to contact if you receive a suspicious e-mail. Please forward the suspicious e-mail to phishing@irs.gov. The IRS can use the information, URLs and links in the suspicious e-mails you forward to trace the hosting Web site and alert authorities to help shut down the fraudulent site. Unfortunately, due to the unexpected volume, the IRS will not be able to acknowledge receipt or respond to you.

Another tax scam is a bogus IRS letter including Form W-8BEN asking non-residents to provide personal information such as account numbers, PINs, mother's maiden name and passport number. The legitimate IRS Form W-8BEN, which is used by financial institutions to establish withholding tax for foreign individuals, does not request this information.

If you receive a letter or are otherwise aware of the fraudulent misuse of the IRS name, logo, forms or other IRS property, please contact the Treasury Inspector General for Tax Administration at www.ustreas.gov/tigta or the toll-free hotline at 1-800-366-4484.

FLORIDA REPEALS INTANGIBLE PERSONAL PROPERTY TAX

It's now official. Florida has repealed its intangible personal property tax effective January 1, 2007.

INCOME AND ESTATE TAX IRS AUDITS

We knew that the IRS substantially increased its income tax audits. However, we were surprised to learn that the IRS plans to lay off almost half of its estate tax auditors by September 30th. As a result of the increased exemption previously enacted, the number of estate and gift tax returns filed has decreased by 70 percent since 2000. The Service anticipates that the estate tax

returns filed in 2007 will decrease to approximately 30,000, a 75 percent decrease since 2000. The IRS says that it will continue to focus its efforts on “high-value” estates which provide most of the tax deficiencies. Ten percent of the estate tax audits yield 80 percent of the tax adjustments. These estates typically are worth over \$5 million. The Service will continue to audit approximately 30 percent of estates that are in excess of \$5 million. It appears that both Congress and the IRS are rapidly losing interest in estates that are smaller than \$5 million. This seems to be another indication that legislation will be forthcoming in the near future increasing the exemption to approximately \$5 million.

STATE TAXATION - MUNICIPAL BOND INTEREST

Taxpayers recently successfully challenged a Kentucky statute which taxed their out of state municipal bond interest. Kentucky’s statute is similar to many other state taxation statutes. The statute taxes municipal interest income received from out of state bonds but exempts from taxation interest earned on bonds issued within the state. Predictably, the Kentucky Department of Revenue is petitioning the U.S. Supreme Court to review the case.

This case has a far-reaching effect because of the similarity of the Kentucky statute to the statutes of many other states. Similar challenges are pending in Arizona and North Carolina.

Thus far, the bond market has not been affected by the Kentucky decision. The reason for the apparent lack of interest arguably is because it will take a long time for this issue to be resolved.

TELEPHONE TAX REFUNDS

Earlier this summer, the IRS conceded that the 3% federal excise tax that it had been charging on certain long distance telephone calls doesn’t

apply. It stopped charging the tax July 31, 2006 on long-distance service. It agreed to refund the tax paid by users from March 1, 2003 through July 31, 2006.

The IRS recently agreed to allow refunds without requiring non-business taxpayers to use old telephone bills to compute the actual tax paid. Taxpayers are allowed the following “safe harbor” refunds based on the exemptions claimed on their 2006 tax returns:

One exemption	\$30
Two exemptions	\$40
Three exemptions	\$50
Four exemptions	\$60

Individual taxpayers also have the option of computing the actual tax that they paid. Business and nonprofit organizations must calculate the actual tax paid. However, the IRS is looking into reasonable methods for estimating the refund due business users.

Individuals will not receive a separate check for the refund. The refund will either increase their income tax refund or decrease the tax that they owe.

PLAN NOW TO REDUCE YOUR 2006 INCOME TAX

What could be better - reduce your income tax by contributing money to yourself? The maximum amount that employees under age 50 can contribute this year to a 401(k) increased to \$15,000 this year. If you are 50 or over, the maximum has increased to \$20,000. The maximum contribution to an IRA is \$4,000 if you are under 50, \$5,000 if 50 or over. Your tax deferred savings can be greater if your employer also contributes to your plan. By contributing to a retirement plan, you will be funding your retirement while reducing your current income tax.

UPDATE ON HYBRID VEHICLES

Following is a listing of the vehicles that qualify for the credit and the amount of the credit:

Vehicle	Year	Certified Credit Amount
Ford Escape Hybrid Front WD	2006	\$ 2,600
Ford Escape Hybrid 4 WD	2006	\$ 1,950
Honda Insight CVT	2005, 2006	\$ 1,450
Honda Civic Hybrid MT and CVT	2005	\$ 1,700
Honda Civic Hybrid CVT	2006	\$ 2,100
Honda Accord Hybrid AT and Navi AT	2005	\$ 650
Honda Accord Hybrid AT and Navi AT without updated calibration	2006	\$ 650
Honda Accord Hybrid AT and Navi AT, with updated calibration	2006	\$ 1,300
Lexus GS 450h	2007	\$ 1,550
Lexus RX 400h 2WD and 4WD	2006	\$ 2,200
Mercury Mariner Hybrid 4WD	2006	\$ 1,950
Toyota Camry Hybrid	2007	\$ 2,600
Toyota Highlander Hybrid 2WD and 4WD	2006	\$ 2,600
Toyota Prius	2005, 2006	\$ 3,150
Ford Escape Front WD Hybrid	2007	\$ 2,600
Ford Escape 4WD Hybrid	2007	\$ 1,950
Mercury Mariner 4WD Hybrid	2007	\$ 1,950
GMC Sierra 4WD Hybrid pickup truck	2006	\$ 650
GMC Sierra 4WD Hybrid pickup truck	2007	\$ 650
Chevrolet Silverado 4WD Hybrid pickup truck	2006	\$ 650
Chevrolet Silverado 4WD Hybrid pickup	2007	\$ 650
GMC Sierra 2WD Hybrid pickup truck	2006	\$ 250
GMC Sierra 2WD Hybrid pickup truck	2007	\$ 250
Chevrolet Silverado 2WD Hybrid pickup truck	2006	\$ 250
Chevrolet Silverado 2 WD Hybrid pickup truck	2007	\$ 250

The credit will be phased out beginning with the second calendar quarter after 2005 where the manufacturer sells a cumulative total of at least 60,000 vehicles. The full credit is allowed for purchases made during the 1st quarter after the manufacturer sells the 60,000th vehicle.

Example – If the manufacturer sells its 60,000 vehicle in the 2nd quarter of 2006 (April 1 – June 30, 2006) a buyer can get the full credit if he purchases a listed vehicle during the 3rd quarter (July 1 – September 30th 2006). Purchases made in succeeding quarters would be entitled to scaled down credits.

The taxpayer is allowed 50% of the credit for vehicles purchased in the 2nd and 3rd quarters following the sale of the 60,000th vehicle. For purchases made during the 4th and 5th quarters, 25% of the credit is allowed. No credit is allowed for purchases after the 5th quarter.

Toyota has sold its 60,000th vehicle in the quarter ended June 30, 2006. Therefore, you can only get the full Toyota credit if you buy the vehicle by September 30, 2006. If you buy it from October 1, 2006 through March 31, 2007, you will receive 50% of the credit. The full credit remains available for all of the other vehicles listed through the end of 2006.

Caveat – The list of vehicles approved for the credit continues to increase as new vehicles are approved. Also, the credits become scaled down. Therefore, it is important that you verify that a vehicle is approved and the amount of the credit prior to purchasing the vehicle.

These rules are hard to follow. If you are contemplating purchasing a hybrid vehicle, please call us.

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