Parker Financial Services, LLC

www.retireontime.net

3830 Packard Road; Suite 260
Ann Arbor, MI 48108-2051

Owner: David E. Parker, CPA, CFP®
dave@retireontime.net

Office: 734-975-8711
Fax: 734-418-2106

"Helping Business Owners and Professionals Retire on Time"

Wednesday, November 14, 2007

YEAR-END 2007 TAX PLANNING

INDIVIDUAL TAX PLANNING

Income and Deductions. Absent other circumstances, the usual tax strategy for individual taxpayers is simple: When it is possible, accelerate deductions into the current year and defer taxable income to future years. First, income is generally taxable in the year it is received, so you can postpone the tax that is due for at least a year and keep your money that much longer. Second, the deductions you bring into this year will offset income that is currently taxable and lower your overall tax liability for 2007.

> The actions you take, or do not take, between now and the end of the year can have a significant impact on your 2007 tax liabilities.

Although tax rates have remained the same during the last few years, the internal tax brackets are still indexed for inflation. As a result, you can earn more income this year than last year without triggering a higher tax rate. The following chart provides the 2007 bracket ranges for single and joint filers.

TAX BRACKET	SINGLE FILERS	JOINT FILERS
10%	$0 - $7,825	$0 - $15,650
15%	$7,826 - $31,850	$15,651 - $63,700
25%	$31,851 - $77,100	$63,701 - $128,500
28%	$77,101 - $160,850	$128,501 - $198,850
33%	$160,851 - $349,700	$198,851 - $349,700
35%	Over $349,700	Over $349,700

Source: www.IRS.gov

***TAX TACTIC**: Do not assume "the usual strategy" is always the best for you. Depending on your situation, you might be better off deferring deductions and/or accelerating income. This may be true if 2007 is for any reason a relatively low income year or if you face alternative minimum tax (AMT) complications (see below).*

Advisory Services and securities offered through NEXT Financial Group, Inc., Member FINRA/SIPC, 2500 Wilcrest, Suite 620, Houston, TX 77042 877-876-6398. Parker Financial Services, LLC is not an affiliate of NEXT Financial Group, Inc.

Personal Exemption. You can claim a personal exemption for yourself, your spouse, and any qualified dependent. In 2007, each exemption you claim reduces your taxable income by $3,400, unless your income is great enough to trigger the exemption phase-out. That phase-out starts when AGI exceeds $234,600 for joint filers and $156,400 for single filers.

The good news is that the amount of personal exemptions a taxpayer can lose through the phase-out is being reduced, with the phase-out scheduled to be eliminated in 2010.

Alternative Minimum Tax. The Alternative Minimum Tax (AMT) was originally intended to apply only to the wealthiest taxpayers. However, it continues to affect a wide range of filers in all income brackets.

> **How it works.** The complex AMT calculation involves certain "tax preference" items, technical adjustments and an exemption amount based on your filing status. When the calculation is complete, the result is compared with your regular income tax liability. Then you effectively pay the higher of the two. The AMT rate is 26% for the first $175,000 of AMT income; 28% on amounts above $175,000.

For several years, we have benefited from elevated exemption amounts but this year those exemption amounts revert to the year 2000 levels as shown here.

FILING STATUS	2000	2001-2002	2003-2005	2006	2007
Joint Filers	$45,000	$49,000	$58,000	$62,550	$45,000
Unmarried Filers	$33,750	$33750	$40,250	$42,500	$33,750

Source: www.IRS.gov

Some of the items that may trigger the Alternative Minimum Tax:

- A large capital gain
- A higher than average number of dependency exemption
- An unusually large deduction for state income tax
- A large deduction for un-reimbursed employee business expense or miscellaneous deductions
- Tax exempt interest from "private activity" municipal bonds

***TAX TACTIC**: Have your AMT liability assessed before year-end. When it makes sense, you might shift tax preference items to 2008 to avoid the AMT for 2007. Otherwise, it may make sense to accelerate income into 2007 if your regular top marginal tax rate is higher than your AMT rate. We can assist you with the analysis for your situation.*

Charitable Donations. Strict new substantiation requirements apply to monetary gifts (including gifts made with cash or by check or credit card) in 2007. No deduction is allowed unless you maintain a record of the contribution, such as a bank statement, receipt or written communication from the charity. The written communication must show the charity's name, the date of the contribution and the amount of the donation.

Furthermore, deductions for charitable gifts of clothing and household goods are generally limited to items in "good condition." This change applies to donations after August 17, 2006. **Exception**: If you obtain an appraisal of more than $500 for a single item, the amount may be deductible, regardless of this item's condition.

***TAX TACTIC**: Charge charitable donations or make online gifts before January 1. As long as a contribution is posted by December 31, it can be deducted on your 2007 return - even if you do not actually pay off the charge until 2008.*

Be aware that the IRS has become increasingly concerned about abuses relating to certain types of charitable donations.

Kiddie Tax. Under the so-called "kiddie tax," unearned income received by a child above an annual threshold ($1,700 for 2007) may be taxed at the top marginal tax rate of the child's parents, instead of the child's lower tax rate.

> **New rules**: For 2007, the kiddie tax provision applies to children under age 18. Previously, the age limit was age 14. Even worse, the new small-business law is extending the reach of the kiddie tax to older children.
>
> Beginning in 2008, the age limit is increased to age 19 (age 24 for children who are full-time students). These higher age limits apply if the child does not have earned income equal to half of his or her annual support. In other words, the kiddie tax is expected to affect many families with college students.

***TAX TACTIC**: Take steps to minimize your child's unearned income for 2007. For instance, you might have a child invest in short-term obligations or growth stock where taxable income will be deferred. Another option is to use investments in tax-free municipal bonds or muni bond funds.*

Estimated Tax Payments. The IRS requires you to pay federal income tax through quarterly installments or tax withholding - or a combination. Otherwise, it may impose an estimated tax penalty for underpayment. However, no estimated tax penalty is assessed if you meet one of the following "safe harbors" available under the tax law:

- Your annual payments equal at least 90% of your current liability;
- Your annual payments equal at least 100% of the prior year's tax liability (110% if your AGI for the prior year exceeded $150,000); or
- You make installments on a current basis under an "annualized income" method. This method is best suited for taxpayers who have received or accrued a large part of their annual income during a short span of time.

***TAX TACTIC**: Adjust withholding at year-end to meet one of the safe harbors. If you make the adjustment after you clear the annual Social Security wage base ($97,500 for 2007), you may increase withholding with little or no reduction in your take-home pay.*

Education Tax Breaks. The ever-escalating cost of higher education is a main concern of many families. At least you may take some solace through two key tax breaks available in 2007.

1. **Tuition deduction**: Joint filers can deduct up to $4,000 of tuition and related expenses if their AGI is $130,000 or less in 2007 ($65,000 for single filers). The maximum deduction is $2,000 for an AGI up to $160,000 ($80,000 for single filers).

   New rules: The tuition deduction, which was scheduled to expire after 2005, was retroactively extended through 2007. Under current law, this is the last year you can claim the deduction (unless it is extended again).
2. **Tax credits**: You may qualify for either the Hope Scholarship credit or the Lifetime Learning credit for qualified higher education expenses. For 2007:
   - The Hope Scholarship credit is equal to 100% of the first $1,100 of qualified expenses and 50% of the next $1,100 of qualified expenses for each of the first two years of higher education. The maximum credit is $1,650.
   - The Lifetime Learning credit is equal to 20% of the first $10,000 of qualified expenses. The maximum credit is $2,000.
   - Each credit is phased out at relatively low levels. The phase-out range for joint filers is an AGI between $94,000 and $114,000 ($47,000 and $57,000 for single filers).

***TAX TACTIC**: Unlike the Hope Scholarship credit, the Lifetime Learning credit cannot be claimed on a per-student basis. Your tax advisor can help determine which credit, if any, to claim at tax return time.*

Social Security Taxes and Benefits. Social Security marked its 72nd anniversary on August 14, 2007. The major changes in taxes and benefits for 2007 are shown here:

- The maximum earnings on which you paid Social Security taxes increased to $97,500 in 2006 (It was $3,000 72 years ago!).
- The cost of living increase for benefits paid in January 2006 was 4.1%. For January 2007, it will be 3.3%.
- Full Retirement Age (FRA) is 65 years and 10 months if you turn 65 in 2007. The FRA for people reaching age 62 in 2007 is 66. Reduced benefits are still payable at age 62.
- The average monthly benefits paid by Social Security are $1,044 for retired workers and $1,713 for retired couples.

Are you already receiving benefits? You will not have to pay taxes on your benefits unless your "provisional income" – basically, your AGI with certain modifications plus one-half of Social Security benefits exceeds certain levels. Then up to 85% of your benefits may be taxable.

Rather than taking a large taxable distribution from your IRA or other retirement plan at the end of 2007, consider taking some of the money in 2007 and the rest in 2008.

PROVISIONAL INCOME JOINT RETURN	PROVISIONAL INCOME UNMARRIED	MAX % OF BENEFIT TAXED
Less than $32,000	Less than $25,000	0%
$32,000 to $44,000	$25,000 to $34,000	50%
Over $44,000	Over $34,000	85%

Source: Mercer Human Resources

Other Tax Ideas.

- You are entitled to a medical expense deduction only to the extent that your annual un-reimbursed expenses exceed 7.5% of your AGI. If you are near the 7.5% mark - or already over it - schedule non-emergency medical and dental visits before year-end.
- Despite recent tax law modifications, you can still claim a dependency exemption of $3,400 for a child if you provide more than half of the child's support in 2007. There is no gross income limit for a child who is under age 19 or a full-time student under age 24. **Note**: The tax benefit of personal exemptions is phased out for certain high-income taxpayers.
- When permitted by state law, you might consolidate outstanding personal debts into a home equity debt. Although interest on personal debts is not deductible, you may deduct the mortgage interest paid on the first $100,000 of home equity debt - regardless of the use of the proceeds. **Caution**: Because the debt must be secured by your home, use this technique with discretion.
- Miscellaneous expenses are deductible to the extent that the annual total exceeds 2% of AGI. If possible, pay these expenses at year-end to maximize your deduction for 2007.

Miscellaneous.

- Take advantage of the energy tax credit for installations in your home. The current tax breaks for energy saving are scheduled to expire after 2007.
- You can deduct your annual unreimbursed medical expenses over 7.5% of your AGI. If you are near the 7.5% mark—or already over it—schedule nonemergency medical and dental visits before year-end.
- In general, you may be able to claim a dependency exemption of $3,400 for a child if you provide more than half of the child's support in 2007. There is no limit on taxable income of a child under age 19 or a full-time student under age 24. **Note**: The tax benefit of personal exemptions is phased out for certain high-income taxpayers.

FINANCIAL TAX PLANNING

Individual Retirement Accounts. There are two main types of IRAs designed for retirement savings: the traditional IRA and the Roth IRA.

1. **Traditional IRAs**: Contributions are tax-deductible unless you are an "active participant" in an employer-sponsored retirement plan *and* your AGI exceeds a certain level. For 2007, deductions are phased out for an AGI between $83,000 and $103,000 for joint filers ($52,000 and $62,000 for single filers). If your spouse is an active participant and you are not, the deduction is phased out for an AGI between $156,000 and $166,000.

The maximum IRA contribution for 2007 is $4,000. However, if you are age 50 or over, you are permitted to make an extra "catch-up contribution" of $1,000.

***TAX TACTIC**: The deadline for 2007 IRA contributions is your tax return due date. Nevertheless, you can boost retirement savings by making contributions sooner. This provides more time for contributions to grow on a tax-deferred basis.*

New rules: An individual age 70½ or over can take tax-free IRA distributions of up to $100,000 for gifts directed to a qualified charity. This tax break expires after 2007.

2. **Roth IRAs**: Contributions are not tax deductible, but withdrawals after five years may be tax-free. To qualify, distributions must be received after age 59½, upon death or disability or to pay first-time homebuyer expenses (up to a lifetime limit of $10,000). The ability to contribute to a Roth IRA for 2007 is phased out for joint filers with an AGI between $156,000 and $166,000 ($99,000 and $114,000 for single filers).

The contribution limits for Roth IRAs are the same as for traditional IRAs. If you choose, you may allocate contributions to both types of IRAs, up to the total annual limit.

***TAX TACTIC**: You may convert a traditional IRA to a Roth IRA if your AGI is $100,000 or less. However, you must pay tax on the conversion. If this meets your needs, try to keep your AGI for 2007 below $100,000 by postponing taxable income to 2008.*

New rules**: Beginning in 2010, you can convert to a Roth IRA, regardless of your AGI level. For a conversion in 2010, the resulting tax can be paid over the following two years (2011 and 2012). Therefore, it may be advantageous to postpone a conversion.**

401(k) Plans. A 401(k) plan allows you to defer your salary to an account where the funds can grow tax-deferred. In addition, your company may provide matching contributions.

As with other tax-qualified retirement plans, a 401(k) plan must meet strict nondiscrimination requirements to maintain its tax-favored status. Furthermore, there is an annual dollar cap on elective deferrals. For 2007, you can defer up to $15,500 to your account, and you can make a catch-up contribution of $5,000 if you are age 50 or over. Thus, the total maximum annual deferral for 2007 is $20,500.

***TAX TACTIC**: Adjust your 401(k) plan contributions at year-end to increase your retirement nest egg. For instance, you might want to defer more dollars to your 401(k) account after you clear the 2007 Social Security wage base of $97,500.*

New rules: The Pension Protection Act of 2006 liberalized many of the tax rules pertaining to 401(k) plans. For instance, it will become easier in 2008 for employers to establish automatic-enrollment 401(k) plans. Beginning in 2007, plan providers are permitted to offer personalized investment advice to 401(k) account holders.

Furthermore, non-spouse beneficiaries who inherit 401(k) plan assets now have greater flexibility. Effective for 2007, a non-spouse beneficiary can roll over the assets to an IRA the same as a spousal beneficiary. Subsequently, the beneficiary can stretch out required minimum distributions (RMDs) over a period of time.

Finally, many favorable tax provisions for 401(k) plans and other tax-qualified plans that were scheduled to "sunset" after 2010 have been made permanent.

Capital Gains and Losses. At the end of the year, you have a unique tax opportunity to time capital gains and losses from securities sales. However, this year you face new tax complications.

As before, capital gains and losses offset each other to produce a net capital gain or loss. Any excess loss can then offset up to $3,000 of high-taxed ordinary income. (If a loss exceeds $3,000, the excess is carried over to next year.) The maximum tax rate on net long-term capital gain is 15%; 5% for those in the lower, 10% and 15% tax brackets.
Thus, if you have already realized capital gains in 2007, you might realize capital losses at year-end to offset those gains. On the other hand, if you are showing a net capital loss, capital gains realized at year-end are tax-free up to the amount of the loss.

New rules: The maximum 5% tax rate for long-term capital gains for lower-income taxpayers drops to zero for 2008. Consider the following year-end ideas:

- If you will be eligible for the 0% tax rate in 2008, defer capital gains to next year.
- If you will not be eligible for the 0% tax rate in 2008, you might give gifts of stock to other family members (e.g., young children) who will qualify for this tax break.
- If your child will be eligible for the 0% tax rate in 2008, but the kiddie tax will probably be triggered, you may have the child realize capital gains before year-end.

***TAX TACTIC**: Due to the changes in the kiddie tax rules for older children, these tax-timing techniques should reflect your family's overall situation. Finally, you must take all economic factors for security transactions—not just taxes—into account.*

Estate Planning Techniques. The massive Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) will continue to affect estate-planning techniques over the next few years. For starters, the estate-tax exemption will effectively increase to $3.5 million for 2009 before the estate tax is completely repealed in 2010. Furthermore, the top estate-tax rate of 55% is gradually reduced to 45%. However, the estate tax will be revived in 2011 with a top 55% rate unless additional legislation is enacted.

Following is the tax law schedule for the rate reductions and exemption increases.

YEAR	TOP ESTATE-TAX RATE	EFFECTIVE EXEMPTION AMOUNT
2002	50%	$1 million
2003	49%	$1 million
2004	48%	$1.5 million
2005	47%	$1.5 million
2006	46%	$2 million
2007–2008	45%	$2 million
2009	45%	$3.5 million
2010	Repealed	Not applicable
2011	55%	$1 million

Source: www.IRS.gov

***TAX TACTIC**: You may reduce the size of your taxable estate with a series of lifetime gifts. Under the annual gift-tax exclusion, a donor can give each recipient up to $12,000 in 2007 ($24,000 for joint gifts by a married couple).*

Therefore, a couple might give a family member up to $24,000 in December and another $24,000 in January. If they do this for 10 recipients, the couple can reduce their assets by $480,000 in just a two-month period without eroding the estate-tax shelter.

Other Tax Ideas.

- Under the "wash sale rule," you cannot deduct a loss on securities sales if you acquire substantially identical securities within 30 days. To avoid this result, you can: (1) wait at least 31 days to repurchase the securities, (2) acquire replacements and wait at least 31 days before selling the first shares or (3) buy similar (but not identical) securities.
- From a tax perspective, it is generally beneficial to sell mutual fund shares before the fund declares dividends at year-end (the "ex-dividend date") and to buy shares after the date the fund declares dividends.
- Defer tax on investment income from certificates of deposit (CDs) and Treasury securities by acquiring investments that mature after 2007. Generally, the income from these investments is taxable in the year it is received.
- Consider investments in dividend-paying stocks. As with long-term capital gains, the maximum income tax rate on qualified dividends received in 2007 is only 15% (5% for taxpayers in the 10% and 15% regular income tax brackets).
- If you are purchasing mortgage insurance, pay the premiums before year-end. Some individuals may be able to deduct the cost of premiums paid in 2007.

CONCLUSION

This year-end tax letter is intended only to serve as a general guideline. Of course, your personal circumstances may require in-depth examination. We would be glad to schedule a meeting with you to provide assistance with your tax-planning needs.

It is always our honor and pleasure to serve your needs.
Please call for more information on any of these issues.

This year-end planning letter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered.

IRS Circular 230 requires us to inform you that the information contained in this letter is not intended or written to be used for the purpose of avoiding any penalties that may be imposed under federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. Before any action is taken based upon this information, it is essential that competent, individual, professional advice be obtained.