UPDATE

KesslerOrleanSilver
& Company, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

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Tax-Free IRA Distributions for Charitable Purposes

Thanks to a recently enacted law, it is now possible to make tax-free charitable distributions up to $100,000 from your Individual Retirement Account. This may present a tax savings opportunity. However, the time for doing so is limited, and various rules apply.

The Pension Protection Act of 2006 enacted a significant change with respect to charitable distributions from a traditional or Roth IRA. Under pre-Act law, there was no provision allowing a tax-free distribution from an IRA where the distribution was donated to a charitable organization. Instead, the normal rules relating to distributions applied, meaning the individual recognized income from the distribution of a traditional (taxable) IRA, and any charitable contribution which the owner made from the distribution proceeds was reported as an itemized deduction on Schedule A, subject to the normally applicable limitations on deductibility of contributions (such as generally being limited to 50% of adjusted gross income).

Under the new Act, the individual can exclude from gross income his or her charitable donation from an IRA distribution, up to $100,000. This can have tax benefits as compared to the pre-Act law. One advantage, where the donation is large relative to income, is that the 50% of adjusted gross income limitation does not apply. A second advantage is that, because the distribution is not included in AGI, it will not increase AGI for purposes of the phase-out of itemized deductions, personal exemptions, or any other deduction, exclusion or tax credit that is limited or lost when AGI reaches certain specified levels. Yet another potential advantage is the removal of the distributed amount from the owner's taxable estate.

Note that the distribution to charity is taken into account in determining the owner's required minimum distribution for the year, even though the distribution is not included in gross income. Therefore, if the amount distributed from the IRA to a charity at least equals the amount of the owner's required minimum distribution, no additional distributions are required.

Various rules apply to these distributions. The distribution must be paid directly by the IRA trustee to a qualified charitable organization. The distribution must be

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Six Steps For Cultivating Business Contacts

The business environment has changed dramatically since the onset of the electronic age, but networking is still often essential for continued success. This is the old-fashioned method of establishing contacts with influential people who can provide benefits to your business.

Successful networking is usually the result of diligent groundwork. Although there is a chance you might bump into someone at the airport or in town, most professionals will tell you that the best contacts are the ones planned in advance. While "accidents" may happen, it is better to be proactive than reactive.

With that in mind, here are six steps for networking your way to profitability.

DEVELOP A NETWORKING CALENDAR

At the beginning of each month, write down all the professional and social events you have been invited to attend. Examine each one closely and decide which offers the best chance for generating new business. Make it a point to attend those meetings.

GET THE JUMP ON THE COMPETITION

For each meeting you plan to attend, call beforehand and obtain a list of the scheduled attendees (if this is possible). Go down the list and check off the names of the people with whom you would most like to make contact. It's a good idea to keep this "who's who" list with you at the meeting as a handy reference tool.

STUDY THE MEETING'S AGENDA

What are the important issues that the attendees will most likely be talking about? Once you zero in on the"hot topic," arm yourself with as much information as possible so you can carry on thoughtful, informative conversations with the contacts that you have targeted.

MAKE A GOOD FIRST IMPRESSION

When you introduce yourself to a prospective client, be sure to say your name and the name of your company clearly and with conviction. Don't get lost in the crowd. By the same token, listen closely to introductions. The surest way to lose a contact is to forget how to pronounce someone's last name or the location of his or her business.

COLLECT CARDS

At the very least be sure to get a business card from everyone on your "must meet" list. You might obtain other business cards from contacts you make. On each card, make a note of your conversation with that person and any ways in which you can help their business.

FOLLOW UP

Your networking attempts should not end when you leave a meeting or social event. When you get back to your office or home, make a list of the things you said you would do for the people you met. It is important to fulfill the obligations that you have promised. Frequently, your credibility is at stake.

When you are compiling your list of important contacts, do not forget to use your business advisers and other associates as sources.

INSIDE THIS ISSUE

Perfectly Legal: When You Can Deduct Legal Expenses

Can you deduct the legal expenses you pay during the year? There's no definitive answer to that question. While certain types of legal fees are currently deductible, others must be capitalized and still others provide no tax benefit whatsoever. With that thought in mind, let's take a closer look at the tax treatment for different types of expenses.

BASIC RULES

As a general rule, legal fees incurred by a business are currently deductible (assuming they are not capital expenditures). According to the relevant section of the tax law, you may deduct a legal expense that is "ordinary and necessary" to the conduct of your trade or business. However, the rules are considerably more complicated for nonbusiness expenses.

To be deductible, a nonbusiness legal expense must be incurred due to one of the following circumstances:

- The collection or production of taxable income;
- The management, conservation or maintenance of income-producing property; and
- The determination, collection or refund of any tax.

While nonbusiness legal expenses incurred in connection with a rental property may be deducted from your annual gross income, other costs generally are deducted as miscellaneous expenses. Key point: Miscellaneous expenses are deductible only to the extent the total for the year exceeds 2% of your adjusted gross income (AGI). In other words, you may not get the full tax benefit of these legal expenses.

EXAMPLE

Ms. White has an annual AGI of $100,000. In 2006 she incurs $2,200 in miscellaneous expenses, including $1,000 for legal expenses related to personal stock investments. As a result, White can deduct only $200 ($2,000 less 2% of AGI) on her tax return.

As a general rule, legal expenses incurred to acquire property or to defend or protect its ownership must be capitalized and added to the "basis" of the property. This may allow you to claim depreciation deductions over a period of time or cut your taxable gain when the property is sold. Similarly, legal fees that are incurred in connection with buying a personal residence are added to its basis. When the home is sold, legal expenses may reduce the taxable gain.

On the other hand, legal costs related to personal or family matters generally do not provide any tax benefit. This includes fees paid in connection with a divorce or separation. The portion of the cost associated with determining the tax ramifications of alimony or other tax aspects may be deductible.

You should ask your attorney for an itemized bill spelling out the cost for various services rendered. At the very least, make sure your attorney specified the amount of the fee (if any) that is tax deductible. This is particularly important in the estate-planning area, where taxes can be a significant factor.

Note that similar principles apply to the accounting profession. For example, many accounting fees incurred in connection with a business can be deducted currently. Further guidance can be provided upon request.

Swapping Real Estate Through Multiple Parties

Have you ever gone to a swap meet? For some real estate investors and property owners, the stakes can be very high. For instance, you may be able to arrange a swap of real estate properties with another person of a similar mind.

TAX BONUS

If the properties are "like-kind," you can avoid any current tax on the exchange. This term refers to the nature, character or class of the property—not its grade or quality. For example, a swap of an office building for an apartment building of the same value can qualify as a like-kind exchange. The result is neither party has to report taxable income.

However, in the real world, trading real estate properties is usually not so simple. Suppose you want to acquire real estate but the owner is not interested in any of the properties that you own. Fortunately, you can take this concept one step further. The exchange can involve multiple parties if the two owners cannot agree on the properties to be swapped.

The IRS has approved the use of a qualified intermediary to facilitate the deal as long as the intermediary is not connected with one of the other parties.

Be aware that there are time restrictions involved in a multiple-party swap. In general, (1) the property you are receiving must be identified within 45 days of the original transfer and (2) you must take title within 180 days (or your tax-return due date plus any extensions, whichever comes first).

EXAMPLE

Say that Mick wants to acquire property owned by Keith. However, Mick does not own any property that Keith desires in return. After discussing a number of locations, the two of them strike a deal with Ron. Keith agrees to take Ron's property, Ron acquires title to one of Mick's properties and Mick gets the property he wanted all along.

Assuming like-kind properties are involved, the entire transaction may be tax-free if the deal is completed within the necessary deadlines.

CAUTION

If you receive any money or property as part of the deal, the additional amount—called "boot" in tax lingo—is subject to tax. However, no loss is recognized by the taxpayer who provides the boot. The assumption of a greater mortgage is also treated as boot for this purpose.

The amount of taxable boot is equal to the lesser of : (1) the realized gain (i.e., the difference between the tax basis of the property you are giving up and the fair-market value of what you have received in exchange, including any boot) or (2) the fair-market value of the boot.

This is a complex area of the tax law, so be sure to consult with us before you strike a deal.

Helping Your Child Buy a Home

With today's housing prices, it is often difficult for a young couple to scrape together enough money for a down payment. If you can simply give your child the money needed to buy a home—that's great. But you may not be able to be so generous.

One possible solution is to enter into an "equity sharing" arrangement with your child. As the name implies, you share the ownership rights in the home, but you get to keep most of the tax breaks. After a specified period of time, you sell your interest in the home to your child.

With this type of arrangement, your children can gain a foothold in the housing market without dire consequences. At the same time, you may be able to claim tax deductions that can benefit people in your high income tax bracket.

HYPOTHETICAL EXAMPLE

Let's say your daughter is getting married in June and would like to move into a single-family house. Unfortunately, the newlyweds cannot afford the home they have their hearts set on. Instead of letting the couple pass up their dream house, you agree to buy 50% of the home through an equity sharing arrangement.

For starters, you pay half of the down payment for the home and the young couple pays the other half. They move into the house and pay you a fair rental value in return. Then you use the rent money to pay expenses such as homeowner's insurance, repairs, property taxes and mortgage interest. The newlyweds are required to pay any remaining amounts. Both parties agree to split the cost of any capital improvements to the home.

Finally, the agreement includes a provision that the home

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TIPS, TRAPS AND TRENDS

IRS DISCONNECTS THE TELEPHONE TAX

After suffering several losses in court cases, the IRS has finally conceded that long-distance phone services are not subject to federal excise tax. As a result, both individual and business taxpayers may qualify for refunds or credits on their 2006 tax returns.

Background

The excise tax on long-distance services was first imposed in the late 1800s to help finance United States efforts in the Spanish-American War. In a new ruling, the IRS has said it will issue credits or refunds of excise taxes paid on long-distance services billed between February 28, 2003, and August 1, 2006.

The IRS has stated that it will stop collecting the current 3% tax after July 31, 2006. In addition, it clarified that the tax would not apply to "bundled" services (i.e., local and long-distance service provided under the same charge). However, the tax will continue to be collected for local-only services.

Furthermore, the IRS also noted that the federal excise tax should not apply to wireless telephone services and prepaid calling cards.

Hold the Line

We will have more to report on the process for receiving refunds and credits in the coming months.

MEDICARE PREMIUMS: INCREASES ON TAP

There's a hidden "tax hike" for some retirees on the way. Beginning in 2007, you may have to pay higher premiums for Medicare Part B. As opposed to Part A covering hospitalization, participation in Part B covering doctor bills in voluntary.

Background

Participants in Medicare Part B pay monthly premiums for the benefits. This amount is adjusted annually for inflation. For 2006, it costs each covered individual $88.50 per month. However, under a change buried in the 2003 Medicare Act, certain high-income individuals are required to pay a surcharge, beginning next year.

This surcharge is based on a complex calculation involving the recipient's modified adjusted gross income (MAGI).

The estimated new monthly premiums are shown below. These rates will continue to increase for the next five years. However, the bracket levels are scheduled to be indexed for inflation.

MAGI for Single Filers	MAGI for Joint Filers	Monthly Premium for 2007*
Under $80,000	Under $160,000	$100.40
$80,000 - $100,000	$160,000 – 200,000	$113.30
$100,000 - $150,000	$200,000 - $300,000	$133.30
$150,000 - $200,000	$300,000 - $400,000	$153.30
Above $200,000	Above $400,000	$173.30

**Actual figures may vary.*

Four Retirement Plans For Small-Business Owners

Until recently, the retirement plan options available to small-business owners and self-employed individuals were limited. But now you can choose one of these four types of plans.

SIMPLIFIED EMPLOYEE PENSIONS (SEPS)

A SEP is generally exempt from the reporting requirements for other qualified plans. With a SEP, you must make contributions on behalf of all employees age 21 or older who have worked for a company during three out of the last five years (absent any union agreement).

For 2006, you can make a deductible contribution up to the lesser of 25% of compensation or $44,000 (the defined contribution plan limit). The maximum amount of compensation taken into account for this purpose is $220,000. Contributions are discretionary, so you are not locked into a figure for the year.

As with other qualified plans, distributions must begin by April 1 of the year following the year in which you turn age 70½. If you take an early distribution, you will trigger a 10% tax penalty, unless an exception applies.

SAVINGS INCENTIVE MATCH PLANS FOR EMPLOYEES (SIMPLES)

A SIMPLE is only available to employers with 100 or fewer employees. Like SEPs, SIMPLEs are exempt from most reporting rules. A company cannot contribute to a SIMPLE in a year in which it maintains another qualified plan.

For 2006, an employee may elect to contribute up to $10,000 to the plan. If you are age 50 or older, you can add a "catch-up contribution" of $2,500. As a general rule, the employer may provide matching elective contributions subject to nondiscrimination rules. The rules for mandatory distributions after turning age 70½ also apply to SIMPLEs (but the 10% penalty tax is increased to 25% for early withdrawals in the first two years).

KEOGH PLANS

To set up a Keogh plan, you must be a self-employed individual. It does not matter if you have any other employees or not.

The amount you can contribute annually depends on whether the plan is a defined contribution or defined benefit plan. For 2006, the maximum amount you may contribute and deduct for a defined contribution Keogh is the lesser of 20% of earned income or $44,000.

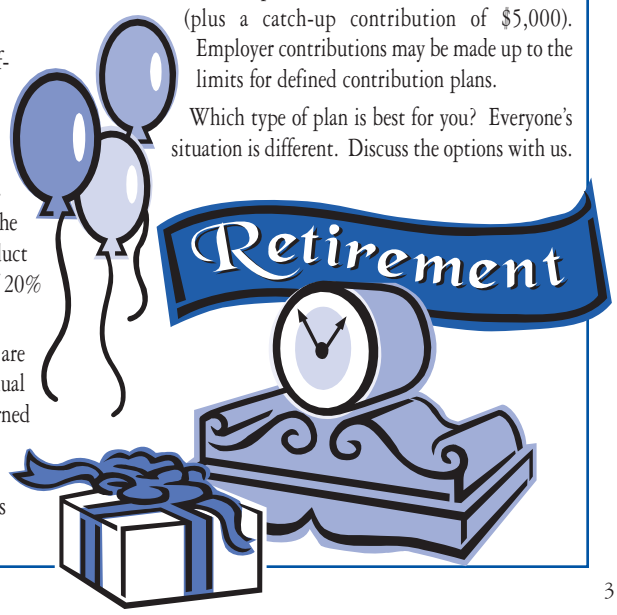
With a defined benefit Keogh, contributions are actuarially computed. You can provide an annual retirement benefit of the lesser of 100% of earned income for the three highest-paid years or a specific dollar amount adjusted for inflation ($175,000 for 2006). The rules for distributions from qualified retirement also apply.

SOLO 401 (K) PLANS

A 401 (k) plan generally combines elective deferrals with matching contributions by the employer. The contributions are made on a pretax basis. The rules for contributions and distributions from qualified plans generally apply to solo 401 (k) plans.

Assuming you are the only employee, you don't have to worry about nondiscrimination rules. There is an annual dollar cap on the elective deferrals that can be made to a solo 401 (k) plan. For 2006, the limit is $15,000 (plus a catch-up contribution of $5,000). Employer contributions may be made up to the limits for defined contribution plans.

Which type of plan is best for you? Everyone's situation is different. Discuss the options with us.



NEWS *from* KOS

Amanda Pictor has joined us as a staff accountant. She has a Masters of Science in Accounting from Bradley University.

Theodora Goldman comes to our tax department after many years working downtown. Included in her work experience is spending some time with the Internal Revenue Service. She has a strong background in estate and trust taxation.

Paula Tanielian also joined our firm as a staff accountant. She has her Bachelor of Administration from DeVry University. She is pursuing her Masters of Science in Accounting from the Keller Graduate School of Management.

Congratulations to **Annie Giorgi** on successfully completing the CPA exam.

Roberta Thompson has two new additions to her extended family. Margarita Jessica, a granddaughter, born in July and Elizabeth Grace, a great-granddaughter, born in August.

Valerie Anderson-Jones has joined the Northwest Suburban Estate Planning Council.

Larry Krupp was a guest lecturer at the National University of Health Science in September. He spoke about accounting and tax matters with the senior class. In addition, Larry is serving as Treasurer of Congregation B'nai Jehoshua Beth Elohim Brotherhood this year.

Jeffrey Butler was elected Vice President of the Stewardship Commission of Temple Judea Mizpah this year.

In November **Sandy Alper** and **Ben Darcy** attended the Career College Association C.P.A. seminar on accounting and auditing in Washington, D.C.

Tax-Free IRA Distributions for Charitable Purposes

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made on or after the date the IRA owner attains age 70½. A distribution is treated as a qualified charitable distribution only to the extent that the distribution would otherwise be includible in gross income (apart from the new exclusion); thus if the IRA owner has an IRA with nondeductible contributions, a calculation is required to determine the portion of the distribution that is eligible for qualified charitable distribution treatment. The new Act only applies to distributions made in 2006 or 2007. Simplified employee pensions (SEPs) and simple IRAs are not eligible.

If you will be utilizing this opportunity, we strongly suggest that you obtain sufficient substantiation from the charitable organization as to deductibility, as it is unlikely that the IRA trustee will undertake the responsibility of doing so.

The new charitable IRA distribution rules may present significant tax savings to charitably-minded individuals, particularly to nonitemizers, but for many others as well. Please contact our office if you would like to discuss this option and whether it will provide tax savings to you.

Helping Your Child Buy a Home

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is to be sold after five years (or some other period of time). The occupants are given the right of first refusal. After five years on their own, they should be able to come up with the money needed to buy you out.

RESULT

Now let's see what you have accomplished. The rental income is offset by the available deductions for insurance, repairs, property taxes and mortgage interest plus depreciation based on 50% ownership of the home. You must legally own 50% of the home to claim a deduction for that percentage of the interest. Caution: Make sure you charge a fair rental value to the occupants or the IRS may challenge the deal.

If you show a loss for a given year, it is treated as a passive activity loss (PAL). You can generally use the PAL to offset up to $25,000 of ordinary income such as salary. If your other annual income exceeds $150,000, the PAL is carried forward to future years. And, when you finally sell your interest in the home, any gain is taxed at favorable capital gain rates.

Of course, the newlyweds will be shortchanged on their share of the usual tax deductions. But the tax breaks are worth a lot more to you in your high tax bracket than they are to the young couple in their lower bracket. Plus, they are able to live in—and eventually own completely—the house of their dreams.

Equity sharing usually involves family members, but it can also work with nonrelated parties. In any event, be sure to consult with us.

BRIEFS

COMPUTER FIXES

If you are experiencing a minor computer problem, one of the simplest solutions is to simply reboot your computer. This can work for certain types of software, word processing programs and Internet connections. Then wait at least 10 to 15 seconds before you start the computer up again. If this "quick fix" works, you may have saved yourself a lot of time and aggravation.

DIRECT DEPOSIT OPTIONS

Starting with 2006 tax returns, you will have more options when you are entitled to a federal income tax refund. The IRS will allow you to directly deposit the funds into a checking, savings or retirement account. According to a new IRS release, you can use one, two or all three of these accounts. To accommodate your refund choices, the IRS is devising a new election form.

THAT'S GREAT, BUT…

One mark of good leadership is getting the most out of your employees. If possible, try to avoid the "but" part of statements designed to compliment a worker. For example, suppose you say, "You did a great job on that project, but you didn't quite meet all of my objectives." The employee is likely to focus on the phrase following the "but" and not the part preceding it. Give out compliments without ruining them with "buts." If necessary, you can revisit a particular issue at a later date.

CORPORATE REPORTING

The IRS recently announced a series of regulatory changes designed to ease the tax reporting burden for corporations and shareholders. The announcement is part of an ongoing IRS effort to make it easier to file returns and information reports by electronic means (e.g., by authorizing electronic signatures). Many of these new revisions apply to corporate transfers, mergers, spin-offs and liquidations. Consult with a professional tax adviser for details.

ABOUT *UPDATE*

If you have any questions or comments about articles featured in this issue or about the newsletter in general, please call one of the principals at Kessler Orlean Silver & Company, or the Update editors, Jeffrey Arnol or Jeffrey Butler.

Do you have any associates or friends who would benefit from receiving our Update Newsletter? If so, please call Lynn Steer in our office and we will be glad to add their name to our mailing list. If you need to update your e-mail address, please send it to **info@koscpa.com**.

KesslerOrleanSilver
& Company, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
1101 Lake Cook Road, Suite C, Deerfield, Illinois 60015 • (847) 580-4100 • (847) 580-4199 (FAX) • www.koscpa.com