

# Tax Talk

*A quarterly publication of Bridges & Dunn-Rankin, LLP*

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Dear Clients and Friends,

"Tax season" is here. Actually, for those of us at Bridges & Dunn-Rankin it is "tax season" year round, but clearly January to April 15 is a peak time of the year for us, and the lights are on late at our office each night now. We always love to see April 15 fall on a Saturday or Sunday (that extends the due date by a day or two), and this year with the 15<sup>th</sup> falling on a Sunday and Monday the 16<sup>th</sup> being Emancipation Day (a D.C. holiday) the deadline is extended to April 17; so don't panic if your returns (or extensions) are not filed this year until the 17<sup>th</sup>.

Our extended family here continues to grow. Our long-time Office Manager, Laura Niklasson, recently had her third child (Gabriel Aidan), firm member Bridget Dunk is expecting her second child this summer, and firm member Alexis Bischoff (now Treadwell) recently married.

New tax legislation has been enacted since the last issue of our newsletter, and more tax legislation is currently working its way through Congress. In this issue we will review highlights of the recent tax legislation, discuss charitable gifting strategies and the IRS annual "Dirty Dozen" list of tax scams, and, as always, highlight a member of our firm and one of our clients.



Kent Bridges,  
Managing Partner

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

*Kent Bridges*

## The Tax Relief and Health Care Act of 2006

On December 20, 2006, President Bush signed into law the *Tax Relief and Health Care Act of 2006*. Highlights of the Act include:

*Alternative minimum tax credit relief* – Taxpayers who exercised incentive stock options (ISOs) during 1999 and then tried to hold onto the stock for a year in order to qualify for long-term capital gains treatment were in many cases badly burned when the stock price fell dramatically in 2000. The excess of the value of the stock over the exercise price on the day of exercise is an addback for purposes of the alternative minimum tax (AMT). Accordingly, many were left with a substantial AMT bill, and nothing to show for it but an AMT credit carryforward. Unlike the AMT that results from "permanent differences" (like the addback for the deduction of state income taxes), AMT that results from "timing differences" (like the exercise of ISOs or accelerated depreciation) gives rise to a credit that can be carried forward and utilized to offset tax in future years. Heretofore, the tax law has provided that you could only use the AMT credit to the extent your "regular tax" exceeded your "minimum tax". Under the current AMT scheme, taxpayers who live in a state with a state income tax (like Georgia) and have annual income between \$150,000 and \$500,000 are almost by default in the

AMT each year, making it difficult for them to ever utilize their AMT credit. The new law, designed to provide a little help to those who got burned by ISO exercises, provides that up to 20% of your AMT credit carryforward (or \$5,000, if greater) can potentially be claimed each year, even if you are in the AMT posture for the year.

As with most tax legislation, this provision is fraught with unnecessary complexity and potential limitations. For example, you cannot claim under this special new rule any AMT paid during the 3 immediately preceding tax years, and the ability to claim the credit is phased out once your income exceeds a certain level (\$234,600 for 2007 and indexed for inflation each year). The new rules do not prevent you from claiming the credit under the old rules, so there is only upside and no downside in the new rules.

*Deduction for sales tax* – The tax break allowing individuals to elect to take an itemized deduction for sales tax in lieu of the deduction of state income tax has been extended through 2007. This is good news for our clients in Florida and Texas (states with no individual income tax).

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Bridget J. Dunk, CPA

## Member in the Spotlight – Bridget Dunk

Bridget Dunk joined Bridges & Dunn-Rankin in 1997 after a 2-year stint with Arthur Andersen. Bridget, a native of Cleveland, Tennessee, received a Bachelor of Business Administration degree (with concentrations in both Accounting and International Business) from the University of Memphis, where she graduated with Honors in Business and with the Summa Cum Laude distinction. The focus of her practice is taxation, and she has extensive experience in the taxation of individuals, corporations, partnerships and trusts.

Bridget, her husband Bill, and their 4-year old son, Bailey, live on Lake Allatoona and enjoy boating, water skiing and go-karts. They are expecting a new addition to their family (a girl) this summer. In addition to her work as a CPA, Bridget, together with husband Bill, conducts pre-marital and marriage strengthening conferences through GTO Marriage and Family Ministries.

Bridges & Dunn-Rankin is proud to have Bridget Dunk as a member of our firm.

## The Tax Relief and Health Care Act of 2006 - continued

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**Tuition deduction** – The tax deduction for qualified higher education expenses (up to \$4,000, depending on your income level) is extended through 2007.

**Deduction for educators' expenses** – The \$250 tax deduction permitted to teachers for out-of-pocket expenses for supplies is extended through 2007.

**Medical savings accounts** – New MSAs can be set up through 2007. After 2007, contributions may only be made by or for individuals who previously had MSAs.

**Health savings accounts** – The new law includes many changes for HSAs, including allowing one-time rollovers from

health flexible spending accounts and health reimbursement arrangements into HSAs, repeal of the annual plan deductible limit on HSA contributions, expanded contributions limit for part-year coverage, and allowing one-time rollovers from IRAs into HSAs.

**Research tax credit** – The research tax credit, which had expired as of the end of 2005, is extended through 2007.

**Information reporting for option exercises** – Effective for tax years beginning after December 20, 2006, corporations must report to the IRS the transfer of stock from exercises of incentive stock options and from employee stock purchase plans.

## Charitable Gifting Strategies

Many of our clients are quite philanthropic. Fortunately, the tax law greatly rewards philanthropy. Here is a brief synopsis of the general rules and suggested strategies.

**Cash donations** – The most common and straightforward type of charitable gift is a gift of cash to a public charity (e.g. your church, alma mater, Red Cross, etc.). A cash donation can offset up to 50% of your income for the year, with any excess carrying forward for up to 5 years.

**Noncash donations** – You can also claim a tax deduction for the fair market value of property other than cash which you donate to charity. This can include for example clothing and furniture. However, the greatest tax benefit typically comes from donating appreciated property like stocks or real estate. Let's assume that you have some highly appreciated stock which you are about to sell. If instead you make a donation of the stock to charity, you avoid paying tax on the gain and you get a tax deduction for the value of the property; a double benefit. The potential tax savings in this case can be up to 60% of the value of the property. In other words, your favorite charity can get a dollar at an after-tax cost to you of 40 cents. The amount of your deduction for a donation of appreciated property is limited to 30% of your income, with any excess carrying forward for up to 5 years.

**Conservation easements** – Let's assume you have a tract of land which could potentially be developed into a residential subdivision, but you don't want to ever see the land developed, desiring for it to forever remain in its beautiful natural state. If you are willing to grant a perpetual conservation easement to a qualified organization (effectively giving up your rights to develop the property), then the tax law will reward you with a tax deduction. The amount of the deduction is the difference between the appraised value of the land assuming its highest and best use value before the granting of the conservation easement and its value after granting the conservation easement. Be careful here, however. The IRS perceives that there has been a lot of abuse in this area and is now carefully scrutinizing deductions for conservation easements.

**Strategies where carryforwards may expire unused** – As noted above, the deduction for cash donations is limited to 50% of your income and the deduction for appreciated property is limited to 30% of your income. In each case, these amounts carry forward for up to 5 years, subject each year to these same percentage limitations. Tax rules provide that you must utilize current year donations before dipping into your carryforwards. Accordingly, for taxpayers who regularly make donations that

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## Charitable Gifting Strategies - continued

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are very significant compared to their taxable income, there can be a risk of carryforwards expiring unused. In these situations, we sometimes suggest that a client consider bunching significant donations into one tax year, then skip a year in order to be able to dip back into the carryforwards (on a FIFO basis) before they expire. In other cases, it may make sense to accelerate income into the final year of a carryforward. In situations where there is concern that the IRS might challenge the value placed on a gift (e.g. a conservation easement), having a carryforward can actually be comforting as it can provide some potential cushion against such a challenge.

*Private foundations* – For those who wish to get a tax deduction today (e.g. potentially matching the deduction against a large gain), but wish to effectively control the money for a long period of time (perhaps even leaving a legacy for future generations to manage), a private foundation can work well. With a private foundation, you get a tax deduction when the money goes into the foundation, but are typically only required to gift 5% of the value of the foundation's assets to charities each year.

*Donor-advised funds* – Private foundations are subject to a number of limitations and require some upfront set-up cost and on-going administrative effort. For those who want to get their tax deduction now and have some time to decide which charities will benefit, but don't want the cost, hassle or limitations of a private foundation, a "donor-advised fund" can be the answer. These organizations are technically public charities, and with a gift to them you are relinquishing control over the funds. However, these organizations have a long history of following the advisement of their donors. When you make a gift to a donor-advised fund, they set up an account in your name with the assets. Whenever you want to make a gift to charity, you

provide them with the name of the organization and amount and they send a gift of that amount to the charity with a letter indicating that the gift is from you. You can continue this process so long as a balance remains in your account.

*Charitable remainder trust* – Plan to leave assets to charity at your death, but need an income stream from such during your life? A "charitable remainder trust" (CRT) can be the answer for you; particularly if you have highly appreciated property you are about to sell. Instead of selling the property yourself, you gift it to your CRT and the CRT sells it and avoids paying tax on the capital gain. Also, you get a tax deduction for the net present value that will go to charity at your death. The CRT makes distributions to you each year, which are generally subject to tax (often at capital gains rates, depending on the income of the CRT).

*Estate tax benefits* – The Federal estate tax can potentially consume a substantial percentage of your estate. However, any amounts gifted to charity during your lifetime or at your death escape the estate tax.

*Substantiation requirements* – Under present law, you must have in hand at the time you file your income tax return a "donee acknowledgement statement" for any gift of \$250 or more. Your cancelled check alone is insufficient documentation.

*Charitable gifts from IRA* – Legislation enacted in August 2006 permits those age 70 ½ and older to have distributions made from their IRA to a charitable organization, without such amount being included in their income. The amount is limited to \$100,000 per year, the IRA distribution cannot be to a private foundation or donor-advised fund, and this benefit applies only for tax years 2006 and 2007.

## Client in the Spotlight – Rochester & Associates, Inc.

Rochester & Associates, Inc. recently celebrated its 40<sup>th</sup> anniversary with a brunch at The Georgia Aquarium for its employees, clients, vendors and their families. The Gainesville, Georgia based company was founded in 1966 by the late Keith Rochester and his wife Dale as a land surveying firm. Today, under the leadership of brothers Darrell and Brian Rochester, the company has grown to approximately 200 employees and is a leading relationship-based land development solutions provider for the Southeast, providing services in the areas of

civil engineering, land surveying and project management.

While the company now also has offices in Atlanta and Fayetteville, Georgia and Tampa, Florida, it remains committed to its Gainesville roots and is a leading corporate citizen in the Gainesville community.

Bridges & Dunn-Rankin is proud to be associated with Rochester & Associates, Inc.



## The "Dirty Dozen"

The IRS has just released its annual "Dirty Dozen" list of tax scams it is on the lookout for.

1. *Telephone excise tax refund abuses* – The 3% Federal excise tax on long-distance calls was recently found to be unconstitutional and taxpayers can claim a refund for it on

their 2006 returns. The IRS has found, however, many taxpayers claiming significantly excessive amounts.

2. *Abusive Roth IRAs* – Some taxpayers have attempted to circumvent the annual maximum contribution limit on Roth IRA contributions by transferring to their Roth IRA assets

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## The “Dirty Dozen” - continued

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- with an artificially low value.
3. *Phishing* – The IRS warns taxpayers to ignore e-mails they receive purporting to be from the IRS. The IRS does not contact taxpayers by e-mail, so any such e-mails you receive are likely from identity thieves.
  4. *Disguised corporate ownership* – The IRS is aware that shell corporations are being formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity in order to facilitate the underreporting of income, non-filing of returns, money laundering, etc.
  5. *Zero wages* – This scam involves a taxpayer filing a substituted W-2 or corrected 1099 showing little or no income in order to avoid being taxed on the income reported on the actual W-2 or 1099.
  6. *Return preparer fraud* – The IRS is targeting dishonest tax return preparers and their clients.
  7. *American Indian employment credit* – Some individual taxpayers submit returns claiming a deduction for an American Indian employment credit. While there is such a credit for businesses employing Native Americans, there is no such deduction for individuals.
  8. *Misuse of trusts* – With limited exceptions, any income earned by a trust is subject to income tax, either on the return of the trust or on the return(s) of the beneficiary(s), depending on how the trust is structured and whether the income was retained in the trust or distributed. The IRS is aware of attempts to avoid paying tax on income by placing assets in trust (onshore or offshore).
  9. *Structured entity credits* – Partnerships are sometimes formed for the purpose of transferring to investors various state tax credits to be used to reduce their state income tax. Once the credits have been allocated, the investors may sell their partnership interests for a nominal amount and claim a capital loss for the amount of their investment. In the opinion of the IRS, no deductible loss results from this transaction.
  10. *Abuse of charitable organizations and deductions* – The IRS continues to observe the use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur when a taxpayer moves assets to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets. Contributions of non-cash assets continue to be an area of abuse, especially with regard to overvaluation of contributed property. In addition, the IRS is noticing private tuition payments being disguised as charitable contributions to religious organizations.
  11. *Form 843 tax abatement* - This scam rests on faulty interpretation of the Internal Revenue Code and involves the filer requesting abatement of previously assessed tax using Form 843.
  12. *Frivolous arguments* – Claims such as that the Sixteenth Amendment was never ratified, wages are not income, filing a return and paying taxes is voluntary, etc. don't fly with the IRS and the courts.

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Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth individuals.

*The information provided in this newsletter is presented for educational and informational purposes only, and is not intended to constitute legal, tax or accounting advice. The articles provide only a very general summary of complex rules. For advice on how these rules may apply to your specific situation, contact a professional tax advisor.*

### Trivia

Last quarter's trivia question was "What was the name of the special tax on the oil companies which was enacted in 1980 and repealed in 1988?" The first person to respond with the correct answer of "the windfall profits tax" was Gail Stevens of Rochester & Associates, Inc.

Now, for this quarter's contest. Our lead article this quarter was on charitable gifting strategies. This quarter's trivia question is "How much did Americans donate to charity in 2005?"

The first person to provide the correct answer will receive 4 tickets to a Braves game of their choice. E-mail your answer to [alexis.bischoff@bridgesdunnrankin.com](mailto:alexis.bischoff@bridgesdunnrankin.com).