KIRKLAND ALBRECHT & FREDRICKSON P.C.

CERTIFIED PUBLIC ACCOUNTANTS

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SPECIAL ALERT! New Tax Law Changes - What it Means to You

After months of bickering, Congress finally agreed on a tax package that includes protecting millions of people from having to pay more this year because of the alternative minimum tax (AMT). The AMT is a parallel tax system originally created to make sure that a small number of high-income people who paid no federal income tax would have to pay at least something. Because it wasn't indexed for inflation, it has been hitting rapidly growing numbers of people. The new legislation is designed to halt (temporarily) the AMT's growth by raising the exemption levels for this year and providing AMT relief for certain personal tax credits. If Congress had done nothing, AMT would have affected more than 22 million for 2006, up from about 4 million last year. This is only a one year fix and no one knows what will happen next year.

Another provision in the $70 billion package calls for continuing today's tax rates on capital gains and dividends through the year 2010, instead of having them expire after 2008. Long term capital gains and most corporate dividends will be taxed at the top rate of 15%.

However, the legislation includes a surprise zinger: more taxpayers will get hit by the so-called "kiddie tax". Currently the "kiddie tax" applies when a kid under 14 years of age collects dividends, interest, and other "unearned" income. The first $850 is tax-free, the second $850 is taxed at the child's rate. Anything above $1700 is taxed at the parents' top rate. Under the new legislation, the age limit goes up to children under 18, effective January 1st this year. As a result, parents with children who may be affected should consider investments that generate little or no current taxable income (i.e., savings bonds).

Furthermore, starting in 2010 upper-income people will be allowed to convert their traditional individual retirement accounts to Roth IRAs. But this provision is already drawing heavy fire within Congress and may be repealed before it takes effect.

For more information on how these changes may affect your situation please contact KAF at 781-356-2000.

GAO Says Sarbanes-Oxley Section 404 Beneficial but Costs High for Small Firms

The Government Accountability Office (GAO) concluded in a study released May 8 that Section 404 of the 2002 Sarbanes-Oxley Act is imposing "disproportionately higher costs" on smaller companies.

The study, Sarbanes-Oxley Act Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies, comes on the heels of the SEC's Advisory Committee on Smaller Public Companies recommendation that the smallest companies be exempted from Section 404. The GAO report also arrived just before a May 10 roundtable called by SEC and the Public Company Accounting Oversight Board to discuss second-year experience with Section 404 and its impact on internal control reporting requirements. Section 404 requires public companies to report on the effectiveness of internal controls over their accounting practices and requires outside auditors to verify whether those controls are effective. Because of the costs entailed in that process, the SEC has delayed implementation of the requirement for small publicly traded companies.

"While regulators, public companies, auditors, and investors generally agree that [Sarbanes-Oxley] has had a positive impact on investor protection, available data indicates that smaller public companies face disproportionately higher costs (as a percentage of revenues) in complying with the act, consistent with the findings of the Small Business Administration on the impact of regulations generally on small businesses," the GAO report said. It defined "smaller public companies" as those with less than $700 million market capitalization.

The SEC small company advisory panel recommended the SEC exempt from internal control reporting requirements those companies with market capitalization less than $128 million and annual revenues of less than $125 million, and also exempt companies with market capitalization between $128 million and $787 million and with less than $10 million in annual revenues.

The SEC and PCAOB are expected to make their decisions on the advisory committee's exemptive relief proposal sometime after the May 10 roundtable.

GAO Recommendations

GAO, which is Congress' chief investigative arm, did not recommend any specific actions or law changes that Congress, the SEC, or PCAOB should adopt to reduce small company costs. GAO confined its recommendations to:

- urging the SEC to assess the available guidance on internal control reporting and determine whether it is "sufficient and whether additional action is needed, such as issuing supplemental or clarifying guidance to help smaller public companies meet the requirements of Section 404";
- urging the SEC to coordinate with PCAOB to help ensure Section 404 related audit standards and guidance are consistent with any other guidance to aid management assessment of internal controls; and
- urging the SEC and PCAOB to "identify additional ways in which auditors can achieve more economical, effective, and efficient implementation of the standards and guidance related to internal control over financial reporting."

GAO also found that "while smaller companies historically have paid disproportionately higher audit fees than larger companies as a percent of revenues, the percentage difference between median audit fees paid by smaller versus larger public companies grew in 2004, particularly for companies that implemented the act's internal control provisions."

Lower Future Costs

GAO noted that "it is generally expected that compliance costs for Section 404 will decrease in subsequent years, given the first-year investment in documenting internal controls."

Nonetheless, Sarbanes-Oxley, "along with other market forces, appeared to have been a factor in the increase in public companies deregistering with SEC [going private] from 143 in 2001 to 245 in 2004," GAO said.

Congressional and other critics of Section 404 have complained that such deregistering is part of a phenomenon in which Section 404 is also inducing many companies to register their stocks on non-U.S. exchanges, causing what they call a flight of capital formation.

However, the number of companies going private was "small by any measure and represented 2 percent of public companies in 2004," GAO said. Also, the impact of Section 404 on smaller companies "remains unclear" because of extensions of the date for complying with Section 404, most recently to July 15, 2007 for companies with less than $75 million in market capitalization, GAO said.

GAO also found that smaller public companies "have been able to obtain access to needed audit services since the passage" of Sarbanes-Oxley, but "data show" that a "substantial number of smaller public companies" have switched large accounting firms to mid-sized and small firms as their auditors. The smaller companies cited audit cost and service concerns for switching to smaller audit firms, while the larger auditors cited profitability and risk concerns among their reasons for dropping some clients the agency said.

GAO was asked by the Senate Committee on Small Business and Entrepreneurship to conduct the study.

BNA Daily Tax Report 2006

Telephone Tax Refunds

Refunds with Interest to Be Granted Back to March 2003.

Buckling under the combined weight of five federal circuit courts of appeal losses, numerous district court losses, and the outcry of congressional leaders and the communications industry, the IRS has finally conceded that long distance telephone charges that vary only by time elapsed (not by distance) are not taxable under Code Sec. 4251.

The IRS now says that it will no longer litigate the issue and will instead follow the federal appellate court opinions that rejected its position.

In fact, the IRS is going one step further than the courts in that it will no longer collect the three-percent excise tax on any long distance services, even those plans that bill based on both elapsed transmission time and distance of the call. The government, therefore, will stop collecting the federal excise tax on long distance telephone service and will issue credits or refunds of all excise taxes paid on long-distance service billed after February 28, 2003, along with interest.

The key points of the IRS's new policy concerning the communications excise tax are discussed below:

Long distance and bundled service nontaxable: Long distance service is communication with persons outside the local telephone system of the caller. Bundled service is local and long distance service provided under a plan that does not list the local telephone service charge separately. Bundled service includes Voice over Internet Protocol service, prepaid telephone cards, and plans that provide both local and long distance service for either a flat monthly fee or a charge that varies with elapsed transmission time. Both long distance service and bundled service are now nontaxable.

Refunds with interest back to March 2003: Collectors or taxpayers may request a refund of tax paid for nontaxable service that was billed to the taxpayers after February 28, 2003, and before August 1, 2006 (the "relevant period"). The IRS will schedule an over assessment under Code Sec. 6407 to keep the period of limitations open for these requests. The IRS will deny all taxpayer requests for refund of tax on nontaxable service that is billed after July 31, 2006. Such requests should instead be directed to the collector.

Particular forms required: Taxpayers may request a credit or refund of tax only on their 2006 federal income tax return, which is the income tax return for calendar year 2006, or the first tax year including December 31, 2006. Those who are not otherwise required to file a federal income tax return must nevertheless file a return to obtain a credit or refund. Concerning the proper way to request a credit or refund, the notice provides specific guidance for individuals, entities, partnerships, S corporations, estates and trusts, tax-exempt organizations, corporations and other nonfiling entities. Generally, the IRS will not process requests for a credit or refund on forms other than those prescribed by the notice.

Certification and recordkeeping: Instructions to the various federal income tax returns will require taxpayers to certify that (1) the taxpayer has not received a credit or refund from the collector, and (2) the taxpayer will not ask the collector for a credit or refund and has withdrawn any request that the taxpayer previously submitted. Except for taxpayers requesting the safe harbor amount (see below), the instructions will also require taxpayers to retain records to substantiate their requests.

Safe Harbor Amount: Individual taxpayers can request a safe harbor amount without having any supporting documentation, but qualify to make that request only if they (1) have paid all taxes billed by their service provider after February 28, 2003, and before August 1, 2006, (2) have not received a credit or refund from the service provider, and (3) have not requested a credit or refund from the service provider or have withdrawn any request. The safe harbor amount is still under consideration and will be announced in later guidance. No safe harbor amount is allowed for entities, however, and they can request only the actual amount of tax paid on nontaxable service.

Interest on credit or refund taxable: Interest on the credit or refund of the tax paid for nontaxable service must be included as income on the taxpayer's income tax return for the tax year in which the interest is received or accrued. Therefore, individuals are generally required to report the interest on their 2007 income tax returns.

Estimated taxes: A credit or refund claimed with respect to the excise tax will not be considered to be a credit against tax for purposes of determining the amount of estimated tax installments to be paid in 2006. For purposes of determining the amount of the required installments of estimated tax for 2007, the income attributable to the excise tax credit or refund may be taken into account on the date the income is paid or credited in the case of a cash method taxpayer and on the date the return making the request is filed in the case of an accrual method taxpayer.

By David Becker, Stephen K. Cooper and Dave Hansen, CCH News Staff, 2006

Applicable Federal Rates

June 2006

	Short Term	Mid Term	Long Term
Annual	4.99%	5.06%	5.32%
Semi annual	4.93%	5.00%	5.25%
Quarterly	4.90%	4.97%	5.22%
Monthly	4.88%	4.95%	5.19%
Adjusted AFR for Original Issue Discount (Code Sec. 1288(b))	3.61%	3.82%	4.45%
Code Sec. 382 Adjusted Federal Long Term Rate			4.45%
Long Term Tax exempt rate			4.45%
Low income Housing Credit (Code Sec. 42(b)(2))			
70% present value			8.21%
30% present value			3.52%
Valuation Tables (Code Sec. 7520)			6.00%
Deemed Rate of Return for Transfers to Pooled Income Funds (Code Sec. 642(c)(5))			3.80%

Garnishment Orders: A Command Which Employers Should Not Ignore

Employers should be knowledgeable about garnishment orders. Garnishment is a procedure through which a court may require an employer to withhold an amount from employee wages to satisfy an outstanding debt to a third party. The third-party creditor initiates this legal action against the employee, using the employer essentially as a debt-collection agent.

Garnishment orders have rules ***different*** from child support orders. While a garnishment order seeks to liquidate a specific debt, child support orders set up a mechanism which provides an on-going succession of deductions for the support of a child or other family dependent. Also, the maximum deduction amounts for child support orders usually are considerably greater than those for garnishments.

Both Federal and state laws govern garnishment orders, generally setting a limit on the amount of the employee's wages that may be withheld at one time, and restricting the power of an employer to discharge an employee who is the subject of a garnishment order. Federal law supersedes all state garnishment laws except those where the state law is more favorable to the employee, such as one imposing lower limits on the amounts that may be withheld.

The Federal Consumer Credit Protection Act (CCPA) restricts the maximum amount that may be garnished. For a creditor garnishment, the weekly amount withheld may not exceed the lesser of:

- 25 percent of the employee's disposable earnings, or
- The amount by which an employee's disposable earnings exceeds 30 times the current Federal minimum wage (30 x $5.15 =$154.50)

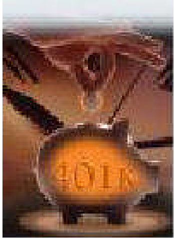
When pay periods cover more than one week, multiples of the weekly restrictions should be used to calculate the maximum amounts that may be garnished.

Generally, an employee's “disposable” earnings are equal to the employee's gross earnings minus deductions required by state or Federal law. Payroll tax deductions are an example of the latter. Importantly, the definition of “earnings” subject to creditor garnishment orders may differ among states, and compared to the Federal definition.

Some states authorize the employer to withhold and retain an “administrative fee” to cover the employer's costs in complying with the creditor garnishment order. While some of these states allow the administrative fee to be taken from the garnishment deduction amount, other states permit a separate deduction for this purpose.

Article from "ADP Tax Researcher Newsletter" May 2006 Issue

The Top Seven 401(k) Mistakes



Not contributing to a company’s 401(k) plan is probably the biggest mistake people make, but there are a few others that can cost you. Millions of workers are blowing it every day when dealing with their retirement plans. Here are the seven biggest mistakes people make:

1. **Not participating**. The majority of plans offer a decent range of investment options, reasonable fees, and about 96% of the large companies offer matches. Almost one out of every four workers fails to sign up.
2. **Missing out on the full company match**. It makes sense to take advantage of what is essentially free money. If you don’t think you can contribute enough for the match remember that each dollar you don’t put into your 401(k) is subject to federal, state, and local income taxes. So if you are in the 30% tax bracket each dollar you put into a 401(k) will reduce your paycheck by just 70 cents.
3. **Taking too little risk**. Leading financial planners believe that investors need to keep at least half of their portfolio invested in stocks, regardless of age, if you want an adequate income for retirement.
4. **Taking too much risk**. At the opposite end of the scale are those individuals that overload their risk and invest too heavily in stocks with little or no exposure to fixed-income investments. A good rule of thumb for most investors is a classic balanced portfolio of 60% stocks, 30% bonds, and 10% cash.
5. **Investing too heavily in your company’s stock**. Remember Enron? The moral of the Enron story is that you do not want your retirement account to be dependent on the same company that provides your job. Limit your exposure and limit the overall investment to 10% of your balance in company stock.
6. **Taking out loans**. Borrowing from your retirement funds is often a sign that you are overspending. Keep the money invested and earning. If you need a loan find a good home equity product or other avenues.
7. **Cashing out instead of rolling over**. Too many people cash out of their retirement account when they leave a job. Combined, the income taxes and penalties you pay typically equal 25- 50% of your balance. The younger you are the more important it is to leave your money invested and growing, tax deferred!

Your 401(k) may be all that you have to live on when you retire, so treat it carefully.

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