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SPRING 2008 NEWSLETTER

The Heartland, Habitat, Harvest, and Horticultural Act of 2008 and the Heroes Earnings Assistance and Relief Tax Act of 2008 were approved in May. They provided extensive provisions with regard to active duty military, reservists, veterans, and farm related income and losses. (See below)

1. Continuing California Budget Impasse. The rhetoric swirling around the budget impasse appears to be centered on partisan politics. With our dire economic situation, we might prefer more discussions on the economic impact of the various proposals. We hope they get it right, even if it is by accident.

2. Estate Tax Planning. A common estate planning tactic is to create multiple ownership interests in property. On the death of an owner owning less than 50% of the property, the value of that person's interest for estate tax purposes is less than that percentage of interest times the full fair market value of the property due to various discounts available in determining value. Some people have been very aggressive in applying this principle. Because of these tactics, you are now required to disclose any split interest ownership and how it was valued on IRS Form 706, the Federal Estate Tax Return.

This is still a beneficial technique. Just don't be greedy.

3. Your Home as an Investment? Going back 20 or so years, investment advisors advised people to acquire a home and thereafter use excess monies for investment purposes. In the past 7 to 10 years, a shift in perception occurred to treating your home as an investment. I have not run into an investment advisor with that philosophy, but this perception filtered through our society. Considering the recent subprime debacle and the crash of home prices, this may be changing. Unlike the stock market, you are not in a position to be able to sell off your home to stop the bleeding.

As with anything, an investment venture should be treated like surgery. Get a second, even a third opinion before you do it.

4. Tax Preparer Disclosures. The IRS has issued proposed Regulations (REG-136596.07) that would bar tax return preparers from disclosing or using taxpayer return information to market refund anticipation loans and similar ancillary products. This apparently is to eliminate financial incentives to inflate refunds.

5. GRIT's, GRAT's, and GRUT's. No these are not sounds coming out of a weight lifting competition. IRC Section 2702, provides that any retained interest of a gift to an irrevocable trust is valued at zero. Thus the entire gift is subject to gift tax. Section 2702 provides for three types of trusts in which the value of a retained interest is not zero. This means less gift tax consequences, and more value and growth that escapes Estate Tax. These trusts are the Grantor Retained Interest Trust (GRIT), the Grantor Retained Annuity Trust (GRAT), and the Grantor Retained Unitrust (GRUT).

These trusts involve the transfer of income producing assets to a trust while retaining an interest in the trust assets through a flow of income to the person creating the trust. By complying with the rules of these trusts, the remainder of the trust goes to the beneficiaries designated under the trust and appreciation in value escapes inclusion in Federal Estate Tax on the passing of the creator of the trust.

6. Heartland and Heroes Legislation. The following is a quick summary of a few aspects of the legislation passed in May.

A. Combat Pay. An election to treat combat pay as earned income for purposes of the earned income code is made permanent.

B. Veteran's Bonus. State or local bonuses for veteran service in a combat zone are excluded from gross income.

C. Reservist Service Retirement Plans. A Reservist called to active duty for more than 179 days is entitled to penalty-free withdrawals from retirement plans.

D. SSA Distributions. Reservists called to duty for more than 179 days can withdraw unused health flexible spending account contributions.

E. "C" Corporation. Capital gains for qualified timber gains is temporarily reduced to 15% for "C" Corporations.

F. Farm Income and Losses. Numerous changes have occurred including limitation on farm losses and issues related to farm and non-farm self-employment tax computations.

7. Flat Tax/A Change in Perception. William F. Buckley, the famous conservative columnist, passed away February 27, 2008. Mr. Buckley was a man I revered due to his ability to treat emotionally charged political issues intellectually. Mr. Buckley's passing brought to mind a interesting footnote to his legacy. Approximately 20 years ago, Mr. Buckley led a group of conservatives in a series of debates across the country between his group and another group over the advisability of having a flat income tax. Mr. Buckley's group, the conservatives, were against the flat tax. The other group was in favor of the flat tax. Interestingly enough, the group favoring the flat tax was led by none other than Jerry Brown, the former Governor of California.

Why do many conservatives today seem to be in favor of a flat tax? My how perceptions change over time!

8. Commentary: Greed, Real Estate and Subprime Credit/Formula for Disaster. You would not think Wall Street, real estate, and subprime lending would turn into a Halloween horror story, but it has. The problem is, it's not a Halloween story. It's real!

Considering how many people have been economically damaged and injured, and the damage to the entire financial structure of this country, you would think a lot of people would be angry and outraged. It's not that the anger and outrage is not out there, it's just that no one is quite sure where to direct it. We have Wall Street that profited from the run-up of securities, the real estate industry; real estate investors, home buyers that were chasing profits and higher prices; city and local governments that derived increased tax revenues; the Federal Reserve who didn't seem to see it coming; the United States Treasury (was this really their job); the President, (I'm not sure it's even his job, but he is getting the blame anyway).

This leaves Congress. In January 2007, Mr. Greenspan said he could see the possibility of economic problems and a recession by the end of 2007. The response to his comments seemed to be for him to “shut-up”.

It would seem when a man as experienced and revered as Mr. Greenspan makes such comments, Congress would have called for hearings to determine the validity of Mr. Greenspan’s comments. They didn’t have any trouble calling hearings about baseball players sticking drugs in their butts.

I am not aware of any hearings that occurred either by virtue of the House, or the Senate addressing this issue. If any readers out there know of such, please let me know.

We have had a number of people from the United States Senate running for President and railing on the economy. Again, I am not aware of any action undertaken by any Senator running for President this year trying to find out what Mr. Greenspan knew, and whether there was a way to head it off.

If they didn’t do it as a Senator, what makes us think they will be any better as President.

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