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**We are pleased to provide you our online informational newsletter which we believe you will find of interest. Each month brief articles on relevant topics will be included, along with a tax calendar for the current and following months.**

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### **Temporary rental of residence (update)**

As we pointed out in our June newsletter, tax laws allow individuals to rent their personal residence for up to 14 days without reporting the income.

One of our “eagle-eyed” readers (an insurance agent by trade) contacted us to point out that some insurance carriers may not provide coverage while the home is rented. Therefore, prior to renting your home (or any other property, for that matter), contact your agent to confirm proper insurance coverage.

## **Estate Tax**

With action on an estate tax repeal bill stalled in the Senate, late on June 19, House Ways and Means Committee Chair Bill Thomas (R-CA) introduced H.R. 5638, the “Permanent Estate Tax Relief Act of 2006.” Among other changes, the bill would eliminate the one-year repeal of estate and generation-skipping transfer (GST) taxes that is scheduled for 2010. At the same time it would, on a “permanent basis,” substantially reduce estate, gift and GST tax rates and substantially increase exemptions from these taxes, compared to current levels and higher levels that are scheduled to return in 2011 under the “sunset” provision.

## **Proposed transfer tax relief**

H.R. 5638 would make the following changes to estate, gift and GST taxes for estates of decedents dying, generation-skipping transfers, and gifts made, after December 31, 2009.

- Reunify the estate, gift and generation-skipping transfer taxes so that both a common exemption amount and a common rate schedule apply to cumulative taxable transfers made by an individual during life and at death. A summary description of the bill states that this would give individuals greater flexibility to make estate planning decisions during life. A non-unified estate and gift tax provides less favorable tax treatment for gifts made during lifetime than gifts made (through a will) at death.
- Increase the estate, gift and GST tax exemption amounts to \$5 million per person.
- Lower the estate, gift and GST tax rates on the first \$25 million of transfers to the maximum capital gains tax rate (currently 15%, set to increase to 20% in 2011, unless extended) and to twice the maximum capital gains rates on transfers in excess of \$25 million (currently 30%, set to increase to 40% in 2011, unless extended).

## **Midyear Tax Planning**

When it comes to taxes, 2006 is already off to a fast start – we have already seen one Tax Act and it looks likely that there will be more before the year’s end. All this is right on the heels of 2005, where we saw four major Tax Acts. What does all this mean to you? Despite the tax rules being in a seemingly endless state of flux, the current tax environment is about as good as it’s going to get. If you wait until the tax laws settle down before doing any serious planning, you may miss out on some great opportunities to reduce your overall tax burden. What’s important is to set long-term financial goals now and then update them as the tax law evolves.

Use the following ideas as a starting point to identify specific actions you can take while there is still time to take action. Some planning ideas need to be implemented before year-end to be effective for this year. With that in mind, here are some ideas to consider.

- Make the Standard Deduction Work for You. If your itemized deductions are just at or below the standard deduction (currently \$10,300 for joint filers and \$5,150 for singles), they don't generate any tax benefit for you. Instead, you can bunch itemized deductions into a single tax year to exceed the standard deduction that year and take the standard deduction the following year. Following this two-year pattern results in greater deductions overall. Deductions that work well for this strategy include charitable contributions, property taxes and your January mortgage payment.
- Consider Giving Appreciated Securities to Your Children. A great way to reduce the tax hit on an appreciated security is to give it to your child (or grandchild). The child can hold the security until the year they turn 18 and then sell without being subject to the "kiddie tax." Assuming the current tax rate structure is left in place, the resulting capital gain will probably be taxed at only 5%, if the stock is sold this year or next. Remember, your child's lower tax rates won't apply if the stock is sold before the year she turns 18 (until this year the applicable age was 14). Also, giving the security to your child is considered a gift. However, you can use your annual \$12,000 gift tax exclusion to shelter the transaction from any gift tax.
- Take Advantage of Retirement Plan Options. The earnings on most retirement accounts are tax deferred (with Roth IRAs, they're normally tax-free). Thus, the sooner you fund such an account, the quicker the tax advantage begins. If you can come up with the cash now, there's no need to wait until year-end or the April 15 tax filing deadline to make your 2006 contributions. However, if your employer offers a 401(k) or SIMPLE-IRA plan at work, you'll probably want to contribute enough to that plan to receive a full employer match before making an IRA contribution.
- Retirement Plans. If your business doesn't offer a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. Even if your business is only part-time or something you do on the side, contributing to a SEP-IRA can enable you to reduce your current tax load, while increasing your retirement savings. With a SEP-IRA you generally can contribute up to 20% of your self-employment earnings, with a maximum contribution of \$44,000. A SIMPLE-IRA, on the other hand, allows you to set aside up to \$10,000, plus an employer match that could potentially be the same amount. In addition, if you're age 50 or older by year-end, you can contribute an additional \$2,500 to a SIMPLE-IRA.
- Holding on Longer Can Lower Your Taxes. If you hold appreciated securities in taxable accounts, owning them for at least one year and a day is necessary to qualify for the preferential long-term capital gains tax rates (typically, 15%). In contrast, short-term gains are taxed at your regular rate, which can be as high as 35%. Be sure to consider this when evaluating your investment portfolio. Whenever possible, try to meet the more-than-one-year ownership rule for appreciated securities held in your taxable accounts (of course, while the tax consequences are important, they should not be the only consideration for making a buy or sell decision).

- Sell the Right Shares. Generally, when you sell stock or mutual fund shares, the shares you purchased first are considered sold first, which is good news if you are trying to qualify for the long-term capital gain rate. But, there may be situations where you're better off selling shares that have been held a year or less, rather than those held longer. Selling recently purchased shares at little or no gain (because you purchased them at a higher price) may be better than selling shares held for more than one year, if that sale would produce a significant gain. Whenever you want to sell shares other than those you purchased first, you must properly notify your broker as to the specific shares you want sold.
- Sell Losers with Tax Savings in Mind. It's also important to consider the best time to trigger capital losses, by selling losers held in your taxable investment accounts. Capital losses are used to offset any capital gains for the year. Specifically, short-term losses first offset short-term gains; then long-term gains. Long-term losses first offset long-term gains; then short-term gains. If total losses exceed total gains, the excess can be used to offset up to \$3,000 (\$1,500 if married filing separately) of ordinary income.

**Warning:** Beware of the wash-sale rule when considering sales to trigger tax losses. You cannot deduct the loss if you purchase substantially identical securities within the period beginning 30 days before and ending 30 days after the date of the loss sale.

- Make Sure You Qualify to Exclude Principal Residence Gain. Gains up to \$500,000 on sale of a principal residence are completely tax-free for married couples who file joint returns. To qualify for this break, you normally must have owned and used the house as your principal residence for a total of at least two years in the five-year period prior to the sale. You'll definitely want to take these rules into consideration if you're planning on selling your home.
- Monitor Personal Use of Vacation Homes. Renting a vacation home can help offset the cost of owning and operating the property. However, the tax rules generally limit your rental deductions if you personally use the property during the year for more than the *greater* of 14 days or 10% of the rental days. Personal use days include any day when the property is leased at less than a fair market rental and normally include all the days the property is used by family members or other owners. By monitoring personal use for the rest of the year, you may be able to avoid the limitation on rental

### **Watch out for the Alternative Minimum Tax**

While recent tax law changes have done a lot to reduce your regular federal income tax bill, they didn't do nearly as much to reduce the odds that you'll owe the alternative minimum tax (AMT). Therefore, it's critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Because the AMT rules are so complicated, you may want our assistance in this area. We stand ready to help!

**Tax Calendar**  
**JULY 2006**

**July 10**

Employees who work for tips. If you received \$20 or more in tips during June, report them to your employer. You can use Form 4070.

**July 17**

Social Security, Medicare, and withheld income tax. If the monthly deposit rule applies, deposit the tax for payments in June.

Nonpayroll withholding. If the monthly deposit rule applies, deposit the tax for payments in June.

**July 31**

Social Security, Medicare, and withheld income tax. File Form 941 for the second quarter of 2006. Deposit any undeposited tax. (If your tax liability is less than \$2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until August 10 to file the return.

Federal unemployment tax. Deposit the tax owed through June if more than \$500. All employers. If you maintain an employee benefit plan, such as a pension, profit-sharing, or stock bonus plan, file Form 5500 or 5500-EZ for calendar year 2005. If you use a fiscal year as your plan year, file the form by the last day of the seventh month after the plan year ends.

**AUGUST 2006**

**August 10**

Social Security, Medicare, and withheld income tax. File Form 941 for the second quarter of 2006. This due date applies only if you deposited the tax for the quarter in full and on time.

**August 15**

Social Security, Medicare, withheld income tax. If the monthly deposit rule applies, deposit the tax for payments in July.

Nonpayroll withholding. If the monthly deposit rule applies, deposit the tax for payments in July.