



The Strategic Advisor

Strategies for Success

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It is my pleasure to be able to provide information that can aid you in building your financial future. I hope you enjoy the content and find it helpful.

If I can be of any assistance please feel free to call. We can discuss any of your concerns without obligation.

Wishing you well as you travel the road to financial independence.

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Look at What's New for 2007

Every new year offers some surprises, and 2007 is no exception. Here's a look at some of the changes--big and small--that may affect your finances this year.

Medicare Part B premiums tied to income

Beginning in 2007, Medicare Part B premiums will be higher for beneficiaries with higher incomes. You'll pay an income-related premium if your modified adjusted gross income exceeds \$80,000 if you're single, or \$160,000 if you're married and file your taxes jointly. If you're already receiving Medicare and are among those affected, you should have already been notified by the Social Security Administration. If you enroll in Medicare Part B this year, you can expect to be notified shortly after enrolling in the program.

Tax refunds can be split up

If you expect a federal income tax refund this year, here's a bit of good news. Taxpayers will now be able to split a direct deposit tax refund into as many as three different accounts with three different financial institutions, making it easier to put a tax refund to work toward several financial goals. Regular passbook savings accounts, individual retirement arrangements (IRAs), health savings accounts (HSAs), and Coverdell education savings accounts are among the potential savings options. Of course, you'll need to check with your financial institution first to make sure it accepts direct deposit refunds--not all will. And to make sure your refund is properly split, you'll need to follow carefully the instructions from the IRS and your financial institution.

Refunds due for telephone excise tax paid

More than a century after it was introduced as a luxury tax on wealthier individuals, the federal excise tax on long-distance telephone service has been discontinued. The IRS will refund a portion of tax paid by individuals,

nonprofits, and businesses when they file their 2006 income tax returns.

Although this refund won't make you wealthy--you'll be able to claim a refund only for excise tax paid on long-distance service billed after February 28, 2003, and before August 1, 2006--it will put a few extra dollars in your pocket. If you don't want to pour over old phone records to determine the exact amount of tax you've paid, you can claim a standard refund amount ranging from \$30 to \$60, depending on how many exemptions you claim on your 2006 federal income tax return. Nonprofits and businesses can either claim refunds of the actual amount of excise tax paid or estimate their refunds using a formula.

Charitable contributions from IRAs allowed

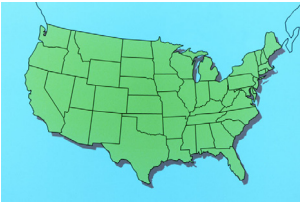
If you're over 70½ and need to take required minimum distributions from your IRA, you may benefit from a new rule that allows you to contribute as much as \$100,000 to a qualified charity directly from your IRA. These IRA distributions are tax free and satisfy minimum distribution requirements. But if you want to make a charitable contribution from IRA funds, don't wait--this option is available only until the end of 2007.

Charitable deductions need more documentation

If you give cash to your favorite charity in 2007, ask for a receipt. The IRS now requires that you have a receipt or other written confirmation for all cash contributions for which you are claiming a deduction, not just for those exceeding \$250. Bank records, such as cancelled checks, bank statements, or credit card statements showing the transaction, can also be used as support. Supporting documents must show the name of the charity as well as the date and amount of your contribution.



According to the U.S. Census Bureau, a net 1.4 million Americans moved from states with income tax to states with no income tax between April 1, 2000, and June 30, 2004.



To find out how your state's tax burden ranks, go to www.census.gov or www.taxfoundation.org.

The Most (and Least) Tax-Friendly States for Individuals

Your state of residence means little when it comes to federal income tax, but makes all the difference when it comes to the state and local taxes you pay. If your state is reaching too deeply into your pockets, you can always move to greener pastures. Before you pack your bags and call a mover, however, here are a few factors to consider.

Comparing states can be taxing

There are as many state tax systems as there are ... well, states. The 50 states and the District of Columbia raise revenue through a variety of taxes, including income tax, sales tax, personal property taxes on real estate and intangibles (e.g., stocks, bonds, notes, and loans), inheritance and estate taxes, and excise taxes on gas and cigarettes, among others. A state may impose all or some of these taxes. Often, a state that doesn't impose one type of tax will make up revenue by imposing higher rates in other types. For an accurate comparison among the states, then, you need to know their total tax burdens.

Fortunately, you don't have to gather and analyze this information yourself; the U.S. Census Bureau and the Tax Foundation, a nonpartisan tax research group, have done it for you.

The U.S. Census Bureau ranks states by total tax collections per capita (collections divided by population), listing (in order for 2005) Vermont, Hawaii, and Wyoming with the highest tax burdens, and South Dakota, New Hampshire, and Texas with the lowest.

The Tax Foundation ranks states by collections as a percentage of total income. The highest are Maine (13.5%), New York (12.9%), and Ohio (12%); the lowest are Alaska (6.6%), New Hampshire (7.3%), and Delaware (8.4%).

Best (and worst) income tax states

That being said, state income tax still accounts for a large percentage of taxes paid. So, you may consider yourself lucky if you live in one of the seven no-income-tax states--Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming (New Hampshire and Tennessee impose income tax only on interest and dividends).

The "worst" income tax states are Vermont, with a maximum rate of 9.5%, and California, with a maximum rate of 9.3% (plus 1% for taxable income over \$1 million).

Best (and worst) sales tax states

Currently, all states except Alaska, Delaware, Montana, New Hampshire, and Oregon collect sales tax. Colorado has the lowest sales tax rate (2.9%), while California has the highest (7.25%). Note, though, that some states also have local sales taxes.

Best (and worst) real property tax states

According to the Tax Foundation, the state with the lowest property tax per capita (for 2005) is Alabama, followed by Arkansas. The state with the highest is New Jersey, followed by Connecticut. But be careful; property taxes are generally collected by local governments, and can vary substantially within an individual state.

The best states to retire in

If you're a retiree on a fixed income, you may be interested in states that provide special tax benefits to seniors. For example:

- Social Security income is completely exempted from income tax in 28 states
- Pension income is fully or partially exempt in 33 states
- Many states offer added exemptions, standard deductions, and credits based on age
- Some states offer property tax reductions

The worst states to transfer wealth in

If you're concerned about transfer taxes, here are the states to note:

- Connecticut, Louisiana, North Carolina, and Tennessee impose gift tax
- The District of Columbia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, Washington, and Wisconsin collect inheritance and/or estate tax
- Kansas, Massachusetts, Nebraska, New York, Vermont, Washington, and Wisconsin impose generation-skipping transfer tax

For more state-specific information, see your tax professional.

Business or Hobby--Proving You Mean Business

Do you have a hobby--an activity you do simply because you love doing it--that also earns you income? That income, as you probably already know, must be reported on your annual income tax return. What you may not know is that sometimes a hobby can be more than just a hobby--it can be a business. On the flip side, however, a legitimate business suffering losses may be classified as merely a hobby, a disadvantage for tax purposes.

The bright side

According to the IRS, a hobby is an activity pursued for pure enjoyment, regardless of the cost, while a business is a for-profit activity; any enjoyment you get from the business is irrelevant. Profit motive is the key difference. Since determining profit motive can be highly subjective, the IRS uses this rule of thumb: Profit motive is presumed if you earn net income (income minus expenses) in three out of five consecutive years (although the IRS can still rebut this presumption).

If your income-producing activity qualifies as a business, you're entitled to deduct qualified business expenses, such as the home office expenses and depreciation, even if they exceed the income produced by your hobby business. In other words, you can use hobby business losses to offset income from other sources.

These tax rules can be a great advantage if you want to turn your hobby into a business. But these same rules sometimes work against taxpayers who are trying to get a new business off the ground.

The dark side

Just as steady net income is evidence of a bona fide business, reporting a net loss in three out of five years is evidence of a not-for-profit hobby. Although there is no presumption, this is a red flag that may result in closer scrutiny by the IRS or even trigger an audit.

If an activity is classified as a hobby, expenses can only be used to offset income generated by that activity; losses are not allowed. Further, hobby expenses, together with other miscellaneous expenses, must equal more than 2% of your adjusted gross income before they can be deducted.

This can be a huge disadvantage to young businesses, which normally incur losses in their first years of existence. Fortunately, you can still convince the IRS that you mean

business and intend to make a profit.

The gray area

The IRS will look at the following nine factors to determine whether you have a profit motive:

1. Whether you run the activity in a business-like manner
2. How much time and effort you put into making a profit
3. Whether you depend on the activity for your livelihood
4. Whether your losses were sustained due to circumstances beyond your control
5. Whether you changed your operating methods to improve profitability
6. Whether you or your advisors have the knowledge needed to carry on a successful business
7. Whether you successfully made a profit in similar activities in the past
8. Whether the activity makes a profit in some years, and how much
9. Whether you can expect to make a profit in the future from the appreciation of assets used in the activity

Practically speaking

What are some practical things you can do to make sure your activity is classified as a business and not just a hobby? Here are a few:

- Have a business name, and put it on stationery, business cards, and invoices
- File a DBA (doing business as) form with your local city/town or county, or incorporate
- Have a separate business phone/fax line
- Open a separate business bank account, and get a separate credit card
- Keep receipts, along with a good set of books and records
- Prepare a business plan
- Get expert advice

See IRS Publication 535, *Business Expenses*, and consult your tax professional for more information.

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Buying time to prove your business is profitable

By filing IRS Form 5213, Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit, you can elect to have the IRS wait until five years are up before examining the profitability of your business.



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Ask the Experts



Is it too late to make an IRA contribution for 2006?

You can make an IRA contribution for 2006 at any time up until the due date for filing your federal income tax return for the year. For most people, this will be April 16, 2007. This deadline isn't affected by any extension you may receive to file your return. So, if you obtain an automatic six-month extension, you'll have additional time to file your tax return, but you won't have any additional time to make an IRA contribution.

If you do make a contribution in 2007 for 2006, make sure you tell your IRA trustee (or custodian) that the contribution is being made for the prior year. Otherwise, the trustee may assume that the contribution is for 2007 (the year in which it's received) and report it as such.

Also, before you make a contribution, be sure you're eligible. Remember that if you're covered by an employer retirement plan, you may not be able to deduct your contributions to a

traditional IRA unless your income is within certain limits. And you can't contribute to a traditional IRA at all after you reach age 70½. You can contribute to a Roth IRA at any age, but again only if your income falls within certain limits.

If you are eligible to make a deductible contribution to a traditional IRA, keep in mind that you can file your 2006 tax return claiming the deduction before you actually make your contribution. Just be sure you meet the April 16 contribution deadline.

You can contribute up to \$4,000 to an IRA (traditional, Roth, or combination of the two) for 2006 (\$5,000 if you were age 50 or older by the end of 2006). You may also be able to contribute up to \$4,000 to an IRA for 2006 in your spouse's name (\$5,000 if your spouse is age 50 or older), even if he or she had little or no taxable compensation for the year.

If you haven't yet made your IRA contribution for 2006, why not do it now?

How do I undo my 2006 Roth IRA conversion?

So you converted your traditional IRA to a Roth IRA in 2006, and now you've determined that the conversion no longer makes good tax sense, or that you were ineligible to make the conversion in the first place. What do you do? You may be able to reverse ("recharacterize") your conversion. When you recharacterize a Roth conversion, it's as though the conversion never occurred, and the funds are treated as having never left your traditional IRA.

Generally, to undo a Roth IRA conversion, you'll need to take the following steps:

1. Identify the traditional IRA that will "take back" the recharacterized contribution (plus any earnings allocated to the contribution) in a trustee-to-trustee transfer. This can be the same traditional IRA you converted from, or a new IRA.
2. Notify the financial institution that you intend to recharacterize your contribution. Your financial institution should have a specific form for this that contains all the information required by the IRS. If more

than one financial institution is involved, you must notify both financial institutions--the one servicing your present Roth IRA and the one that will accept the recharacterized funds. You must provide the notice on or before the date the assets are transferred back to the traditional IRA.

3. Meet all applicable deadlines. The deadline for recharacterizing a Roth IRA conversion is the due date for your 2006 federal income tax return, *including* extensions. So, if you file for an automatic extension to October 15, 2007, you also have until then to recharacterize your 2006 conversion. (A special procedure applies if you file your tax return by April 16, and then later decide to recharacterize.)
4. Report the recharacterization by attaching Form 8606 to your 2006 tax return.

Failure to comply with all the technical requirements for a recharacterization can have serious tax consequences, so be sure to ask your financial professional for assistance.