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Keeping up with IRS code can be taxing, profitable

by Becky Bergman

Some changes in tax code over the next several years might keep financial experts busy.

Effective for 2006 and 2007 only, taxpayers over 70 and a half years old who are required to take a withdrawal from their IRA account -- and thus pay taxes on the income -- can distribute up to $100,000 from the account to qualified charities.

While financial experts are not optimistic that Congress will repeal the estate tax in 2010 and 2011, they believe a compromise is close, says Steven Bell, the president for Northern Trust's Northern California region who is based in San Francisco.

One suggestion to emerge from the controversial debate includes a $3.5 million exemption, which would eliminate 99.7 percent of the estates from inheritance tax.

Another notable change includes the decline -- down to 45 percent -- of the top estate, gift and generation-skipping tax rate in 2007. On the flip side, financial experts said there are several codes that remain unchanged, including:

- Continued IRS scrutiny of Family Limited Partnerships;
- Annual gift tax exclusion remains capped at $12,000 in 2007.

One tax code left unchanged, now in effect until 2010, is the 15 percent maximum rate on capital gains.

"I think wealthy taxpayers should run, not walk, to take advantage of the low rate on capital gains," says Mr. Bell. "This is a fantastic opportunity to diversify concentrations of securities, or real estate, at a very low tax rate."

- Charitable lead trusts -- a significant vehicle for transferring wealth to grandchildren without incurring estate, gift or generation-skipping tax -- will remain popular, as well as charitable remainder trusts.

The maximum capital gains rate for lower-income taxpayers will drop from 5 percent to zero in 2008 through 2010, allowing for tax-free transfers of appreciated property from higher to lower income taxpayers.

The 2001 Pension Protection Act, a law that increased annual contribution limits for IRAs and qualified pension plans, is slated to expire in 2010, says Karen Shapiro, chief executive for San Francisco-based Dedicated DB, a defined benefit solutions company.

The reform also helped create additional "catch-up" contributions for individuals 50 years old and over, while creating incentives for small employers to offer pension plans.

Ms. Shapiro's firm advises clients about solo-defined benefit plans, which allow wage earners to put more pre-tax income into a plan than is possible with a SEP or 401(k), which place a ceiling on how much can be contributed.

To qualify for a solo-defined benefit plan, individuals need to be between 45 and 65 years old, have self-employment income as a business owner, consultant or independent contractor; or own a business with five or fewer permanent employees. The average contribution is $125,000.

Starting in 2010, the Pension Protection Act will allow small companies to establish combined defined benefit and automatic enrollment 401(k) plans using a single plan document and trust fund.

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