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Tax Memo

*Proud to be in our 70th year of
serving Kansas!*

Selling Your Life Insurance

Consider whether you fit this profile: You have been successful in your career and are now enjoying a pleasant retirement. During the years when you had small children and a big mortgage, you took out a significant life insurance policy to cover the family and/or your business obligations, (or, perhaps estate taxes.) Now that you are retired, or you have succeeded in your estate planning goal of avoiding significant estate tax, you no longer depend on life insurance for your family's financial security. Therefore, you intend to quit paying premiums and let your policy lapse. Sound familiar? Experts estimate that about 85% of all life insurance policies lapse and do not pay a death benefit, so it must be a fairly common occurrence.

If you fit this profile, and you have a life insurance policy with a death benefit in excess of \$250,000, then you may want to consider an alternative. Rather than deciding to simply stop making the premium payments and allowing the policy to lapse, you may want to investigate whether a life settlement (in effect,

selling your policy "intact") makes more financial sense. A life settlement is a transaction entered into between a company and an insured whereby the company pays the owner a sum of money, takes over the policy ownership, names itself as the beneficiary, and then begins making the premium payments. The owner/insured puts the cash in his pocket, and goes on about his business. When the insured dies, the life settlement company collects the death benefits and realizes its profit on the transaction. It is similar to a viatical settlement, but different because it does not involve the company issuing the policy. Viatical settlements are typically transactions where a terminally ill patient negotiates with his insurance carrier to basically pre-pay the death benefit.

Because of the increasing estate tax exemptions, and because many people have attained some measure of financial security by the time they reach their retirement years, the business of purchasing existing life insurance policies is growing. Experts warn people to

keep in mind that declining health and increasing age may mean the insured will be unable to obtain new insurance if necessary. Also, these transactions may involve some tax consequences. Typically, the owner of a policy will have some significant basis in the policy, and if the proceeds received are less than the owner's basis, no gain will be recognized. However, on a case-by-case basis, there could be some gain to recognize and tax to pay.

The professionals at Bever Dye can provide assistance in reviewing various options with respect to your existing life insurance products. We are not affiliated with, nor do we derive any income from, the sale or servicing of any insurance, financial, or brokerage products. Instead, we will offer professional, independent advice on such matters.

Hybrid Cars and Tax Credits

Due to the heavy advertising budgets of the car companies, most of us know that if you buy certain new cars, a tax credit is available. The most popular hybrid car is the Toyota Prius, but other options include the Ford Escape, the Honda Civic, the Saturn Vue, and a whole host of other new cars. The amount of the credit varies depending upon the car. Buyers of the Prius receive a credit for 2007 of \$3,150. Purchasers of the Ford Escape and Mercury Mariner can receive up to \$2,600. The credit amount varies depending upon the fuel savings, and is phased out when a manufacturer reaches 60,000 hybrid cars sold in a year.

The tax credit operates as most people would expect. It effectively lowers the cost of the car. For example, assume your neighbor, Bill, buys a new Ford Escape Hybrid. He pays the dealer \$24,000 for the car. When Bill prepares and files his 2007 tax return, he calculates his tax to be \$15,000. But, that's before the credit for his new hybrid car. The Ford Escape he purchased qualifies for the \$2,600 credit, so his tax bill, after the application of the credit, becomes \$12,400. Effectively, the tax credit has lowered the cost of his new Ford Escape from \$24,000 to \$21,400.

But, beware of the impact of the AMT (alternative minimum tax) on the use of the credit. The AMT is a parallel tax system. It taxes most of the same income as the regular tax system, but it doesn't permit all the same tax deductions. There is an exemption amount, which for 2007 is \$45,000 for married individuals and \$33,750 for single individuals. If Bill were one of the many people who are

now subject to the AMT, his hybrid credit will be of no value. Again, an illustration is in order. Assume Bill has two other neighbors, Bob and Joe, who go with Bill to the Ford dealership, and on the same day in 2007 they all buy Ford Escape Hybrids paying \$24,000 each to acquire their new cars. Further, assume all three have now had their tax returns prepared, and all three have been told (without taking into account the credit for their new car) their tax bill will be \$15,000. We already know that Bill's taxes went down to \$12,400 because of his credit. But, that was because all of his tax was "regular" tax.

Bob and Joe, on the other hand, have a tax bill of \$15,000, but a portion of their tax bill is attributable to the AMT. In Joe's case, because of his very large state income tax deduction and an unusual employee business expense item, virtually all of his tax bill was attributable to the AMT. In a case such as Joe's, the hybrid credit is of no value. He can't use any of the \$2,600 credit to offset his AMT, and his tax bill remains \$15,000. Joe truly pays \$24,000 for his Ford Escape Hybrid.

Bob, on the other hand, has a regular tax bill of \$15,000, but he also has large state income tax deductions. Because of those deductions, when he calculates his tentative minimum tax, it is \$14,000. Without taking the hybrid credit into account, Bob would owe no AMT, because he would pay his regular tax bill of \$15,000. However, Bob can claim \$1,000 of the \$2,600 available credit because it is offsetting his regular tax, and

thus he can reduce his overall tax bill to \$14,000. Bob ends up paying only \$23,000 for his Ford Escape Hybrid. Not as good as Bill's deal, but better than Joe's.

Small Charities Will Have a New Filing Requirement in 2008

The IRS recently announced that small tax-exempt organizations that previously were not required to file returns may be required to begin filing an "electronic postcard" in 2008. The IRS has traditionally exempted from any filing requirements a small tax-exempt organization whose gross receipts are under \$25,000. As a result of a provision in the Pension Protection Act of 2006 ("PPA"), such small tax-exempt organizations will now be required to file electronically a Form 990-N. The IRS will be sending out information letters beginning in July notifying such small tax-exempt organizations of the filing requirement. Organizations such as local school foundations, sports organizations, social clubs, civic clubs and other small tax-exempt organizations will need to watch for this new filing requirement. There are some penalty provisions. If a tax-exempt organization fails to meet its filing requirement for three consecutive years, then the PPA provides the tax-exempt status of such an organization is automatically revoked.

IRA Rollover to Charity

The Pension Protection Act of 2006 ("PPA") provides a valuable tool to the charitable donor with balances in Individual Retirement Accounts ("IRA"). The "IRA rollover" provision of the PPA allows donors to fund charitable gifts during lifetime with contributions from IRAs without the recognition of taxable income. Without this legislation, a donor who withdraws funds from an IRA to make charitable gifts would recognize income at the time of the withdrawal, and then may not be able to offset the income completely due to the limitations on charitable deductions and itemized deductions. In addition, such a withdrawal may cause a reduction in tax exemptions or an increase in taxes on social security benefits. This provision is effective only through 2007.

Some key points to note: (i) the donor must have reached age 70 ½ at the time of making the qualified charitable distribution ("QCD"), (ii) a donor may exclude from income up to \$100,000 of QCDs (\$200,000 for married donors, but must be from separate IRA accounts held by each donor) from traditional or Roth IRA accounts, but not from other deferred compensation accounts, (iii) the rollover will count toward the required minimum distribution requirements of traditional IRAs, (iv) the charity must receive payment directly from the IRA custodian or trustee and must provide the donor with contemporaneous written acknowledgment of the gift, (v) the gift must be to public charities, not private foundations, supporting organizations or donor-advised funds, and (vi) although a charitable income tax deduction is not allowed, the entire

amount of the QCD must be otherwise allowable as a charitable income tax deduction.

Nonqualified Deferred Compensation Plan Reminder

Internal Revenue Code Section 409A, enacted in late 2004, significantly changed the rules regarding nonqualified deferred compensation arrangements and imposes large tax penalties for noncompliance. The new law imposes requirements on nonqualified deferred compensation plans with regard to participant elections, distributions, acceleration and funding. The new requirements will likely necessitate amendments to most nonqualified deferred compensation plans. Final regulations regarding the new nonqualified deferred compensation rules were published on April 17, 2007, and compliance with the final regulations is generally required by the end of 2007. The steps needed to comply include analyzing changes in design and administration and, in many cases, implementing revised election procedures and obtaining payment elections. If you or your company use nonqualified deferred compensation arrangements, it is important that you consult with your tax advisor about the steps that must be taken prior to the end of the year to bring the arrangements into compliance.

Franchise Tax Relief

Governor Kathleen Sebelius recently signed legislation that will

phase out the Kansas Franchise Tax over the next five years. The legislation will provide tax relief for corporations, limited liability companies, limited partnerships and limited liability partnerships registered to do business in the State of Kansas.

These new amendments to the current law phase out the franchise tax over a five-year period, beginning with increasing the franchise tax exemption threshold from \$100,000 of net worth to \$1 million of net worth for tax year 2007. Additionally, the tax rate will be cut from \$1.25 to \$0.9375 per \$1,000 of shareholder equity or net worth in tax year 2008. The rate will be further reduced in tax years 2009, to \$0.625 per \$1,000, and 2010, to \$0.3125 per \$1,000. The tax is completely repealed effective in tax year 2011.

Did You Know It's Been 70 Years?

Bever Dye, LC is proud of its long history of providing tax and related legal services to individuals and businesses throughout Kansas. The firm is completing its 70th year of business in Wichita.

Built on a strong tradition of service and expertise, Bever Dye, LC was founded in 1937 by Ellis D. Bever, a prominent Kansas attorney who had served his state with distinction. The principal draftsman of the initial Kansas Income Tax Act, Mr. Bever was also the first Director of the Kansas Department of Revenue. He also

served as an attorney with the U.S. Board of Tax Appeals (now the United States Tax Court).

From the beginning, the firm's practice capitalized on Mr. Bever's vast experience, focusing primarily in the areas of federal and state tax law, including tax planning, administrative controversies, and tax litigation. Today, the firm also practices in the areas of estate planning and administration (probate), trust law, employee benefits and ERISA, business organizations, charitable and tax-exempt organizations, business and commercial transactions and real estate.

**WE ARE PLEASED TO ANNOUNCE
THAT WE NOW HAVE ATTORNEYS
LICENSED TO PRACTICE IN
NEBRASKA AND TEXAS.**

Bever Dye, LC
Epic Center
301 N. Main Street, Suite 600
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Best Lawyers

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They are:

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William M. (Bill) Cobb
Jack D. Flesher
R. Chris Robe
Eric J. Larson
Robert M. (Bob) Hughes
Gregory L. (Greg) Franken

Check it out at
www.bestlawyers.com

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*Also licensed to practice in Texas.
**Also licensed to practice in Texas and Nebraska.