

# Right On The Money

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## You Can Learn a Lot from the IRS

By: Paul Mangum



I just love poking around on the IRS website (<http://www.irs.ustreas.gov/>) – don't you? I know, I know – "Get a life!" But, it really does have some interesting stuff, particularly in the "Tax Stats" area. I go there occasionally to try to extract some facts to help me sort out the "dialogue" coming out of Congress. There are tables and tables and tables of statistics. Most of the information is mundane and useless but occasionally you run across some things that make you think.

For instance, you can learn that the estimated population of the U.S. for 2004 was 294.7 million. Another table reveals that for the year ended September 30, 2004 (fiscal year 2003), 130.7 million individual income tax returns were filed. We can learn that there were 51.5 million married filing jointly (MFJ) tax returns filed leaving 79.2 million single person returns filed. We can calculate that the MFJ returns account for roughly 103 million people. So, we can guess that the 130.7 million returns account for about 182.2 million people. That leaves approximately 112.5 million people, or approximately 38% of the population, that didn't file a tax return. Of course, many of these are kids. There are also, unfortunately, many people who simply don't have enough income to file. But, however you slice it, that's a lot of people that don't file income tax returns.

What can we learn about the 182 million or so people that filed returns? There were 128.6 million individual returns filed with positive adjusted gross income. The table below shows the relationship of tax paid to income level.

	Number of Returns*	Percent of Total Returns	Percent of Total Tax Paid
\$30,000+	62.7	48.1%	96.2%
100,000+	11.4	8.8	63.7
200,000+	2.5	1.9	41.9
1,000,000+	0.2	0.1	17.7

\* In Millions

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By contrast, the bottom 75% of returns, about 96.6 million returns, paid 16.6% of individual income taxes.

Let's take a look at an area that is getting a lot of political dialogue and press – estate taxes. As you are aware, many in Congress favor repeal of the tax altogether. Others vigorously and passionately oppose repeal. What's at stake? Well, in fiscal 2005, estate tax collections totaled \$23.6 billion. That sounds like real money. However, this is only 1.0% of total IRS collections. Individual income taxes, at \$1.1 trillion (or 48.9%), are by far the largest single source of tax revenues. Employment taxes are next at \$771.4 billion. Corporate income taxes contribute less than one third of the individual income tax amount or \$307 billion.

Here's a stat that might be of some interest – the number of full time IRS employees peaked at 116,673 in 1992. Since then it has more or less steadily declined so that for fiscal 2005, it stood at 94,269. Does that indicate anything about your chances of being audited? Probably not. However, as you might expect, there are some statistics available that may be more revealing. Of the 130 million individual returns filed for 2003, slightly more than 1.0 million were examined or 0.77%.

Interestingly enough, the single largest category of individual return examination were returns with “total positive income” of less than \$25,000! Just over 245,000 of these returns were examined. This probably reflects an emphasis on suspected cheating with respect to the Earned Income Credit. Which is understandable given that 21.9 million returns were filed in fiscal 2005 claiming a total of \$39.7 billion dollars (yes, that's a “b”) of the credit.

It is also somewhat surprising to observe that a return with Schedule C (sole proprietor income) gross income of less than \$25,000 was more than twice as likely to be examined as one with gross receipts in excess of \$100,000. This may be a reflection of the IRS belief that there is an enormous amount of income that simply goes unreported. Finally, there were only slightly more than 7,000 Schedule F (farm and ranch income) returns examined.

Let's see, what else? Texans filed 9.4 million individual tax returns in fiscal 2005, second only to California. However, we were third in total individual income taxes paid behind California and New York. Those three states account for slightly more than one fourth of all individual income taxes paid in the U.S. Looking for seclusion? Try Wyoming - there were only 243,000 individual returns filed there.

A couple of final tidbits. You know the boxes at the top of your tax return where you can designate a dollar or two to the Presidential Election Campaign fund? Would you believe that in fiscal 2005 \$53.3 million dollars were collected for this?! I don't think I've ever seen a return where a client made this election. Did you also know that you can also make a voluntary contribution to reduce the public debt? In fiscal 2005, a whopping 48 such contributions were made. How much was the debt reduced? Are you ready? Sitting down? \$21,179. I know I'll sleep better tonight.

*Personal update:* Is it just me or is it hot this summer? We traveled again to northwest Montana in early July. We fortunately escaped the heat for a (much too brief) moment.

## Dates To Remember



By: Sandra Beltran

### August 2006

**Special Dates**  
None

**Office Holidays**  
None

**Tax Due Dates**  
None

### September 2006

**Special Dates**  
September 4 – Labor Day  
September 10 – Grandparents Day  
September 23 – First Day of Autumn

**Office Holidays**  
September 4 – Labor Day

#### **Tax Due Dates**

**September 15**  
*Individuals*  
Make a payment of your 2006 estimated tax if you are not paying your income tax for the year through withholding. Use Form 1040-ES. This is the third installment date for estimated tax in 2006.

*Corporations*  
File a 2005 calendar year income tax return (Form 1120 or 1120-A) and pay any tax, interest, and penalties due. This due date applies only if you timely requested an automatic 6-month extension.

*S Corporations*  
File a 2005 calendar year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic 6-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) or a substitute Schedule K-1.

*Corporations*  
Deposit the third installment of estimated income tax for 2006. A worksheet, Form 1120-W, is available to help you estimate your tax for the year.

### October 2006

**Special Dates**  
October 9 – Columbus Day  
October 31 - Halloween

**Office Holidays**  
None

#### **Tax Due Dates**

**October 16**  
*Individuals*  
If you have an automatic 6-month extension to file your income tax return for 2005, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, and penalties due.

*Partnerships*  
File a 2005 calendar year return (Form 1065). This due date applies only if you were given an additional 6-month extension. Provide each partner with a copy of Schedule K-1 (Form 1065) or a substitute Schedule K-1.

## Texas Franchise Tax Revision

By: Sandra E. Schieffer



For many years we have advised clients how to structure new entities doing business in the Texas to minimize their Texas franchise tax. During that same conversation we frequently told them that we expected changes to the existing law which could eliminate some or all of those structural advantages.

The long promised changes to that law finally passed with House Bill 3 signed by Governor Perry on May 18, 2006. This bill does provide business tax reform along with the largest property tax cut in the state's history. Many entities formerly structured to avoid the state's franchise tax will now be subject to the tax.

The new tax replaces the current franchise tax effective for franchise tax reports due on or after January 1, 2008. Thus an entity's structure and financial results for years beginning in 2007 will determine its liability under the revised tax system.

The tax applies generally to entities with statutory liability protection including general and limited partnerships, corporations, limited liability companies, business associations and trusts, joint ventures and professional associations. Sole proprietorships and certain specific types of partnerships and trusts remain exempt from the tax.

The revised tax base is no longer based upon federal taxable income as adjusted but the entity's "taxable margin". Margin is defined as the lesser amount of three calculations, revenue minus cost of goods sold, revenue minus compensation, or revenue times seventy percent. The entity's margin is then taxed at one percent for all entities except for those entities primarily engaged in retail and wholesale trades and eating and drinking establishments which will be taxed at a rate of one half of one percent. In addition, there are special rules that exempt certain revenues received by health care providers.

Taxable entities with revenues of less than or equal to \$300,000 are exempt from the tax. In addition, if the computed tax liability is less than \$1,000 the entity is exempt from margin tax.

The new margin tax will most certainly require that revenues and expenditures are properly classified to correctly calculate the tax. It also is going to require that entities review their current operations to determine what is included in revenues and expenses and may require modifications or changes in order to minimize the margin tax.

We're ready to help you minimize this tax. But you must act well before year end 2006 to be sure your records are straight for 2007.

*Personal update:* John and I have been busy with family since April 15. At the end of May we celebrated our youngest son's high school graduation. In June we spent a week in Maui joined by our children and their families, which was absolutely wonderful, and in July we celebrated the marriage of our oldest son.



## **The Five Worst Retirement Planning Mistakes**

By: Don A. Pace

What should you avoid in your retirement planning? We've seen them all, but here are the five worst mistakes.

### **Insufficient Savings**

Your retirement nest egg is the key to your success. Today, this means that you must save as much as you can, as early as you can. It is impossible to make up for the failure to save. Time is your most important asset when looking for growth of your retirement savings and the earlier you begin the more time you will have. Begin today regardless of your age, or the amount you can save.

Another reason to save early and often is that your retirement years may be longer than you can imagine. The average 65 year-old man has a 28% chance of living to 90; a woman 41%. More than half of the time one of them will live to 90.

### **Insufficient Cash**

Even in retirement you will need an emergency fund. It will provide a cushion in case of the unexpected. Having cash means you can avoid selling equities after a big market decline. Keep at least three years of withdrawals in cash or bonds.

### **Insufficient Diversification**

Investing entirely in any one asset class, equities or bonds, CDs or real estate, can wreck your financial future. Use any of the commonly available asset allocation questionnaires to see what your allocation should be. Remember, you are likely to live twenty or more years in retirement so you need growth to offset inflation and maintain purchasing power.

Whether you will run out of money is very closely tied to your asset allocation and withdrawal rate. For example, over a 25-year period, a 6% withdrawal rate will affect the portfolio as follows:

75% equity allocation will keep you in funds 60% of the time.

25% equity allocation will work only 22% of the time.

Diversify your portfolio over markets (US and international), large and small companies, and eliminate concentrations in single stocks. This will fortify your portfolio against excessive losses. Better yet get a professional investment advisor (we're available!) to look at your portfolio and recommend changes. After all you can't afford any mishaps at this stage in your life.

### **Underestimating Health Care Costs**

Sure Medicare will cover a lot of health care expenses. A Medicare supplemental plan may pick up even more of your costs. However, prescriptions, dental care and eye exams may be a big part of your budget in retirement. The more health issues you have the higher your costs may be. So, don't underestimate these costs in your retirement budget.

### **Spending on the Fly**

Once you are retired and on a fixed income, controlling expenses is your biggest concern. Sit down and develop a realistic budget. Once done, your job is to keep your expenses in line with your budget. Don't spend on the fly.

One last thought: be sure to plan what you will do in retirement. Develop the hobbies or interests that will keep you occupied and make your non-working years enjoyable. Good luck and smooth sailing.

*Personal update:* In July, my family and I enjoyed a week in Colorado and, later, a week in Alaska. The cooler weather was a welcome break.



## Did You Ever Wonder?

By: Michelle Mobley

- **Did you ever wonder why dimes, quarters and half dollars have notched edges, while pennies and nickels do not?**

The US Mint began putting notches on the edges of coins containing gold and silver to discourage holders from shaving off small quantities of the precious metals. Dimes, quarters and half dollars are notched because they used to contain silver. Pennies and nickels aren't notched because the metals they contain were not valuable enough to shave.

- **Why do X's at the end of a letter signify kisses?**

In the Middle Ages, when many people were unable to read or write, documents were often signed using an X. Kissing the X represented an oath to fulfill obligations specified in the document. The X and the kiss eventually became synonymous.

- **Why is shifting responsibility to someone else called "passing the buck"?**

In card games, it was once customary to pass an item, called a buck, from player to player to indicate whose turn it was to deal. If a player did not wish to assume the responsibility, he would "pass the buck" to the next player.

- **Why are people in the public eye said to be "in the limelight"?**

Invented in 1825, limelight was used in lighthouses and stage lighting by burning a cylinder of lime which produced a brilliant light. In the theater, performers on stage "in the limelight" were seen by the audience to be the center of attention.

- **Why is someone who is feeling great... "on cloud nine"?**

Types of clouds are numbered according to the altitudes they attain, with nine being the highest cloud. If someone is said to be on cloud nine, that person is floating well above worldly cares.

*Personal update:* Late last summer, my husband and I built a new home in the Boerne area. We are truly loving the beautiful Texas hill country as well as raising our girls in a small community.

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### Estate Tax Legislation:

Congress is still considering a dramatic change in the estate tax laws. The current proposal suggests an eventual \$5 million exemption per person (\$10 million per couple). The current exemption is \$2 million per person and is scheduled to rise to \$3.5 million in 2009. For estates higher than the exemption, the tax rate would be 15%, the same as the current capital gains rate, but far less than the current rate of 46%. Estate tax repeal is a fluid issue. We'll keep you informed.