

# THE GUARDIAN

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## Can America's Pensions Be Salvaged?



I would like to update you on a some recent legislation that passed through Congress as well as in form of you on home office deduction in this newsletter. I invite you to call with any questions and feel free to pass this along to some one you think may benefit from it. I look forward to working with you this tax season. I am al-

ways thank ful for trust ing me with your fi nan cial needs.

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Seeking to avert a melt down and tax payer bail out of tra di tional pri vate pen sion plans, Con gress has passed a comprehensive pen sion re form bill. The mam moth *Pension Protection Act of 2006 (H.R. 4)* not only strength ens tra di tional pen sion plans. It also ex tends and, in some cases, im proves over 20 re tire ment tax-savings ben e fits, many of which tax pay ers had come to ex pect as per ma nent; adds ex tens ive new rules gov ern ing spe cific char i ta ble do na tions; im poses tight er con trols on ex empt or ga ni za tions; and im pacts over a dozen other ma jor tax pro vi sions.

The new law iden ti fies trou bled pri vate pen sion plans, helps sta bi lize them be fore em ploy ers re sort to bank rupt cy and strength ens the Pen sion Ben e fit Guaranty Cor por a tion (PBGC), the pen sion pro vider of last re sort. It uses the tax law to do so by im ple ment ing a tra di tional car rot- and-stick ap proach: al low ing a higher limit on the amount of em ploy er con tri bu tions that are de duct ible while gen er ally re quir ing higher fund ing lev els in or der to con tinue qual i fied plan tax status.

**Impact.** *Some pen sion profes sion als are con cerned that the re form bill could have the un in tended con se quence of en cour ag ing em ploy ers to ter mi nate trou bled plans or re duce ben e fits rather than pay more into their plans to sta bi lize them. If this oc curs, and it snow balls, the en tire tra di tional*

*pen sion sys tem could col lapse leav ing tax pay ers to pick up the bill. Roughly 44 mil lion Amer i cans are cov ered by tra di tional pen sion plans. Most are con cen trated in man u fac tur ing and other non-ser vice in dus tries. Many are se ri ously fi nan cially strapped. As pen sion costs have sky rock eted over re cent years, many em ploy ers have aban doned tra di tional plans for 401(k) and other sav ings plans.*

### Deduction Limits

The new law en cour ages plans to cre ate a fund ing cush ion. Gen er ally, un der cur rent law, an em ploy er is al lowed a tax de duc tion for plan con tri bu tions up to 100 per cent of the plan's cur rent li a bil ity. Con tri bu tions above that amount are sub ject to a 10 per cent ex cise tax.

For plans be gin ning in 2006 and 2007, the new law am ends to in crease the max i mum de duct ible amount to 150 per cent of cur rent plan li a bil i ties. After 2007, de duct ible con tribu tions may be made up to an amount equal to the ex cess of the fund ing tar get, nor mal costs, and a "cush ion ac count" equal to 50 per cent of tar get li a bil ity plus ac count a bil ity for pro jected com pen sa tion in creases over the value of the plan as sets. Plans with 100 or fewer par tic i pants get a break on com put ing ben e fit in creases for highly com pen sated em ploy ees.

### Full Funding

The new law re quires most pen sion plans to be come fully funded over a seven-year pe riod. The tran si tion from cur rent 90 per cent fund ing to 100 per cent full fund ing is grad ual.

**Impact.** *An es ti mated 30,000 pen sion plans are now un der funded and will need to put more money into their plans. The La bor De part ment es ti mates that plans are cur rently about \$450 bil lion un der funded.*

## NEW AND ENHANCED RETIREMENT-SAVINGS INCENTIVES

Although new rules for defined benefit plans account for more than half of the *Pension Protection Act*, the new law also addresses retirement savings held in IRAs, and other defined contribution plans. These provisions affect tens of millions more taxpayers than do the pension rules.

### IRAs and Tax Refunds

Taxpayers will have more options when it comes to depositing their tax refunds. Under the new law, taxpayers can direct the IRS to deposit their refund into an IRA.

*Reminder. In May, the IRS announced that taxpayers will be able to split their refunds and deposit them into as many as three different bank accounts.*

### Direct Plan-to-Roth IRA Roll overs

Effective for distributions after December 31, 2007, the new law will allow direct roll overs from a qualified retirement plan, tax-sheltered annuity, or governmental plan directly to a Roth IRA and will treat it as a Roth conversion if all other conversion qualifications (e.g., income below the \$100,000 level before 2010) are met.

### EGTRRA 2010 Sunset Eliminated

The major Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) retirement provisions that would be made permanent rather than sunset at the end of 2010 include:

- Permanent higher dollar amount for IRA contributions (\$4,000 starting in 2006, \$5,000 in 2008, in inflation adjusted thereafter)
- Permanent higher dollar limits on defined contribution plans (\$44,000 in 2006), elective deferrals (including \$15,000 in 2006 for 401(k) plan deferrals), 457 plan deferrals (\$15,000 in 2006), SIMPLE plan contributions (\$10,000 in 2006) and compensation that may be taken into account under a plan;
- Permanent increases in the annual benefit limit under a defined benefit plan (\$175,000 for 2006);

- Permanent catch-up contributions for older workers (\$1,000 after 2005 for IRAs, \$2,500 for SIMPLE plans, \$5,000 for 401(k) plans);
- Permanent faster vesting of employer matching contributions (full vesting under three- or six-year schedules);
- Permanent greater portability for 403(b) and 457 plans;
- Permanent higher deductible amounts for employer contributions to employee retirement plans (inflation-adjusted to \$220,000 in 2006; 25-percent compensation deduction limit for stock bonus and profit sharing plans);
- Permanent Roth 401(k)s and 403(b)s;
- Permanent start-up tax credit for new small employer-sponsored plans (maximum \$500/year for each of the first three years);

### Saver's Credit

Unlike the other EGTRRA provisions that were to sunset at the end of 2010, the Saver's Credit would have ended very soon, in tax years beginning after December 31, 2006. The new law makes the Saver's Credit permanent. Under this provision, lower- and middle-income taxpayers can claim a nonrefundable tax credit for their contributions or deferrals to retirement savings plans and IRAs.

*Impact. The credit amount is equal to the credit rate (50, 20, or 10 per cent) times the dollar amount of qualified retirement savings contributions for the year (not to exceed \$2,000), based on income and filing status.*

As an enhancement to the Saver's Credit, the new law provides that the adjusted gross income amounts used to figure the amount of the credit will be adjusted for inflation starting in 2007.

### CHARITABLE DONATIONS

The *Pension Protection Act* tightens the rules for donations of cash, clothing, household items, and other items. At the same time, it also allows - for the first time - direct, tax-free contributions of IRA proceeds to charities.

### Clothing and household goods

Under the new law, no deduction is allowed for used clothing and household items unless the items are in "good condition." This change is effective after the date of enactment. There is a limited exception for donated single items appraised at more than \$500.

*Impact. The new law does not define "good condition." An earlier draft of this proposal directed Treasury and the IRS*

**Nicholas says... Have you ever noticed that if you put the words "the" and "irs" together, it spells "theirs?"**

to prepare an annual list identifying various items of clothing and household goods and their values. That direction was left out of the final version.

**Impact.** Household items include furniture, furnishings, electronics, appliances, linens, and similar items. Food, paintings, antiques, objects of art, jewelry, gems, and collectibles are not household items.

### Cash

In a major change, no deduction is allowed for any contribution of cash, check or other monetary gift unless the donor can show a bank record or a written communication from the charity indicating the amount of the contribution, the date the contribution was made, and the name of the charity.

**Impact.** Charities will likely be spending more time and money on administrative duties to make sure that every taxpayer who wants a receipt receives one, regardless of the amount of his or her donation.

### IRAs

Under the new law, taxpayers will be able to make tax-free distributions from IRAs for charitable purposes through December 31, 2007. The maximum annual cap is \$100,000.

**Impact.** This treatment applies to traditional and Roth IRAs. No charitable deduction, however, will be allowed for any portion of these with drawals that would have been otherwise taxable.

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## Mama's Favorite Recipes

### POLLO DI LUCIA

3 pounds skinless chicken thighs  
1 cup white wine  
2 tablespoon chopped rosemary  
2 tablespoon chopped sage  
3/4 tablespoon salt  
1/2 tablespoon pepper  
3/4 teaspoon nutmeg  
1/2 stick cinnamon  
1 tablespoon Tabasco  
2 cloves  
8 whole garlic cloves  
2 tablespoons chopped ginger  
1 tablespoon parsley  
3 green bell pepper, broiled peeled and cut in julienne strips  
2 carrots, peeled, diced  
2 onions, sliced  
1/2 cup olive oil  
2 pound white button mushrooms, cut in quarters  
3 cups rice, cooked al dente (preferably Arborio)  
1/4 teaspoon saffron or turmeric



Marinate the chicken in the wine, with 1 tablespoon of rosemary and 1 tablespoon of sage for a minimum of 1 hour.

Preheat oven to 400°.

Drain the chicken from the marinade, discard the marinade.

In a large stainless steel bowl, mix together the chicken, salt and pepper, nutmeg, cinnamon, Tabasco, cloves, garlic cloves, ginger, rosemary, sage, bell peppers, carrots, onions, olive oil and mushrooms.

Place all ingredients in a baking casserole with the chicken on top and bake covered at 375° for 1 hour. Take the chicken out of the casserole and set aside. Mix the rice with all the ingredients and juices in the casserole, add the saffron diluted with 2 tablespoons of water to the rice mixture and mix well.

Place the chicken on top of the rice and return to the oven and cook for 15-20 more minutes at 350°.

# Tax Increase Prevention And Reconciliation Act Highlights

The Tax Reconciliation Act impacts a broad cross-section of taxpayers. The new law extends the controversial dividend and capital gains tax rate cuts for two more years beyond 2008, gives taxpayers some immediate relief from the alternative minimum tax (AMT), extends small business expensing thresholds, and allows high-income taxpayers a Roth conversion opportunity. Moreover, it makes over 20 other significant changes.

## AMT RELIEF

**Higher AMT exemption amounts.** Through December 31, 2006, taxpayers will be able to take advantage of higher AMT exemption amounts. The AMT exemption amount for married couples filing jointly is \$62,550 and for single taxpayers is \$42,500.

**Impact.** *Without this 2006-only retroactive relief, an additional 15 million taxpayers, many of them middle class, would be subject to the AMT. Congress will have to face similar “dire consequences” again for 2007.*

**Comment.** *The Working Families Tax Relief Act of 2004 extended the higher AMT exemption amounts through December 31, 2005, but at lower levels (\$58,000 for married couples filing jointly and \$40,250 for single taxpayers).*

**Nonrefundable personal credits.** The Tax Reconciliation Act extends through 2006 the provision allowing taxpayers to use nonrefundable personal credits to offset AMT liability. Nonrefundable personal credits include the dependent care credit, the credit for the elderly and disabled, the credit for interest on certain home mortgages, the Hope credit for certain college expenses and the Lifetime Learning credit.

## DIVIDEND AND CAPITAL GAINS RATE CUTS

In 2003 Congress lowered the maximum dividend and capital gains tax rates - for most, but not all, dividends and capital gains - to 15 percent for qualifying taxpayers. Taxpayers in the 10- and 15-percent tax brackets are eligible for an even lower rate of five percent. In 2008, the rate for taxpayers in the 10- and 15-percent tax brackets falls to zero. As originally enacted, these tax rate cuts were temporary. They were scheduled to expire at the end of 2008.

The Tax Reconciliation Act extends the cuts for two more years through December 31, 2010.

## CAPITAL GAINS

**Self-created musical works.** The Tax Reconciliation Act allows taxpayers to elect to treat the sale or exchange of self-created musical compositions or copyrights as the sale or exchange of a capital asset. This special treatment is effective for sales or exchanges in tax years beginning after the date the President signs the new law and before January 1, 2011.

**Caution.** *Despite some initial proposals to lower the capital gains tax rate on collectibles, the final bill leaves the current 28-percent tax rate on collectibles unchanged.*

**Amortization of song rights.** In a related music-industry development, the Act permits a taxpayer that puts any musical composition or musical copyright into service to elect to use the five-year amortization period for certain expenses paid or incurred with respect to all musical compositions and musical composition copyrights placed in service in that tax year.

## SMALL BUSINESS EXPENSING

Since 2003, Congress has enhanced small business expensing under several times to encourage business investment. The Tax Reconciliation Act continues this special treatment. The enhanced small business expensing thresholds in the *American Jobs Creation Act of 2004* are extended through December 31, 2009.

The maximum amount a taxpayer may expense is \$100,000 of the cost of qualifying property, reduced by the amount by which the cost of qualifying property exceeds \$400,000. Both amounts are indexed for inflation for tax years beginning after 2003 and before 2010. These amounts are increased for Gulf Opportunity Zone property. For 2006, the regular amounts are \$108,000 and \$430,000, respectively.

## CHANGES TO ROTH IRAS

The Tax Reconciliation Act eliminates the \$100,000 adjusted gross income ceiling for converting a traditional individual retirement account (IRA) to a Roth IRA, for tax years after 2009. A conversion is treated as a taxable distribution, but is not subject to the 10-percent early withdrawal penalty. Taxpayers who convert in 2010 can elect to recognize the conversion income in 2010 or average it over the next two years.

## OFFERS-IN-COMPROMISE

The Tax Reconciliation Act increases the amounts that must be paid by tax payers submitting an offer-in-compromise. Under the new law, tax payers are required to make partial payments of their liability in addition to any user fee now imposed by the IRS; however, the user fee will be applied to the outstanding tax liability. For a lump sum offer, tax payers will pay 20 percent of the amount offered. For an installment payment offer, tax payers will make their proposed scheduled payments while the IRS considers the offer. If the IRS fails to process the offer within two years, the offer will be deemed to be accepted.

## KIDDIE TAX

The kiddie tax rules require that a child's unearned income, such as dividends and interest, be taxed at the parents' tax rate, which is usually a higher rate. Under current law, the kiddie tax applies if the child is under age 14, the child has net unearned income over \$1,700, and the parent can claim the child as a dependent. The Tax Reconciliation Act raises the age limit to under 18.

**Impact.** *This provision is effective immediately, for the entire 2006 tax year. Parents who had planned to sell a child's college stock portfolio after age 13 and before entering college have no opportunity now to accelerate that planning technique if the child is over 13. If the family was planning to postpone a sale until 2008, when the top rate for capital gains would be zero, that's a loss of 15 percentage points on the tax otherwise not due on the sale of stock or other portfolio assets.*



## IRS Scrutinizes Home Office

Commuters are getting longer with more Americans than ever leaving home at 5 a.m. to 6:30 a.m. to beat the traffic. The number of workers who drive more than an hour to work rose more than 50% from 1990 to 2000, a recent study by the Transportation Research Board found.

One way to escape gridlock is to work from home. The home-office deduction lets you deduct a portion of your mortgage interest or rent, utilities, insurance and even repairs to your home.

In a September fact sheet, the IRS said that understated business income and overstated business expenses are "areas where compliance is a concern." Translated, that suggests you're more likely to be audited if you claim the home-office deduction.

Not every one who works at home is eligible to claim a home-office deduction. You must meet some fairly rigorous IRS requirements.

If you are an employee of a company, you can't claim the deduction unless you work at home at the convenience of your employer. People who work from home because their employers don't want to provide them with office space are eligible to deduct some of their home-office expenses. If your employer does provide you with an office or a cubicle, you don't qualify, even if you work from home most of the time.

Once you determine to be eligible for the deduction, the home-office expenses are categorized as miscellaneous expenses on Schedule A and must exceed 2% of your adjusted gross income (AGI) before you can take advantage of them.

If you are self-employed, your deductions are on Schedule C and the home-office must be used "exclusively and regularly" for business. Ideally, your home office should be a separate room that is not used for anything else but could be a desk in your bedroom if you have no other extra space available. Figure out what percentage of your home is used for business by estimating the home office area vs. the total area of the home.

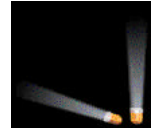
Other deductible expenses include:

- A second phone line that is exclusively used for business and long distance phone calls made for business purposes are deductible.
- A portion of repairs that benefit your entire home, such as a new roof. Improvements that have nothing to do with your business - such as a pool or hiring a gardener are not deductible.

Keep mortgage statements and bills for property tax, utilities, telephone, repairs, etc. to substantiate the deduction. If you meet with clients at your home office, keep a log showing the days they were present. Take photos of your work area.

# Client Spotlight

## Noni Biotech, LLC



David Backstrom, N.D. is the president of Noni Biotech, LLC. For over 15 years, David has created a company that is helping thousands of people every day. He and his wife, Marie, worked out of their home selling noni products online until September 22, 2006 when they opened their doors with a Hawaiian Blessing to their newly remodeled office and laboratory. David made a very touching speech during the ceremony. He said, "This was not a dream. It was a vision. A vision for many years to help others and open noni production centers all over the world."

Noni or *morinda citrifolia* has been used for thousands of years in the traditional healing practices of native Hawaiians and other Asian cultures. It was used to treat ailments ranging from sore throat to tuberculosis. Now it is used in mainstream holistic medicine.

Success in business, as defined by many entrepreneurs, means identifying that unique opportunity or gap in the market and being bold enough to move quickly and fill it.

David and his team of doctors set out to research the properties of noni that have so many health benefits.

Although all has not always gone well, David Backstrom and his team have achieved impressive milestones to date:

- Zero toxicity report
- EU approval for sale in Europe
- Patents to develop new concentrated products
- Published medical study by Conrad Hornick MD on the angiogenic inhibition by noni
- Cancer research studies at the University of Hawaii

The Company's noni capsules are used exclusively for the University of Hawaii's on-going cancer research because David Backstrom is insistent in using only 100% Hawaiian noni grown organically, harvested and processed using Hawaiian traditional methods. This insures "grade A" purity and potency. No fillers such as seeds, stems, leaves or bark are used thus the product has higher amounts of the active compounds responsible for some of noni's proposed health benefits.

Although the cost of Hawaiian noni products may be more than those sold by its competitors, David Backstrom thinks it is worth it. "We could make more money by diluting the products but then we wouldn't help people. You have to stick to your principles. Integrity is all you have at the end of the day. It is important for your people to see consistency and how you apply your principles."

The testimonials are amazing and numerous. One on their website states, "I am a 75 year old woman who has smoked for 40 years. I suffer from heart disease, high blood pressure and had trouble breathing. I have been on Noni Maui's program for a year and a half and my blood pressure has normalized, I lost weight and can breathe without difficulty."

Noni Biotech's management team and investors share David Backstrom's vision. If you would like to learn more about their products and possible investment in the company, contact David Backstrom at **808-575-9100** or visit **[www.nonimaui.com](http://www.nonimaui.com)**.

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