



DYER & ASSOCIATES, P.C.

Certified Public Accountants

10415 Armory Avenue

Kensington, MD 20895

(301) 654-6200 FAX: (301) 692-1990

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Client Information Bulletin

INSIDE

**Stake Your Tax Claim
To History**

**What Are the Privacy
Rights at Work?**

**When You Sell
Items Online**

**A Question of Balance:
Managing a Portfolio**

Facts and Figures

Set Your Alarm Clock for the AMT

Heed wake-up call on alternative minimum tax

Originally, the alternative minimum tax (AMT) was aimed at only the most affluent taxpayers. But that's not the case anymore. In fact, this "stealth tax" may eventually become the regular tax regime for the majority of middle- and upper-income taxpayers. If you have been lulled to sleep by the AMT thus far, it is time to sit up and take notice.

How it works: The AMT runs on a separate track beside your regular tax liability. After you have figured out your regular taxable income, compute your AMT liability by following these four basic steps:

1. Add certain tax preference items to your taxable income and make other technical adjustments required by law.
2. Subtract from this figure a special exemption amount based on your filing status.
3. Apply the AMT rate to the net amount. For the 2006 tax year, the applicable rate is 26% on the first \$175,000 of AMT income and 28% for amounts above \$175,000.
4. Compare your AMT liability with your regular tax liability. If the AMT is higher, you are required to pay the excess in addition to your regular tax liability.

The list of preferences and technical adjustments is a long one. Suffice it to say that the AMT computation requires you to add back certain itemized deductions and personal exemptions. That is one of the reasons why more taxpayers have become unintentional victims of the AMT.

There have been several highly publicized cases where couples with many dependents have been hit by the AMT, despite having relatively low incomes. Furthermore, taxpayers who reside in states with high-income tax rates and make high mortgage interest and property tax payments are likely to encounter AMT problems.

Another reason for the increase in AMT-paying taxpayers is inflation. Although Congress has tinkered with the exemption amounts in recent years, the tax relief has been minimal. For the 2006 tax year, the exemption amounts have been slightly increased to \$62,550 for joint filers and \$42,500 for single filers.

What's more, the new **Tax Relief and Health Care Act of 2006**, which extended numerous other expired tax provisions, did not extend the higher AMT exemption amounts. The issue of greater AMT relief, including the possibility of outright repeal, is currently being debated in Congress. Nevertheless, as of this writing, the amounts for 2007 are scheduled to revert to their pre-2001 tax act levels of \$45,000 for joint filers and \$33,750 for singles.

Even worse, the AMT exemption amounts are phased out for high-income taxpayers. Each exemption is reduced by 25 cents for each dollar of AMT income over \$150,000 for joint filers; \$122,500 for single filers and heads of household; and \$75,000 for married couples filing separately. These figures have not been adjusted in recent years.

Caution: *The AMT calculations are not for the faint-of-heart. It is generally best to rely on professional expertise in this area.*

Stake Your Tax Claim to History

How to qualify for historic structures credit

Do you own investment property in an historic part of town that you are planning to renovate? Before you start ripping the place apart, investigate the rules for the historic structures credit. If the building qualifies, you can claim a tax credit—a dollar-for-dollar reduction of your tax bill—equal to 20% of the renovation cost.

Tax-savvy investors may note that the tax credit for restoring historic structures is double the usual 10% tax credit for rehabilitating older buildings. In effect, the federal government is discounting one-fifth of the cost of the work. For example, on a renovation costing \$500,000, you can cut \$100,000 right off the top of the bill.

Background: A taxpayer is able to claim the traditional rehabilitation tax credit for renovating a building placed in service before 1936. The work must be substantial in nature (i.e., expenses over a two-year period must exceed the greater of \$5,000 or the adjusted basis of the building and its structural components). In addition, the rehabilitation work must meet specific wall-retention requirements. Finally, a certified historic structure must be listed by the taxpayer before the rehabilitation work has begun.

Qualified rehabilitation expenses include architectural and engineering fees, site survey and development fees, legal expenses and other construction-related costs—as long as they are added to the property's basis, reasonable in amount and related to services performed.

The tax rules for the historic structure credit are comparable with the rules for the traditional rehabilitation credit. **Key tax differences:** For starters, the percentage for the historic structure credit is doubled. Also, the requirements generally are not as stringent. For instance, there are no age or wall-retention restrictions.

However, you must meet two additional requirements for the historic structure credit:

- ❖ The building must be listed on the National Register of Historic Places or located in a registered historic district and certified by the Secretary of the Interior as being historically significant.
- ❖ The rehabilitation must also be certified. This means the finished product must retain the original historic character (but not necessarily the original use) of the building.

More buildings will qualify for this tax break than you might think. The National Register of Historic Places currently lists over 80,000 locations that are eligible for the credit.

Caveat: *The owner of an historic building must hold it for at least five years after completion of the rehabilitation work or pay back all or part of the historic structure credit. Be wary of this special recapture provision when your crew begins the work.*

What Are the Privacy Rights at Work?

Employers may use technology to monitor employees

Employers have expectations that workers will not spend an inordinate amount of time on personal matters at the workplace. After all, they are supposed to be there to “do work.” On the other hand, employees do not want “Big Brother” looking over their shoulder every single moment. As you can well imagine, these diametrically opposed points of view can result in conflicts.

To compound the problem, technological advances are bringing privacy issues to the forefront at many companies. Employers may now monitor employee communications from the water cooler to the Internet. What is legal? Although the federal law is still evolving, employers are usually free to watch and listen to most work-related activities. The following are some general guidelines concerning privacy in the workplace.

Telephone monitoring: Under the Electronic Communications Privacy Act, employers generally can monitor calls for business purposes. For instance, an employer may record customer service calls for quality control. However, there is a limited exception for calls of a personal nature. When the employer’s representative realizes that a particular call is personal, he or she must stop monitoring the conversation. On the other hand, if employees have been properly notified about the company’s policy of monitoring all calls from its telephones, they run the risk that even personal calls may be monitored.

Computer monitoring: An employer may use computer software that enables managers to view what is on an em-

ployee’s computer screen or what is stored on its hard drive. Furthermore, the employer may monitor Internet functions such as Web-surfing and personal e-mails. More sophisticated software can monitor the number of keystrokes at each terminal.

Another program enables employers to track the time spent away from the computer as “idle time.” As a general rule, such computer monitoring is permitted, although it has been argued in some instances that the action violates the Fourth Amendment prohibition against unreasonable search and seizure.

Electronic/voice mail monitoring: If an e-mail system is used at work, the company owns it, and, therefore, is generally allowed to access it. Interoffice messages, as well as e-mail sent to or from outside sources, are also subject to scrutiny. The basic rules extend to “instant messaging” via Web-based e-mail accounts. Similarly, employers have relatively unencumbered access to voice-mail messages. The courts have generally sided with the employers when employees have alleged invasion of their privacy rights.

Note: An electronic or voice-mail system may even retain messages in its memory after they have been deleted. The communications may be restored through backups on magnetic tape.

Of course, employers may choose to preserve some privacy for employees through encryption, which scrambles the message so that only the reader and the recipient have access to it. Finally, be aware that some state laws may offer greater protection than the existing federal law.

***Final word:** Although the law is still cloudy in this area, this much is clear: Employees should remain on guard and keep personal matters to a minimum. Employers can do their part by exercising their authority judiciously.*

When You Sell Items Online

Rather than discarding old items in the trash, you might try to sell them on a prominent Web site. What are the tax consequences? It depends.

If you sell personal items, you do not have to pay tax on those wares if they are sold at a loss. This is frequently the case for occasional online sales. Since you are not required to report the income, you cannot deduct your personal losses either.

On the other hand, it's a different story for sales resulting in a profit. In general, your taxable gain is the difference between the selling price and your basis in the property (usually, your original cost). The gain is generally taxed as a capital gain (i.e., a maximum tax rate of 15% applies to property held longer than one year). Furthermore, do not forget about potential state taxes.

If you are running a full-fledged business online, taxable income from sales may be offset by deductions for "ordinary and necessary" business expenses. Consult with a professional tax adviser for more details.

A Question of Balance: Managing a Portfolio

Investment techniques for your future

Do you need to “rebalance” your investment portfolio? This is the process of restoring the appropriate percentage levels for the different asset classes. Rebalancing is often required after a significant change due to economic conditions or other circumstances.

Probably the best way to explain rebalancing is to consider an example. Be aware that the figures described below are strictly hypothetical and are being used for illustrative purposes only. The actual percentages and types of investments you choose for your portfolio may differ.

Typical scenario: You have determined that your portfolio should be divided as follows based on your time horizon, risk tolerance and investment objectives. For simplicity, we will assume that you have \$100,000 to invest.

Stocks (60%)	\$60,000
Bonds (35%)	\$35,000
Cash (5%)	\$5,000
Total	\$100,000

Due to a few astute selections, your stocks have grown in substantial value since your original investments were made. Currently, the allocation is as follows:

Stocks (68%)	\$85,000
Bonds (28%)	\$35,000
Cash (4%)	\$5,000
Total	\$125,000

“What’s wrong with that?” you might ask. “My portfolio has increased in value by \$25,000.” Naturally, that is a good thing, but it has also shifted the allocation of the asset classes you originally established. Now you may be exposed to more risk than you would normally be willing to accept.

Accordingly, you might sell some of the stocks to bring the percentages back in line or invest funds to achieve the proper balance. Tempting as it may seem, to do nothing would run counter to your investment objectives.

Note that rebalancing is not limited to just the major asset classes. You must also try to strike the proper balance within each asset class itself. For instance, again speaking hypothetically, you might have allocated 40% of your stock investments to large-cap growth stocks, 10% to foreign stocks, 25% to utility stocks and so on. (Of course, these percentages will differ for each investor.) A significant change could require you to sell or buy different stocks.

Conclusion: *Develop a basic investment plan and try to stick with it. Then try to examine your portfolio several times during the year. Make changes in the asset allocation as needed. Consult with a financial services professional.*

Facts and Figures

Timely points of particular interest

- **Helping Hand**—If your company is forced to downsize its staff, there are several ways you can help workers get back on their feet. For instance, you might stock the shelves with resume-writing books and supplies, dedicate one or two computer terminals to job-searching, and schedule workshops for improving resumes and correspondence. A huge outlay of cash is not required: Just a little shows your personal interest in the workers' well-being.
- **Mortgage Insurance Premiums**—Beginning in the 2007 tax year, the new Tax Relief and Health Care Act of 2006 allows taxpayers to claim deductions for mortgage insurance premiums. However, there are income limits to this new deduction. Specifically, no deduction is allowed if your adjusted gross income for 2007 exceeds \$109,000. This new tax break applies to mortgage insurance policies issued after 2006.