

# GRAY CERTIFIED PUBLIC ACCOUNTING, P.C.

## THE GRAY REPORT

Winter 2006

*"The only thing that hurts more than paying an income tax is not having to pay an income tax." -Thomas R. Dewar*



# Its Tax Time!

ranging from the type of securities you buy to the amount of money you want to put into tax-advantaged accounts. People who buy tax-free municipal bonds, for example, pay no federal taxes on the interest they earn. But because municipal bonds carry a lower interest rate than a comparable taxable security, people need to do some arithmetic to figure out if their tax rate is high enough to make the muni a better deal.

Right now, while you are working on your 2005 returns with us, is the optimum time to plan for 2006's income taxes.

Your return is a road map to your finances. That is why it is one of the first things which any good financial advisor looks at.

Reviewing your tax return can help with everything from your cash flow and investment strategy to your estate planning. It is a tremendous opportunity to assess your entire financial and personal picture.

And what better time to start than right now when you are knee-deep in your 2005 tax return.

A good way to begin is by figuring out your marginal tax rate, which determines how much of the next dollar you earn will go to Uncle Sam.

This is an important number, affecting investment decisions

The federal tax brackets are adjusted annually for inflation. You can get a good estimate of your situation by looking at taxable income shown on Line 42 of your 2004 Form 1040.

Once you know your top tax rate, go back and see from where your money comes. Most investors can learn a lot by just looking at Schedule B, which shows dividends and interest. Interest is taxed as ordinary income. If there is too much of it, it can be a sign of a tax problem. Is it throwing you into the next bracket? How many dollars is it costing in tax?

If you do not like the answers to these questions, ask yourself whether you really need all that interest income your investments are now producing. If not, it may be time to rethink your portfolio.

We generally counsel against basing investment decisions solely on tax considerations, but taxes are an important factor. Since dividends are taxed at the 15% capital gain rate through 2008, for income tax purposes dividends are preferable to interest, which is taxed at your marginal tax rate.

### The 2005 regular income tax rates are:

Married, Filing Jointly, or Surviving Spouse	
If Taxable Income Is Between:	Your Tax Rate Is:
\$ 0 - \$ 14,600	10%
\$ 14,600 - \$ 59,400	15%
\$ 59,400 - \$ 119,950	25%
\$ 119,950 - \$ 182,800	28%
\$ 182,800 - \$ 326,450	33%
\$ 326,450 - and above	35%

Single	
If Taxable Income Is Between:	Your Tax Rate Is:
\$ 0 - \$ 7,300	10%
\$ 7,300 - \$ 29,700	15%
\$ 29,700 - \$ 71,950	25%
\$ 71,950 - \$ 150,150	28%
\$ 150,150 - \$ 326,450	33%
\$ 326,450 - and above	35%

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# Tax Time

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For instance, shifting some of your money to growth-oriented investments that seek capital appreciation, instead of income from dividends and interest, could cut your tax bill. Although stocks may produce dividend income, gains from increases in share prices are not taxed until the securities are sold. Moreover, long-term capital gains—gains on investments held for more than a year—are taxed at a top rate of only 15% through 2008.



Mutual-fund investors could benefit from studying Schedule B because they often pay too little attention to income and capital gains distributions, especially when those distributions are reinvested automatically in additional fund shares. Funds with a high level of portfolio turnover are particularly likely to generate big taxable distributions, with the biggest payouts typically coming late in the year.

You may decide these mutual funds are just costing too much money. While investors have no control over the size of a distribution, you can look for funds that historically have low distributions. Index funds fit this

description, as do a growing number of funds that are managed specifically for low tax impact, called tax-managed funds.

Other ideas for cutting taxable income? Make sure you are taking full advantage of retirement plans, such as individual retirement accounts and 401(k) plans, which allow you to invest pretax dollars and produce income that is tax-deferred. Also, do not overlook company benefits that reimburse you with pretax dollars for qualifying medical and child-care expenses; these are called “flexible spending accounts.”

While studying your Schedule B, think about whether your finances are well-organized. If it is two pages or more, you need to ask why. Often, it is simply that you have not taken time to clear away your investment clutter. Consolidation is the answer here. That may mean getting rid of small accounts and small stock positions. Or it may mean merging stocks, mutual funds, and money-market funds into bigger accounts with single year-end reports. Not only does it make things easier at tax time, but it also simplifies matters in the case of death or disability.

While you are at it, take note of who owns what. This can be important for estate planning in families in which assets exceed \$2 million—the amount in any estate that can pass free of federal estate taxes. Spouses inherit each other’s assets free of estate tax, but married couples need to make

sure each spouse has enough separate assets to make use of their own \$2 million exemption. Typically these assets go into a trust for the surviving spouse and eventually pass to the children.

Capital gains and losses from individual stock transactions show up on Schedule D, providing a good opportunity for you to review your investment decisions. Be critical about what you did last year. Many people sell stocks without taking the time to match gains with stock losses already existing within their portfolio.

While thinking about capital gains, take a look at your deductions. If you have been making charitable gifts in cash, consider using appreciated securities instead. With the stock market near record levels, a gift of stock will let you avoid paying any capital gains taxes while still claiming the full market value of the gift.



Folks with college-bound youths can look closer to home for a way to save on capital gains taxes. Rather than taking a gain yourselves, you can give appreciated stocks to your children. Each parent can give a

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# A Quick Look at Disability Coverage

Should you suffer a disability, you need to know where your income will come from. Would you have enough in savings to support yourself and your loved ones during a six-month disability? Do you know someone who would freely lend money to you if you were to become disabled? Perhaps your spouse can provide the necessary income, but the burden of being a spouse, parent, private caregiver, and employee can be overwhelming. If needed, how quickly could you liquidate some of your assets to provide cash?

Keep in mind that Social Security will most likely not replace all of your lost wages in case of a serious illness or

accident. You must be severely disabled to qualify for Social Security disability benefits and, even then, you will have to wait



some time for payments to begin.

The alternative avenues for income are, at best, limited.

You need a source of income on which you can depend. The bottom line is that if you lose your ability to earn income, you can lose everything you own.

Clearly, it may be to your advantage to consider purchasing a **disability income insurance** policy. By planning a disability package that will work for you should you face a loss of earning power, you can help provide financial security that would tend to mitigate the potentially devastating effects of a major accident or long-term illness.

Gray CPA can help you examine your financial position, your expenses, and assist you in determining the efficient way to protect against risk, giving peace of mind to you and your family.

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gift up to \$12,000 (\$24,00 per married couple) a year without creating tax consequences. The youngster can sell the stock, paying taxes at his/her own lower capital-gains rate, and use the money to pay tuition.

Do not forget to include your children's tax forms in your annual review. The structure of their accounts becomes more important as account values grow, since children under 14 are taxed at *your* rate on everything above a set amount of unearned

income. That amount, which is subject to annual adjustment is \$1,700 for 2006. Look at what their asset mix is. Instead of producing income, you might want to invest for more growth.

Finally, your tax return is a good starting place for two basic tools of financial planning—the cash-flow analysis and the net-worth statement. To do either, you need more information than just your tax form, but the tax form can be invaluable in getting started.

For example, your return will give you the annual income you need for calculating your cash flow, but you need to pull out your checking-account statements to figure out how much you spent. Likewise, many of your assets are listed on your tax return, but to do a full net-worth assessment you need to include assets such as cars, collectibles, and other investments that do not show up there.



# GRAY CPA

*A Personal Approach to Accounting*

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**Our website has been refreshed!  
Please visit [www.graycpa.com](http://www.graycpa.com) to learn  
about all of the services we provide in  
addition to tax planning and management!**



### Firm News

Gray CPA welcomes **Daniel J. Nitschke** to our firm. In his new role as a staff accountant, Mr. Nitschke will assist Jeanette and Sheila in our tax department. Dan completed his Bachelor's Degree in Accounting from Alfred University in 2003 and is licensed by the State of New York Insurance Department in Life, Accident, and Health. Dan will improve our technical support in advising our clients regarding insurance proposals.

### CLIENT REFERRAL FORM

Thank You!

We cannot thank you enough for your referrals. It is always nice to be thought of in a positive light by our satisfied clients. If you know of anyone who might benefit from our services, please continue to let us know. You may send or fax this referral form or call us. You can be sure that your referrals will be in very good hands.

Your Name \_\_\_\_\_

Referral Name \_\_\_\_\_

Address \_\_\_\_\_

Address \_\_\_\_\_

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E-mail \_\_\_\_\_

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