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"If you think health care is expensive now, wait until you see what it costs when it's free."

--P.J. O'Rourke

Tax and Financial Strategies

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Wealth Creation Strategies

Requiem for a Bubble

Unsold Inventory Index of Homes in Months Supply **

(Source: California Association of Realtors)

	Feb '04	Feb '05	Feb '07	April '07
Central Valley x-Sacramento	1.5	2.0 (Estimated)	13.8	16.4
Los Angeles	1.4	2.7	10.2	12.1
Orange County	.9	6.1	12.5	22.0
California total	2.3	3.9	8.8	10.0

** Number of months it would take to sell the existing homes on the market given the current rate of sales.

While pins have obviously punctured huge swaths of the real estate bubble, a few isolated areas sport surprisingly strong markets, including Northern Wine Country (2.6 month inventory) and San Francisco (3.5 month supply). However, San Francisco's appreciation of 56% and Northern Wine Country's 94% advance from December 2000 to June 2005 paled in comparison with the 120-200% increases throughout most of California, which might explain the extraordinary reaction in those areas. Yet, it's possible we're nowhere near a bottom.

But Doug, it's already bad. How much worse can it get?

The recent worldwide real estate boom was by every measure one of the great speculative manias of all time. Despite the obvious, critics of the housing bubble thesis argue that demand, based on population growth, will always increase. Yet part of that demand may have been fueled by illegal immigration, which is slowing (and we're at the tail end of the baby boom generation). The larger part of that increase resulted from loose lending practices that gave money to anyone who could fog up a mirror. Demand based on such lending has mostly stopped.

The trouble is, just as prices in a mania became disproportionate to any semblance of economic reality, prices after a bubble bursts tend to go to the other extreme. And while population density and growth seemingly supports the idea that prices can only increase, a look at recent price trends in a few countries with high population density explodes that myth. A comparison of prices and population per square mile between the few countries bypassed by the real estate bubble and the U.S. and, in particular, California should disavow anyone of the notion that property prices only go up because they aren't making any more land.

"Buy land. They aren't making any more of it." –Will Rogers

"Time your purchase carefully. A bust could wipe you out." –Doug Thorburn

	1997-2006 % increase/decrease in house prices	Population per sq mile
USA	70%	81
CA	230%	217
Hong Kong	-41%	18,176
Japan	-32%	830
Germany	No change	612

Lose Your Home to Foreclosure, Pay Tax on a Gain. Huh?

Foreclosure rates are way up and heading far higher. Since many of you (my clients, for those reading this on the Internet) have owned for years and few have bought since prices went parabolic in 2003 (and almost none since I began writing about the real estate bubble in late 2004), you are far less likely to end up in foreclosure than others. However, some have increased their debt through refinancing, ending up with loans greater than the new, lower fair market value. Others have family or friends who recently purchased or used their homes like automated teller machines, increasing the risk of foreclosure or "short sale" in the coming real estate debacle. Adding insult to injury, many succumbing to foreclosure will be shocked to learn they have ordinary income, no offsetting deduction and no cash to pay the resulting tax.

Let's say cousin Bob took out a $500,000 loan on a $500,000 home that may (or will soon) be worth $400,000 (those living outside California can chop 50% or more off these numbers). If Bob loses the house, he is deemed to have sold it for its **Fair Market Value (FMV)** on the date of foreclosure. The problem isn't a profit on the sale, since it sold at a loss; it's that Bob has been relieved of $100,000 in debt. With certain exceptions, Bob ends up with $100,000 of **"Cancellation of Debt Income,"** or **CODI**, which is taxed at **ordinary** (not capital gain) rates and does not qualify for the tax-free sale-of-home exclusion.

Worse, losses pursuant to the sale of one's home are not deductible. Therefore, Bob has a non-deductible loss of $100,000, no tax-free exclusion and CODI of $100,000, the tax on which could easily top $35,000.

If the bank allows a "**short sale**" in which it accepts the $400,000 FMV pursuant to a sale, we get the same result: $100,000 in CODI. The $100,000 loss is still not deductible. Doing the right thing by helping out the lender goes unrewarded.

Losing a Main Home to Foreclosure Can Result in Taxable Income

Loan Amount	$500,000	
Fair Market Value (**FMV**) = Deemed **Sales Price** = Short Sale	$400,000	**CODI** $100,000 (tax could exceed $35,000)
Adjusted Cost Basis	$500,000	Deductible Capital Loss $0

If the home cost only $100,000 and it was used as an ATM until loans against it totaled $500,000, the result is even worse. On the other hand, it should be pointed out that $400,000 was already borrowed income-tax free. (We could ask what happened to those funds, but we won't.)

Gain on One's Main Home, Lost to Foreclosure

Loan Amount	$500,000*	
FMV = Deemed **Sales Price** = Short Sale	$400,000	CODI $100,000
Adjusted Cost Basis	$100,000 *	Capital Gain $50,000 **

* Original cost plus improvements were only $100,000, but it was refinanced and is now encumbered by a mortgage far in excess of the adjusted cost basis.
** $250,000 of the gain is non-taxable if the home was a main qualifying home for which the seller met the two-out-of-five year rule or qualified for an exception to that rule.

The rules for a rental property or 2nd home are more complex, with the potential for convoluted results. If the adjusted cost basis is $250,000, its fair market value $400,000 and the loan amount $500,000, Bob could end up with $100,000 of CODI and a capital gain of $150,000.

Gain on Rental Property or 2nd Home, Lost to Foreclosure

Loan Amount	$500,000	
FMV = Deemed **Sales Price**	$400,000	CODI $100,000
Adjusted Cost Basis **	$250,000	Capital Gain $50,000 **

** How could a property with a loan amount of $500,000 have a cost basis of only $250,000? Three possibilities: (1) cash out from refinancing, (2) depreciation, or (3) a combination of the two.

Stranger still, if the cost basis is instead $440,000, the fair market value is $400,000 and the loan amount is $500,000, Bob could end up with $100,000 of CODI and a partially offsetting loss of $40,000.

Loss on Rental Property, Lost to Foreclosure

Loan Amount	$500,000	
FMV = Deemed	$400,000	CODI
Sales Price		$100,000
Adjusted Cost Basis	$440,000	Ordinary Loss of $40,000*

* Loss on the sale of rental property is not limited to $3,000 per year and is, therefore, "ordinary" or fully deductible. The allowable loss on the sale or foreclosure on a 2nd home is zero.

If the property is partially rented (as in a room rental), partially commercial (a home office in a separate building) or was converted to a rental, the results are even more complex. The first two require a bifurcation of the sale between home and rental, while the third requires that for purposes of taking a loss, the cost basis is the market value of the property on the day of conversion if less than the actual cost basis.

There are several exceptions to the rules requiring recognition of CODI.

1. A main home on which the loan is non-recourse, which means the lender cannot go after the owner for the difference between what is owed and the FMV. These are usually limited to loans taken out to purchase the property (i.e., not a refinanced loan).
2. If the CODI occurs in conjunction with a bankruptcy.
3. If the taxpayer is insolvent, CODI is not income to the extent of insolvency (debt greater than assets). However, for purposes of determining the amount of CODI, insolvency rules are not nearly as generous as bankruptcy rules. This creates a perverse incentive due to an absurd result: a foreclosure pursuant to bankruptcy results in no tax while a straight foreclosure may result in fully taxable CODI.

There are several additional exceptions for farmers, certain hurricane victims, student loans of the "Northern Exposure" variety (doctor works 17,000 miles from civilization in exchange for extinguishing debt), seller-financed loans and other more rare and esoteric situations. While counsel is essential, most will be unaware of a looming tax problem, will not be in a psychological mindset to seek help and won't think they can afford advice. However, anyone at risk for realizing cancellation of debt income—whether via foreclosure or otherwise—cannot afford to go without professional help.

How are Social Security Benefits Taxed?

Since 1984, every dollar of income in excess of a "base amount" of $25,000 for single people and $32,000 for married filers has resulted in the addition of $.50 of Social Security income until 50% of Social Security is taxed. In other words, every dollar of income is taxed as if you earned $1.50 once income exceeds those threshold amounts. This "base" income has never been indexed for inflation.

Beginning in 1994, every dollar of income in excess of $34,000 ($44,000 married) results in the addition of $.85 of Social Security income until 85% of Social Security is taxed. In other words, every dollar of income over these limits is taxed as if you earned $1.85. This, likewise, has never been inflation indexed.

The "base amount" is generally other income plus ordinarily non-taxable municipal interest income plus one-half of Social Security income. Keeping this crazy scheme in mind will help while reading the next two articles.

Additional income over the "base amount" subjects increasing amounts of Social Security income to tax

Filing Status	50% Base Amount	85% Base Amount
Single	$25,000	$34,000
Married Filing Joint	$32,000	$44,000
Each additional $1 of income is taxed as if you earned:	$1.50	$1.85

Here are the numbers if they had been indexed for inflation:

Filing Status	50% Base Amount	85% Base Amount
Single	$49,500	$67,320
Married Filing Joint	$63,360	$87,120

Here are the numbers if they had been indexed for inflation and the marriage penalty was eliminated:

Filing Status	50% Base Amount	85% Base Amount
Single	$49,500	$99,000
Married Filing Joint	$63,360	$126,720

"What Tax Bracket Am I In?" Part 2
A Focus on Social Security Recipients

In the last issue, you learned that marginal tax brackets are not what you think they are. Congress has so obfuscated the subject that the question, "What tax bracket am I in?" can be responded to only when we are told the specific kind and amount of income or deduction for which you are asking. This is essential because tax rates vary by their type and enormous changes in rates occur once certain thresholds are breached. One of the most striking series of changes takes place over the phase-in range for Social Security benefits, adding enormous complexity when planning for Social Security recipients and resulting in disincentives to produce additional income for those in the phase-in range. Worse, while these phase-ins and tax brackets border on extortion, they affect folks who are arguably lower-middle income and middle-income taxpayers. We'll begin where we left off in the last issue with some sample answers to the question, "What's the real tax rate on additional chunks of Social Security income?"

Phase-in range for Social Security benefits

The real tax rate for Social Security recipients with additional income in the Social Security income phase-in range is as high as 27.75% for those in the advertised 15% bracket and 46.25% for those in the 25% bracket. It's 17.75% for those in the advertised 5% **Long Term Capital Gains (LTCG)** bracket and 36.25% for those in the advertised 15% LTCG bracket. There are a number of other hidden tax rates due to phase-outs of various other deductions and credits.

This hidden but real tax bracket can be devastating at relatively low income levels. See if you can follow this (referring to the previous article may help): When other income plus one-half of Social Security income reaches $25,000 for single filers ($32,000 for married taxpayers), every $1,000 of additional income is taxed as if there was $1,500 in added income until one-half of the Social Security income is taxed. 15% of $1,500 is $225; $225/$1,000 (the additional income) = 22.5%. Worse, once other income plus 50% of Social Security income reaches $34,000 for single taxpayers ($44,000 for married filers), every $1,000 of additional income is taxed as if there was $1,850 in added income, up to the point at which 85% of Social Security income is taxed. 15% of $1,850 is $277.50; $277.50/$1,000 = 27.75%. The real tax rates for those in the advertised 25% tax bracket are 37.5% and an exorbitant 46.25%. Specifically, 25% of $1,500, the amount added for every $1,000 increase in real income over the 50% phase-in stretch, is $375; $375/$1,000 = 37.5%. 25% of $1,850 is $462.50; $462.50/$1,000 = 46.25%.

This can be at least partially avoided by spreading income among several years, keeping it below the point at which the phase-in subjects the taxpayer to excessive rates. Or, a counterintuitive approach can be taken by realizing income well beyond the phase-in range, where income is subject to lower tax rates.

For example:

Let's say your typical yearly income consists of $17,600 Social Security and $9,700 of other income and you need $30,000 for a new car. We'll assume you can withdraw it from your IRA or take a short-term capital gain (or other similar ordinary income) for the same amount. The phase-in of Social Security income results in a range of shockingly high real tax brackets.

Real v. Advertised Rates for Single Social Security Recipient—Example 1

Additional Income (from starting point of $9,700)	Increases Adjusted Gross Income By:	Because This Much Soc Sec is Taxed:	Tax *	Tax Increase	**Real Tax Bracket**	**Advertised Tax Bracket**
$5,000	$5,000	0	$425	$425	8.5%	10%
$10,000	$11,760	$1,760	$1,240	$815	16.3%	10-15%
$15,000	$19,270	$4,260	**$2,360**	$1,120	**22.4%**	**15%**
$20,000	$28,300	$8,330	$3,730	$1,370	27.4%	15%
$21,250	$30,650	$9,395	$4,075	$345	27.6%	15%
$25,000	$37,600	$12,580	$5,810	$1,735	46.25%	25%
$27,800	$42,770	$14,960	$7,100	$1,290	46%	25%
$30,000	$44,970	$14,960	**$7,650**	$550	25%	25%

* Add as much as 9.3% California state income tax or the tax rate of your resident state. If self-employed, add 15.3% Self-Employment tax to any net income from a sole proprietorship or partnership.

Note that the more years over which you take the discretionary income, the more you'll save. For example, if you spread the discretionary income over two years, you'll save almost $3,000.

Splitting Income Option v. Chunky Income Option

	Additional Income	Tax	Additional Income	Tax	Tax Savings From Splitting Income
Year 1	**$15,000**	**$2,360**	$0		
Year 2	**$15,000**	**$2,360**	**$30,000**	**$7,650**	
Total Tax		$4,720		$7,650	**$2,930**

For those with $50,000 to $100,000 of discretionary income that must be taken sooner or later (for example, mandatory distributions from an IRA), consideration should be given to taking the chunk all in one year—thereby incurring the ludicrous phantom 46% bracket only once and paying just the flat 25% tax on the bulk of the income (with perhaps a bit taxed at 28%). On the other hand, a person who is pondering an exit from a high-tax state for lower-tax environs might want to withdraw only $15,000 (or less) yearly until such move occurs. There are many factors involved including how dire the need for funds, alternative investment opportunities, planned moves, current marital status and other future changes such as remarriage.

Let's assume another single taxpayer has $23,000 of Social Security income, $15,000 of other income and $12,200 in itemized deductions, most of which consist of medical expenses. Since the Social Security income is greater than in the first example and the medical deduction decreases as the income increases, you'll see some even more convoluted real tax rates. By the way, at the start, $750 of Social Security is already taxable, but the itemized deductions and personal exemption wipe out taxable income (accounting for the oddball numbers below). Also, some numbers are rounded.

Real v. Advertised Rates for Single* Social Security Recipient—Example 2-a: The Real Tax Rate on Ordinary Income

Additional Income (from starting point of $15,000)	Increases Adjusted Gross Income By (starting at $15,750):	Because This Much Soc Sec is Taxed:	Tax	Tax Increase	Real Tax Bracket	Advertised Tax Bracket
$5,000	7,500	$3,250	$850	$850	17%	10%
$8,000	$12,200	$4,925	$1,600	$750	25%	15%
$17,000****	$28,800	$12,600	**$4,350**	$2,760	**30%**	**15%**
$26,000	$44,800	$19,550	$8,650	$4,300	**48%**	**25%**
$36,000	$54,800	$19,550	$11,300	$2,650	26.5%	25%

* The reason for focusing on single taxpayers is explained in the next article, "The Social Security Marriage Tax Penalty."

We often hear that the federal tax rate on long term gains from the sale of capital assets held over one year is "no higher than 15%." In fact, at lower incomes it can be 5%, but try telling that to this Social Security recipient.

Real v. Advertised Rates for Single Social Security Recipient—Example 2-b: The Real Tax Rate on Long Term Capital Gains

Additional Income (from starting point of $15,000)	Increases Adjusted Gross Income By (starting at $15,750):	Because This Much Soc Sec is Taxed:	Tax	Tax Increase	Real Tax Bracket	Advertised LTCG Tax Bracket
$5,000	7,500	$3,250	$550	$550	11%	5%
$8,000	$12,200	$4,925	$900	$350	11.6%	5%
$17,000**	$28,800	$12,600	$2,600	$1,700	**19%**	**5%**
$26,000	$44,800	$19,550	$6,000	$3,400	**38%**	**15%**
$36,000	$54,800	$19,550	$7,650	$1,650	16.5%	15%

** Total non-Social Security income at this point is ($15,000 + $17,000 =) $32,000. Note that the real tax rate on a $9,000 long term capital gain from this level of income is 38%.

Tax cost or savings on an additional $1,000 of income or deduction for this taxpayer at $33,000 of non-Social Security income

Income or Deduction	Tax Increase or Decrease	**Real Tax Bracket**	**Advertised Tax Bracket**
Ordinary Income	$500	50%	25%
Wages, under Social Security Cap	$576	57.60%	32.65%
Long-term cap gains	$385	38.5%	15%
Self-employment income	$603	60.3%	40.3%
IRA, 401k, SEPP*	($500)	**50%**	**25%**
Itemized deductions	$250	**25%**	**25%**
Business deductions up to net business income	($603)	60.3%	25%
Business deductions that create a net loss	($500)	50%	25%

* To extent eligible.

The next issue will include a few more examples of real v. advertised tax brackets, including at least one showing real tax brackets for low-income people with children.

The Social Security Marriage Tax Penalty

You may wonder why the examples of exorbitant tax brackets given for Social Security recipients include only single taxpayers. The reason is the “base amounts” for married filers begin at such relatively low income levels that by the time the couple is in the 25% advertised tax bracket, in most instances 85% of the Social Security is already taxed. You might think, then, that the law treats married couples better than singles but, incredibly, you would be wrong. While the disincentives to produce other income are not as great, the combined tax for doing the right thing for the sake of the grandchildren is higher.

Let’s marry two single Social Security recipients, aged 65 or over, neither of whom itemizes deductions. We’ll assume they receive equal amounts of non-Social Security income, along with $18,000 each of Social Security. If we calculate the marriage penalty over a range of other income, we find that the penalty is $540 at “other income” levels of $12,000 each and $2,100 at “other income” levels of $20,000 each. This marriage penalty is particularly deplorable considering these are very moderate income levels.

Single age 65 or over taking Standard Deduction

Non-Social Security Income	Taxable Social Security Income	Tax	Tax Increase	Real Tax Bracket	Advertised Tax Bracket
$12,000	$0	$230			
$16,000	$0	$630	$400	10%	10%
$20,000**	$2,000	**$1,500****	$870	21.75%	15%
$25,000	$4,500	$2,600	$1,100	22%	15%
$30,000	$8,750	$4,000	$1,400	28%	15%
$35,000	$13,000	$6,150	$2,150	43%	25%
$38,000	$15,300	$7,460	$1,310	44%	25%

Marriage Penalty both age 65 taking Standard Deduction

(Assumes each has half the income)

Non-Social Security Income	Taxable Social Security Income	Tax	Marriage Penalty	Percent Tax Increase**	Real Tax Bracket	Advertised Tax Bracket
$24,000	$5,000	$1,000	$540	117%		
$32,000	$11,100	$2,900	$1,640	130%	23.75%	15%
$40,000**	$17,900	**$5,100****	$2,100**	70%**	27.75%	15%
$50,000	$26,400	$7,900	$2,700	52%	28%	15%
$60,000	$30,600	$11,050	$3,150	39%	31.5%	15%
$70,000	$30,600	$13,550	$1,250	10%	25%	25%
$76,000	$30,600	$15,050	$130	1%	25%	25%

** For example, a single person pays $1,500 tax on $20,000 of income assuming $18,000 Social Security income. If two singles earning this income marry, the tax balloons to $5,100, or $2,100 more than the $3,000 they would pay if they remained single. $2,100 is 70% more than $3,000.

Enrolled Agents Challenge Idiotic and Burdensome New Congressional Mandate on Charitable Donations

The National Association of Enrolled Agents has asked the Chief Counsel of the Internal Revenue Service to grant a de minimis exception to the new rules requiring a receipt for every dollar given at an AA meeting or to a bell-ringing Santa Claus. Receipts for business entertainment aren't even required if the expenditure is less than $75, as long as the relevant information is noted in a log book. However, the new recordkeeping requirement for charitable donations under Internal Revenue Code section 170(f)(17) states:

"No deduction *shall* be allowed under subsection (a) for any contribution of cash, check, or other monetary gift unless the donor maintains as a record of such contribution a bank record or written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution." (Emphasis added.)

The IRS will have to overcome a big hurdle to legally carve out an exception to a rule that clearly states "shall." However, Congress has instructed the IRS to reduce recordkeeping burdens wherever feasible, which this would obviously do. I'm proud of my professional association and its President, Lois Manning, EA, for at least trying.

The promulgation of this rule suggests that Congress may have turned from its taxpayer-friendly mode of the past decade and is in the process of, once again, becoming the Grinch.

Congress Decides 23-Year-Olds are Children

Congress has once again expanded the "kiddie-tax" provisions, which require that children pay tax at the parents' rates on investment income above a certain level (currently about $1,700). The rules, which didn't exist a decade ago and affected only children up to age 14 until 2005, now hit children through age 17. However, in 2008 children through age 23 whose work income "does not exceed one-half of the amount of their support" will be roped into this category of taxpayers. It may even affect children who cannot be claimed by their parents as dependents, such as less-than full-time students and non-students living at home with income exceeding $3,400.

The reason Congress enacted this burdensome new rule is related to the tax on long term capital gains for lower-income individuals. Through 2007, taxpayers in the normal 15% bracket pay an advertised rate of only 5% on such gains. Beginning in 2008 (and currently through 2010), the rate on these gains for 15% bracket payers will be zero. Congress figured that wealthy parents would take undue advantage by increasing their gifts of stock with a low cost

basis to college-aged kids, who could then sell the stock at no tax cost to help fund college expenses. While requiring that such gains be taxed at the parents' rates eliminates the potential for this strategy to be implemented by children, it can still be used with other family members or, for that matter, non-family members.

However, this enormous increase in complications for a select few (parents' and children's tax returns must essentially be integrated) raises all of $1.4 billion over a decade (which assumes that the zero rate on long-term capital gains will be extended past 2010). Congress offered no estimate for the increased cost of filing affected returns. Nor did they figure on changes in financial behaviors by such families. Many will avoid tax on gains by increasing their funding of 529 plans, the funds from which are completely tax-free if used for higher education expenses. If we subjected rules to a cost-benefit analysis requiring that the net increase in government revenues exceed the costs of complying plus reduced tax revenue resulting from changes in behavior, the law likely never would have passed.

Those turning age 19 through 22 in 2007 who expect to remain as dependents on their parents' tax returns next year will want to consider realizing taxable gains in 2007, before the new rules go into effect.

Prevent Tax Tragedy with a Phone Call, Fax or E-mail

The first thought that should come to mind when there's a tax or financial question is to "Call/Fax/E-mail Doug." Our "please note" label sent with every tax return says it all. Here's an advance on the revised '08 version:

Please Note

Copies of all correspondence received from the IRS or State governments should be mailed, faxed or scanned and e-mailed to us as soon as received. We will contact and advise you as to any action that should be taken.

Please call us during the year if there are any major changes including but not limited to buying or selling a vehicle used for business or non-commute employment, any real estate (including a home, rental property or land), a business and business equipment. Other changes for which we should be consulted include major portfolio sales (but not those inside retirement plans), marriage, divorce, starting or buying into a business and anything else involving large dollar amounts.

Please do not hesitate to call, fax or e-mail should the need arise. Because we generally know you and your situation, we often can respond quickly and efficiently. Bear in mind, it usually costs far less to deal with an issue before it becomes a problem, rather than letting it become a problem that takes far more time to fix.

After years of emphasizing the idea, most of you are pretty good about calling us. However, there are still two primary areas that need improvement: informing us of a substantial drop in income and unplanned changes in contributions to or withdrawals from retirement plans, including IRAs.

One recent example of a collapse in income could have been mitigated with IRA withdrawals, some of which could have been taken tax-free. Those who can survive without such withdrawals have a major planning opportunity. In one success story, our client called and we prepared "what-if" tax returns. With an expected negative taxable income of $10,000, $17,000 in an IRA and money in the bank to live on, we converted the IRA to a Roth IRA. The tax cost was zero on the first $10,000 and $700 on the next $7,000. Funds that would eventually be subjected to as much as $6,000 in tax during retirement were now positioned to grow tax-free forever. In another case, our client expected a $20,000 loss on his business and had another $25,000 in itemized deductions and personal exemptions. While we could have offset the "net operating loss" of $20,000 against income in another year, after explaining that the other $25,000 in deductions would be wasted (such deductions can generally be used only in the year incurred) he opted to sell stock on which he had a long-term gain of $60,000. The tax cost on the sale was $750 (zero on the first $45,000 and a long-term capital gain tax-favored 5% rate on the next $15,000). Since he didn't really want to sell it, he immediately bought it back (while you have to wait 31 days before or after selling a stock at a loss in order to be allowed the deduction, there is no such restriction on selling stock at a profit). He thereby increased his basis by $60,000 and avoided potential tax in one of his more "normal" income years of as much as $18,000.

Several clients invested in the "wrong" IRA during the year: a Roth when a traditional IRA would have been more appropriate and a traditional IRA when a Roth would have been optimal. While such investments can be changed before the due date of the return, it can take time and aggravation in getting the bank or brokerage firm to get it right. But the largest avoidable error occurred when a client withdrew $4,000 from her IRA. The $1,000 tax and penalty was just the start. Since non-mandatory IRA withdrawals result in loss of eligibility for the low income savers retirement credit for which she was otherwise eligible (while withdrawing $4,000 from an IRA she was contributing more than that into 401k's), she lost another $1,000. She may suffer a similar loss in '07, because such withdrawals result in a loss of eligibility for two years. This error would have been averted had we been consulted.