Cynthia Dawkins: And now, Pam Felton from Region X will introduce our second speaker.

Pamela Felton: I’m pleased today to introduce our next speaker, Ms. Carmen J. Aguiar. She’s a CPA and CFP and is also the President and CEO of the Aguiar Group, a consulting and CPA group here in Bellevue, Washington. The firm provides tax and financial services to small businesses and families.

Also, her extensive community service includes past service on boards and commissions including the Federal Home Loan Bank of Seattle, the SBA National Advisory Council, and she’s also the past Chairman of the City of Bellevue Parks and Community Services Board.

Carmen was formerly with Ernst & Young in New York and also in Seattle.

Ms. Aguiar graduated from Hunter College, City University of New York, with a BS in accounting and honors in economics. And she is also the recipient of the very prestigious Puget Sound Business Journal 40 Under 40 Award.

Please join me today in welcoming Carmen Aguiar.

Carmen Aguiar: Thank you, Pamela. I appreciate the introduction.
I wanted to cover a couple of items, kind of looking and thinking about your tax return in two different ways and of course dealing with the aspects.

But just to sort of kick off, I always encourage people to look at their tax returns as a tool, and a tool with respect to how your financial life…. It actually gives you a little insight as to what your financial picture as a whole might look like or what you can strive for.

As far as the tax implications of investments, one key item that I always like or picture if you draw on a piece of paper -- if you have paper with you -- is that you can think of investments being inside a house or outside that house. And when I talk about the house, I’m talking about your retirement type investments [i.e., those long-term investments set aside for retirement].

So for example, if you have a 401(k) plan or a 403(b) plan at work, those investments that are in that plan would be considered as being inside a house. And anything that’s inside that house as far as stock sales, interest that’s earned, dividend that’s earned, there are no tax implications when that happens.

[A 401(k) plan is a type of tax-qualified deferred compensation retirement plan in which an employee can elect to have the employer contribute a portion of his or her cash wages to the plan on a pre–tax basis. These deferred wages (commonly referred to as elective deferrals) are not subject to income tax withholding at the time of deferral, and they are not reflected on your Form 1040 since they were not included in the taxable wages on your Form W-2. However, they are included as wages subject to Social Security, Medicare, and federal unemployment taxes.]
A 403(b) plan, also known as a tax-sheltered annuity plan, is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations, and certain ministers. You do not pay tax on allowable contributions in the year they are made. You do not pay tax on allowable contributions until you begin making withdrawals from the plan, usually after you retire. Earnings and gains on amounts in your 403(b) account are not taxed until you withdraw them. For more information on 403(b) plans, refer to IRS Publication 571 (http://www.irs.gov/pub/irs-pdf/p571.pdf).

And then you think of your investments outside the house, regular investments - let’s say you have a CD, a mutual fund, savings that you have set aside outside any retirement plan. Those are the ones that are hit with tax consequences.

Now as far as the investments that are outside the house, right, you might earn interest on CDs or bank accounts, and those get taxed at regular tax rates. So whatever tax bracket you are in [A tax bracket is the rate at which an individual pays taxes. It is based on a combination of one’s filing status and taxable income. The 2006 Federal tax brackets are 10%, 15%, 25%, 28%, 33%, and 35%. For more information, visit http://www.irs.gov/formspubs/article/0,,id=150856,00.html.], and we’re in a progressive tax structure, you would pay tax on that income at that rate. So if you’re in the 15% tax bracket, that’s what it would be …25%, 35%, et cetera.

As far as your dividends are concerned - and dividends are the income that you get on stock that you may own - might own. It might be mutual funds that you hold, again outside retirement plans. Those
items [i.e., dividends] get taxed at a lower tax rate -- 5% or 15% -- and that depends on your income tax bracket.

The other type of investment income that you might have is if you sell your mutual funds or you sell some stocks. Those also now have favorable tax rates, which again are 5% or 15%, depending on what tax bracket you’re in.

And so the key thing to recognize is that when you’re filing your tax return, you have to understand what type of income you have and the reports, the [Form] 1099s, that you get from various brokerage houses, banks. Those give information that help you identify what or how those items are going to be taxed.

As far as -- suppose you have a stock loss, right? You’re selling [an] investment and you lost money on it. You’re able to take that loss and use it against other gains. [A loss will offset gain by other investments dollar for dollar, so you can add to your income without adding to your tax bill.]

If you end up having that loss, you’ll have the opportunity to use up to $3,000 of that loss and apply it against other income. And other income could be wages.

So for example, if you have a W-2, and you have some income, and you end up with--on your investments, on sales of investments--with a $3,000 or more loss, you can take up to $3,000 and apply it against the income.
Now, you’re like, “Okay, well, what happens with the rest of the loss?” With that, the remaining loss gets carried over into the following year.

And again, if in that new year you have absolutely no gains or losses or anything like that, but you still have that carried over loss, you can use another $3,000 against your regular income.

So those are kind of some of the items that are keys as far as investments.

[The concept of using capital losses to reduce your tax bill is described in more detail in an article by Kay Bell and Cynthia E. Broderick on Bankrate.com -- http://www.bankrate.com/brm/itax/Edit/news/stories/20001025a.asp.]

A key point is that if you take money out of a retirement fund -- remember the house that I was telling you [about] with the investment inside -- even if they are stocks, mutual funds or what have you, when that money comes out, that money is going to be taxed at your ordinary [income tax] rate. And so that’s a key item to remember.

And the same thing with annuities; annuities get taxed at ordinary rates.

The other item that I wanted to talk about in terms of investments is if you think of your house, your personal residence, if you’re going to sell your home--and in the past, it used to be and people still think that you can roll over your gain from an old house into a new house and not pay tax. Well the rules have changed.
And the rule over the last ...a few years now... is that if you have a gain on your home--which basically is your sale price less whatever you paid for it, you know, less improvements, whatever that net gain is--you as a single person have up to $250,000 of tax free gains. So if you make $250,000 on the deal, then -- and you’re single--you would not have to pay tax on that money. As a married filing jointly couple, the amount [that isn’t taxed] is $500,000. So that’s another key item.

Now the difference here is that if you have - if your gain is above that [i.e., above the $250,000 (for singles) or the $500,000 (for married filing jointly)] on [the sale of] your personal residence--you will actually pay tax, and the tax rate would be the capital gains [tax] rate. So that’s one key item.

And you know--and that kind of brings me into the next topic, which is looking at tax preparer choices versus doing your own tax returns. While there are a lot of vehicles out there -- there’s TurboTax and other computer programs and all that--

we highly recommend that if you are going into a transaction that’s not your typical [one], there are really advantages to using a tax preparer. And we see things as...you know, I always tell clients that in terms of your relationship with your tax preparer, that’s what you’re trying to build so that when the need comes, there’s someone there that understands what your situation is and can guide you.

There are other avenues as well. I mean you can, like I said, guide yourself through TurboTax, and again, remember to ask questions if you’re needing help. There are different sources that you can always go to, like Ron mentioned, you know, the www.irs.gov - G-O-V. The
IRS Web site has questions and answers that you can look into and see if that can help to [provide] an answer.

The other program out there nationwide is VITA, which is the Volunteer Income Tax Assistance Program. There are preparers [who] you would not have to pay, and [you can] get some assistance from those avenues.

The other thing that I’ve used is I have, for example, clients who enjoy preparing their [own] tax returns, and we’ll review them. We’ll review and look at what they’ve done and use that as an educational opportunity.

So again, you know, there are people who do their own taxes, and maybe at least if you’re going into a major transaction, you might want to think -- or things are different, they’re not as simple as usual -- maybe get a little bit of guidance.

The other topic I’m going to cover is what do you do if you haven’t filed in several years. Do you just stay under [the radar screen] and not bring it up? But what happens if you start getting letters from the IRS saying, “Hey, you know, I think you haven’t filed your return?”

One of the key things to do, to recognize is that not filing the returns can have impacts, such as that when you do file, you will end up owing -- if you owe taxes, right? -- you will end up paying penalties as well.

But at the other...you know, the other reality is that if you haven’t filed, you may be leaving money on the table because if you had withholdings from your paychecks for, you know, year after year and
you decide that, “Well, you know I don’t feel like filing. I don’t feel like filing,” [you may be leaving money on the table.]

If you haven’t filed your returns within three years of the due date, you will lose that refund. So again, you’re losing money by not filing your return.

And in addition there are some credits, e.g. Earned Income [Tax] Credit and other types of credits, that you might be entitled to that, once again, you might not be benefiting from. [The Earned Income Tax Credit (EITC), sometimes called the Earned Income Credit (EIC), is a refundable federal income tax credit for low-income working individuals and families. When the EITC exceeds the amount of taxes owed, it results in a tax refund to those who claim and qualify for the credit.]

Now what happens, you know? What’s the first step? Okay, I get all these IRS letters. What do I do now?

Well, the first step is to look into your records and see what you have.

I’ve had instances where clients are like, “I have no clue,” you know? “We just had a flood. I don’t know where the records are. I just threw everything out.”

Well, one approach would be -- and I do, you know, suggest that you do get guidance from a tax preparer at that point in time if this is the route you’re going --

but you can request transcripts from the IRS. And the IRS will lay out what has been reported to them from third parties.
So for example, when you get your W-2, your employer will also send the W-2 to them [IRS]. When you receive a [Form] 1099, the banks, the brokerage houses also send that information to the IRS.

So really that is one way to get information so that you can at least take a step. It might refresh your memory in terms of what occurred in those particular years.

And then the other question is, “Well, you know what? I actually don’t have all the money I need to pay the taxes.”

We can set up, you know…the IRS will set up an installment agreement where you can pay the taxes and whatever other penalties and interest you owe. It’s not an interest-free loan, but you can pay that over a period of time and set that up with the government.

So again, you know, the key thing is to remember to--going back into savings--making sure you maximize any retirement plan that’s out there available for you through work, and IRAs, et cetera, recognizing that the investments, how they get taxed, will be different depending on what kind of investment it might be.

And then also recognizing that by not filing [your tax returns] you might have refunds … you may be leaving money on the table that you can use to invest or do other things. And getting on track and filing really isn’t that challenging. I mean, you can get help. The IRS has information they can provide and then you can… if you do owe… you can have that applied or paid, make payments over a period of time.
Cynthia Dawkins: Thank you so much, Carmen. That was really, really good information.