

THE *JUST TAXES!* CLIENT NEWSLETTER

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Dear Client:

July 2008

It was a very good year . . .

All things considered, we had a very successful tax season. We were truly delighted, and gratified, to have had so many returning clients. And we were equally pleased to have had the opportunity to meet with the many family members, friends, and neighbors that you referred to us. We sincerely appreciate your business and your confidence in us. We are finally settled into our new offices and are now busy working on improvements in preparation for next year. (You've probably noticed that, as tax preparers, we are always a year behind. You think about next year as 2009. We think about 2009 as the 2008 tax season).

Do You Feel Rich or Poor?

As you are reading this newsletter you are probably already weary of the gibberish routinely used by the ubiquitous, egotistical, and sanctimonious political pundits who attempt to convince you that their candidate's vision of the future is not only best for you, but also best for America. Much of their dialogue seems to contain the same hackneyed phrases which no one (and particularly no politician) seems willing to define. The "usual suspects" include terms such as the rich, the middle class, the working class, the poor, the working poor, and (our personal favorite) hard working Americans. So we've decided to try and provide some context so that you can decide for yourself whether the promises spewing forth really make any sense.

Okay, now for the boring stuff (but we'll try to be as brief as possible). The following table is based on IRS data from individual income tax returns for calendar year 2005, the most recent year for which such data are available. The table shows the share of total income earned and total taxes paid based on adjusted gross income. It should be noted that these data are based on household income regardless of filing status and that the taxes paid do not include payroll taxes (i.e., social security and Medicare). Additionally, for ease of reference we've rounded the numbers to the nearest \$1,000 and nearest whole percent.

Household Income

| Ranking | Income | Share of Income | Share of Taxes |
|---------|-------------|-----------------|----------------|
| Top 1 % | > \$305,000 | 21 % | 39 % |
| Top 5 % | > \$145,000 | 36 % | 60 % |

| | | | |
|-------------|-------------|------|------|
| Top 10 % | > \$104,000 | 46 % | 70 % |
| Top 25 % | > \$ 62,000 | 68 % | 86 % |
| Top 50 % | > \$31,000 | 87 % | 97 % |
| Bottom 50 % | < \$ 31,000 | 13 % | 3 % |

As you can see, the top 1 percent of households comprised those with adjusted gross incomes over \$305,000. This group received 21 percent of the total income reported and provided 39 percent of the total income taxes paid. The remainder of the table uses the same format and is self explanatory. It is interesting to note that those in the top 50 percent of household income (i.e., those with gross incomes over \$31,000) received 87 percent of total income and provided 97 percent of the total taxes paid. Conversely, the bottom 50 percent received 13 percent of the total income and provided 3 percent of the total taxes paid.

A simple analysis suggests that the "rich" comprise all of those households in the top 1 percent, and possibly even some of those households in the top 5 percent. Similarly, it also seems reasonable that the "poor" comprise those households with adjusted gross incomes in the bottom 50 percent. So we've adjusted the numbers a bit and have decided that the following "ballpark" definitions are a reasonable starting point. We'd be interested in your thoughts.

Are You Rich or Poor?

| Income | Category |
|-----------------------|-------------------------|
| > \$250,000 | Rich |
| \$150,000 - \$250,000 | Kinda Rich |
| \$110,000 - \$150,000 | Well-Off |
| \$70,000 - \$110,000 | Smack Dab in the Middle |
| \$30,000 - \$70,000 | Hard Working Americans |
| < \$30,000 | Would Rather be Rich |

Random Thoughts

"I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."

Winston Churchill

Our Golden Clients

We are convinced that we have the most interesting clientele in Sacramento (if not in all of California). You vary in age from 15 to 102. You are as racially diverse as the general population. Less than half of you are male, which means that more than half of you must be female (Dennis the "math whiz" figured this out all on his own). Some of you are single. Some of you are married. Some of you are separated. Some of you are divorced. Some of you have significant others. Some of you have domestic partners. Some of you are widowed. Most of you work full time, while others are retired. Most of you own your own homes. In 2007 your incomes varied from less than \$500 to more than \$750,000. You

collectively earned over \$20,000,000. You collectively paid over \$5,000,000 in federal and state income taxes. We also believe that you are better looking (and much more intelligent) than the general population. But we really want to salute our "golden oldies" who give new meaning to the term "senior citizen":

Fred and Helen Yerby who will both reach the century mark this year

Josephine Johnson, who will also celebrate her 100th birthday in 2008

Financial Concepts

As you are aware, we don't provide financial recommendations or advice. However, we are frequently asked to explain financial terms and/or concepts such as "The Rule of 72" or "The 4% Solution."

The Rule of 72 states that if you divide the interest rate that you are receiving into 72 that the product will be the amount of time required to double your investment. For example, if you are receiving 6 percent interest your investment will double every 12 years (i.e., 72 divided by 6).

The 4% Solution is the principle that there's a high probability that you can maintain your standard of living during a 30 year retirement with a portfolio 25 times the size of your first-year withdrawal; or a 4 percent withdrawal rate provides a 90 percent probability that your money will last for 30 years. For example, if your portfolio is \$500,000 then you should be able to withdraw \$20,000 a year for at least the next 30 years. This theory is, of course, dependent on the future return of your investment as well as on the rate of inflation.

Not So Random Thoughts

"Tax reforms are something that benefit you. Tax loopholes are something that benefits the other guy." -- Russell Long, Former U. S. Senator

The "Ripple Effect"

Every year we have clients who fall victim to the "ripple effect" which we loosely define as the unintended tax consequences of a seemingly unrelated event. For example, Sally is a single woman, age 67, who does not itemize her deductions. Her annual income consists of a \$20,000 pension and \$12,000 in social security benefits. Under normal circumstances this would result in a taxable income of \$10,450 and a tax of \$1,180. However, Sally withdrew \$10,000 from her IRA to pay for various home improvements. As a result she anticipated that she would owe additional taxes on \$10,000 or, in her case, another \$1,500. However, unknown to her the \$10,000 from her IRA also increased the taxable portion of her social security income from \$500 to \$6,200. As a result, she owed additional taxes on \$15,700 rather than \$10,000 and her tax increased by \$2,355 rather than the \$1,500 she had planned on. We could easily provide a plethora of similar examples. The bottom line is that if you experience an unusual or unexpected financial event during the year please call us so that we can advise you about the potential tax consequences.

Enhanced Web Site

We recently updated our web site to provide additional information for our clients. Among the improvements are "Tax Hints," a new section that provides tax information of general interest. Additionally, archived copies of The Just Taxes! Client Newsletter are also available. The web site can be accessed at www.just-taxes.com or www.affordable-taxes.com.

Until next time,

Dennis T. Graff

Diana L. Muller
Enrolled Agent

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