Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

YEAR-END 2007 Volume XII, Number 3

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Planning Ahead With Year-End Tax Strategies

The end of the year is traditionally a time to celebrate the holidays, and your 2007 taxes may be the furthest thing from your mind. However, with a few exceptions, it is your last opportunity to alter the results of your 2007 taxes. The following are some of the many possible strategies that can be employed before the year's end that can help you achieve tax savings for 2007.

State Estimated Tax Payments – Although the deadline to make the 4th quarter 2007 state estimated tax payment is January 15, 2008 for most states, the payment will count as a tax deduction on the federal Schedule A for 2007 if that payment is made before the end of December 2007.

Property Taxes – Generally, your property taxes are billed in installments, and that's how most people pay them. However, the tax can be paid all at once, if it provides a greater tax benefit for the current year.

Caution: The preceding two strategies do not benefit taxpayers who are subject to the alternative minimum tax (AMT), since taxes are not deductible to the extent a taxpayer is subject to the AMT. Taxpayers subject to the AMT might, instead, consider deferring deductible tax payments to the subsequent year.

Required Minimum Distributions (RMD) – If you are $70\frac{1}{2}$ or older, make sure that the minimum distribution amount is withdrawn from your IRA or other qualified plans to avoid the 50% penalty for underwithdrawals.

IRA Withdrawals – If you are retired and taking IRA distributions, make sure that you maximize your withdrawal with respect to your tax bracket. It may be tax-effective to actually withdraw more than is needed. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of the Social Security income.

Bunch Deductions – If you are marginally able to itemize each year, it may be appropriate to "bunch" deductions in one year and then claim the standard deduction in the alternate year. This technique frequently can be applied to tax payments, charitable contributions, some medical expenses and to certain business expenses.

Roth IRA Conversions – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost.

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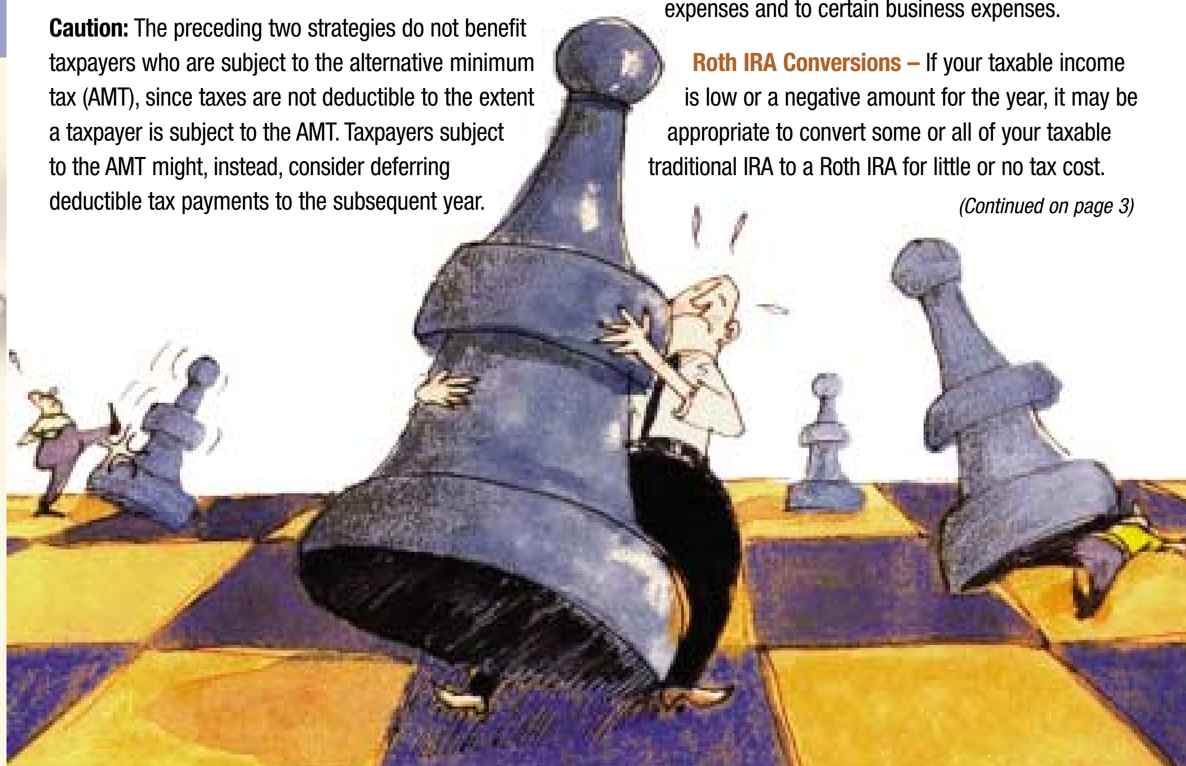

Say Hello and Say Goodbye

With Congress changing tax laws faster than a speeding bullet, it is sometimes difficult for taxpayers to keep up. Here is a brief overview (not all the details and limitations are included) of some of the new, expiring and future tax provisions. In recent years, Congress has made a number of changes at the last minute, so there is a chance that some of these provisions might be extended or modified after this newsletter has been printed.

Last Year for Home Energy-Savings Credits – 2007 is the last year that taxpayers can take advantage of the home energy-savings credits for materials and components certified by the manufacturers. This includes a 10%-of-cost credit (maximum credit $500) for insulation, exterior windows and doors and metal roofs. There is also a 100%-of-cost credit for certain types of water heaters, heat pumps, geothermal heat pumps, air conditioners, furnaces and air circulating fans. Please note that some of the specific items also have credit limits. Please call for further information.

Last Year for Higher Education Expenses Deduction – 2007 is the final year that taxpayers will be allowed to deduct "above-the-line" up to $4,000 of higher education expenses instead of claiming the Hope or Lifetime Learning tax credits or a miscellaneous itemized deduction for employment-related education.

Last Year for Sales Tax Deduction – 2007 is the last year that taxpayers who itemize their deductions will be allowed to deduct the greater of the state income tax or state and local general sales tax paid during the year. Thus, if you are considering a large purchase, such as a car, within the next year, and your sales tax deduction would exceed your income tax deduction, you may want to accelerate the purchase into 2007 to be able to deduct the sales tax on the purchase. This strategy does not apply to the extent that you are taxed by the alternative minimum tax (AMT).

Final Year for Teachers' Expenses – 2007 is the final year that the $250 tax deduction for out-of-pocket costs incurred to purchase books, supplies and other classroom equipment by elementary and secondary school teachers and certain other school professionals can be taken "above-the-line," making it deductible even for those taxpayers who do not itemize their deductions.

Last Year for Combat Pay EIC Election – 2007 is the last year that a taxpayer can elect to have excluded combat pay counted as income for purposes of calculating the earned income tax credit (EIC).

2007-Only Mortgage Insurance Premiums Deduction – Although there is active legislation that would extend this provision, at press time, 2007 is the only tax year during which an itemized deduction is allowed for the cost of premiums for mortgage insurance on a qualified personal residence. Payments for premiums allocable to any period after 2007 aren't deductible. The deduction applies only to mortgage insurance contracts issued in 2007, so premiums paid on mortgage insurance for homes purchased before 2007 don't qualify. The deduction is phased out if adjusted gross income exceeds $100,000.

New Refundable Minimum Tax Credit – If you were unfortunate enough to have been affected by the AMT in a prior year, then you may have a carryover of unused minimum tax credit. This primarily applies to taxpayers who exercised qualified (incentive) stock options and held the stock to qualify for long-term capital gains. Until now, the prior year's AMT credit could be used only to the extent that the regular tax exceeded the AMT for the current year. That, in effect, made the credit useless for taxpayers who are perpetually taxed by the AMT.

However, a new provision in the law taking effect in 2007, and continuing through 2012, allows taxpayers to use a portion of their minimum tax credit carryover that is attributable to the 4th prior year or older (termed "long-term unused minimum tax credit") in the current year, even if taxed by the AMT in the current year. The amount of the unused long-term credit that is refundable in a particular year is limited to the lesser of $5,000 or 20% of the long-term unused minimum tax credit. Unfortunately, the credit phases out for higher-income taxpayers.

Home Solar and Fuel Cell Credits Extended Through 2008 – You still have the chance to qualify for this credit for installation of a solar water heater or for solar electric generating equipment. The credit is 30% of the qualified property's cost, limited to a maximum credit of $2,000. In addition, there is a fuel cell power plant (generation of electricity by electrochemical means) credit of $500 for each 0.5 kilowatt of capacity with no maximum. Costs, including installation and hardware costs, apply only to equipment installed in a home located in the United States, and cannot be used to heat a swimming pool or hot tub. Taxpayers receive no benefit from this credit to the extent that they are subject to the AMT.

Congress Changes the "Kiddie" Tax Again! Beginning in 2008, the kiddie tax has been extended to full-time students under the age of 24. The purpose of the kiddie tax is to keep parents from placing investments in a child's name to take advantage of the child's lower tax rates. Congress was concerned that parents and their full-time student dependents would take advantage of the reduced long-term capital gains rate that starts in 2008, so they again raised the age of who is subject to the kiddie tax. Strategies that you might consider to avoid the kiddie tax are tax-free or tax-deferred investments.

If you have any questions regarding these tax issues and how they may impact your unique tax situation, please give us a call.

(*Planning Ahead With Year-End Tax Strategies* Continued)

Review Estimated Tax Payments – Ensure they are sufficient to meet the "safe-harbor" payment amounts so as to avoid underpayment penalties. This is especially important for taxpayers with windfall income from bonuses, property sales, etc. Employed taxpayers can also increase their withholding for the balance of the year. This is especially helpful in terms of avoiding penalties, since the withholding is treated as if it were received evenly throughout the year.

Profits From Stock Sales – If you have net profits from the sale of stocks or other capital assets during the year, consider selling holdings that will generate losses to offset those gains and even produce a loss up to $3,000 in excess of the gains.

Education Credits – If you qualify for one of the higher education tax credits and have not paid enough tuition during the year to achieve the maximum credit, the law allows you to prepay tuition for an academic period beginning within the first three months of the next year, and claim the tuition for the current year's credit.

Business Deductions – Before the year's end, business owners can purchase and place into service equipment needed for the business, and utilize the Section 179 expense allowance to write-off the entire cost of the equipment in 2007. There are some limitations. If you are short of cash, the deductible purchase can be made on credit.

Energy Credits – If you are thinking "green," you might consider making some credit-eligible, energy-saving improvements to your home. This is especially important, since most credits, except for solar and fuel cell, expire at the end of 2007. A substantial tax credit is still available for certified hybrid vehicles, excluding Toyota and Lexus vehicles (Toyota and Lexus credits expired for purchases after 9/30/07). Purchases must be made before the year's end.

Defer Income – It might be appropriate to make arrangements with your employer to defer a bonus until early 2008.

Charitable Contributions – If you have been planning to contribute used clothing and household goods to a charity, doing so before the year's end can increase your itemized deductions. But keep in mind that under the stringent new rules, the items must generally be in good or better condition, and your contribution will need to be substantiated. Used vehicle contributions are still allowed, but the deduction is generally limited to the amount that the charity receives from the sale of the vehicle.

IRA to Charity Distributions – 2007 is the final year for taxpayers age $70^1/2$ and older to transfer funds from their IRA accounts to charities. The transfer counts toward the year's required minimum distribution but is not counted as either income or a charitable contribution. This is an opportunity for those who do not itemize to effectively benefit from contributions that they would be unable to deduct. At the same time, it reduces the AGI, the amount on which certain deduction limitations are based. A lower AGI may also reduce the amount of Social Security income that is taxed.

If you would like to discuss other possible strategies or how any of the ones listed above applies to you, please call this office.

Six Tax Penalties You Want to Avoid!

Generally, taxpayers don't intentionally incur tax penalties, but many do simply because they are unaware of the penalties and the impact that they can have on their pocketbooks. The following is a rundown on some of the more commonly encountered penalties:

Underpayment of Estimated Taxes and Withholding – Taxpayers are essentially required to pay their tax liability throughout the year, either through withholding or by making estimated tax payments. If the taxpayer owes more than $1,000 when filing his or her return for the year, the IRS will assess the underpayment of estimated tax penalty, which is currently 8% of the underpayment computed quarterly. There are "safe-harbor" payments that can protect you from this penalty; they include paying the following amounts: 90% of the current year's tax liability or 100% (110% for high-income taxpayers) of the prior year's tax liability. Farmers and fishermen need only prepay $66^2/_3$% of the current liability or 100% of the prior year's liability.

Late-Paying Penalty – When the tax owed on a return is paid after the unextended due date of the tax return, the taxpayer is subject to a penalty of $^1/_2$% per month (maximum 25%) on the unpaid balance. Taxpayers are frequently caught by this penalty when they have an extension of time to file their tax returns. Many fail to realize that the extension does not include an extension to pay. The only way to avoid or minimize this penalty is to have no or little balance due on the return when it is finally filed. The extension form includes a provision to pay the projected balance owed when filing the extension.

Late-Filing Penalty – If the return is filed after the due date, including extensions, a late-filing penalty of 4.5% per month (maximum 22.5%) applies. The automatic extended due date for 2007 returns is October 15, 2008. Thus, the penalty would generally apply to 2007 returns filed after that date.

Negligence – 20% of the tax underpayment is charged when the underpayment is due to negligence on the part of the taxpayer or when there are errors in tax valuations. This penalty is frequently encountered when the IRS adjusts a filed return due to unreported income or overstated deductions.

Dishonored Check – The penalty for dishonored checks is 2% of the check amount but not less than $25.

Missing ID Number – This penalty of $50 for each missing number is charged when a taxpayer doesn't provide a required Social Security number (SSN) for him/herself, a dependent or another person on the tax return. This also applies when he or she doesn't provide his/her SSN to another person when required.

There are more severe penalties that are not mentioned here which apply to fraudulent actions or claims. In some cases, it is possible to have some of the penalties abated for reasonable cause. If you have questions related to the application of any of these penalties, please give us a call.

Tax calendar

Nov.07 – Apr.08

November – December 2007
Time for 2007 year-end and 2008 tax planning! This is highly recommended if you have substantial increases in income or fewer deductions than last year. Please call for an appointment.

December 31, 2007

- Last day to pay deductible expenses for the 2007 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2007.
- Last day to make the minimum required withdrawal of funds from a traditional IRA account in order to avoid a penalty if you turned age $70\frac{1}{2}$ before 2007.
- Last day to set up a Keogh retirement account if you plan to make a 2007 contribution.

January 15, 2008
The fourth quarter 2007 federal estimated tax payment is due unless the 2007 return is filed by January 31, 2008. **Caution:** Some states may have different filing dates for state estimated payments.

January 31, 2008
Deadline for providing 1099s and W-2s to those people you paid during 2007. If you are a business owner or rental property owner and you paid $600 or more for the services of individuals (other than employees) during the year, you need to provide 1099s for those workers by January 31, 2008. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by February 29, 2008. Our firm can prepare these documents for you.

February 29, 2008
Deadline for filing (sending) 1099s and W-2s to the government.

April 1, 2008
Last day to withdraw funds from your traditional IRA if you turned age $70\frac{1}{2}$ in 2007 and haven't taken your 2007 distribution yet. In addition, this is the last day to withdraw funds from a SEP or Keogh plan for individuals who are retired and turned age $70\frac{1}{2}$ in 2007. Failure to take the required distributions can result in substantial penalties.

April 15, 2008

- Deadline for individuals to file a 2007 federal return or request an extension of time to file.
- The first installment of the 2008 federal estimated tax payment is due.
- The first installment of the 2008 defined benefit pension plan contributions is due.

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Since You Asked...

You Asked: I heard that the Medicare B premium might increase next year. Is that correct?

Answer: It all depends upon the amount of your income for the 2006 tax year. The increase applies only to higher-income taxpayers. Thus, if you didn't have an increase last year and your income in 2006 was near the same as it was in 2005, you probably will not see an increase in 2008. The federal government has been supplementing the Medicare B insurance premiums for some years, even as the costs have exceeded the funds generated from the premiums. Beginning in 2007, the premiums were increased for higher-income individuals based upon their modified (includes tax-free income) adjusted gross incomes (AGI) for the year two years prior. It is a tiered increase starting at $160,000 for joint-filing taxpayers and $80,000 for most others (these amounts will be inflation-adjusted). The increases are being phased in over three years, with the increases starting at 13.33% and going as high as 73.33% for the 2007 premium. The increase in 2008 will be double those amounts and triple in 2009.