tax& financial UPDATE

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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Required Minimum Distributions (RMD) – If you are 70½ or older, make sure that the minimum distribution amount is withdrawn from your IRA or other qualified plans to avoid the 50% penalty for underwithdrawals.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.

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

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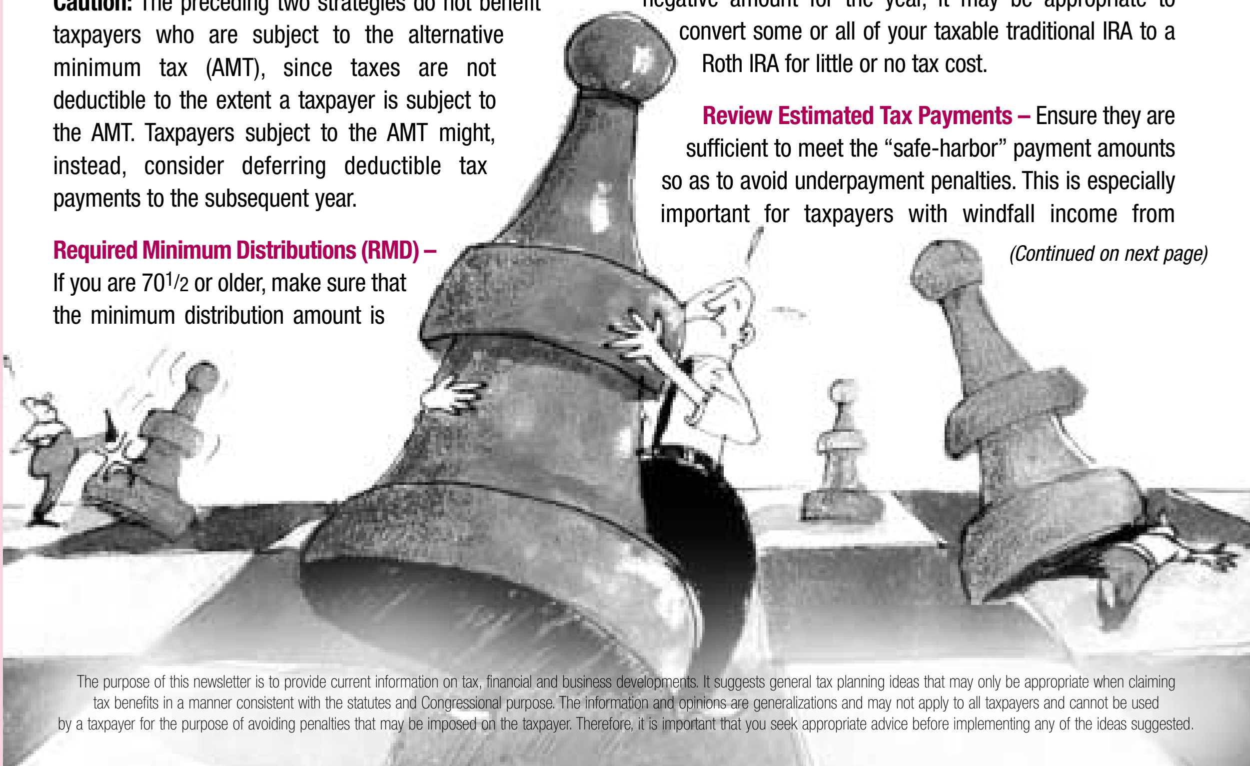

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

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.

Vacation Home Rentals:
Are the Tax Rules On Your Side?

If you have been considering acquiring a second or vacation home, this soft real estate market may be the right time to make this purchase. However, vacation home rental rules include some interesting twists that should be considered beforehand.

Although some individuals prefer to never rent out their homes, others find this to be a helpful way to cover the cost of the home. If you choose not to rent it out at all and it is your designated second home, the property taxes and the home mortgage interest may be written off as part of your itemized deductions. However, the interest is deductible only as long as the acquisition debt on your first and second homes does not exceed $1,000,000. In addition, the interest on up to $100,000 of equity debt can be deducted. If you are unfortunate enough to be subject to the alternative minimum tax (AMT), to the extent that you are taxed by the AMT, the property taxes and equity debt interest will not be deductible.

If the home is partly rented out, then there are three rules to consider, based on the length of the rental:

Rent Less Than 15 Days – If the property is rented out for less than 15 days, the money can be pocketed tax-free, and the interest and taxes can continue to be deducted as if the property were not rented out at all. In this situation, any other directly-related rental expenses, such as the agent fee, utilities, post-rental cleaning, etc., are not deductible. This rule has led to some significant tax-free income for individuals who own a home or second home that is suitable as a filming location.

Personal Use is Less Than the Greater of 15 Days or 10% of the Rental Days – In this scenario, the home's use would be allocated into two separate activities, a rental and a second home. Let's say that the home is used 5% for personal use; 5% of the interest and taxes would be treated as home interest and taxes that can be deducted as an itemized deduction. The other 95% of the interest and taxes would be rental expenses, combined with 95% of the insurance, utilities, allowable depreciation and 100% of the direct rental expenses. The result can be a deductible tax loss, which would be combined with all other rental activities and limited to a $25,000 loss per year for taxpayers with adjusted gross incomes (AGI) of $100,000 or less. This loss allowance is ratably phased out between $100,000 and $150,000 of AGI. Thus, if your income exceeds $150,000, the loss cannot be deducted; it is carried forward until the home is sold or there are gains from other activities that can be used to offset the loss.

Personal Use Exceeds the Greater of 14 Days or 10% of the Rental Days – In this scenario, no rental tax loss is allowed. Let's assume that the personal use of the home is 20%. As for the remaining 80%, it is used as a rental. The rental income is first reduced by 80% of the taxes and interest. If, after deducting the interest and taxes, there is still a profit, the direct rental expenses (such as the rental portion of the utilities, insurance and any other direct rental expenses) are deducted, but not more than will offset the remaining income. If there is still a profit, you can take depreciation, but it is again limited to the remaining profit. End result: No loss is allowed, but any remaining profit is taxable. The other personal 20% of the interest and taxes is deducted as an itemized deduction, subject to the interest and AMT limitations discussed earlier. Take note that if the rental income becomes less than the business portion of the interest and taxes, the balance of the interest and taxes is still deductible as home mortgage interest and taxes.

Sale of the Vacation Home – When the sale of the home results in a loss, the loss may or may not be deducted. If the property is treated partly as personal-use property and partly as a rental (as discussed above in the example, where the personal use was 5%), then the loss would be divided between a nondeductible personal-use portion and the deductible rental portion. In all of our other scenarios, the loss would not be deductible at all.

Unlike your primary home, the second home does not qualify for the home gain exclusion. Any gain would be taxable, unless the rental is the primary residence for two of the five years preceding the sale. If so, the rental is converted for the personal use of the taxpayer, and any gain is deferred until the property is ultimately sold. This option may be ideal for someone who wants to buy a home while prices are low, rent it out for a while, and eventually occupy the home full-time as a retirement residence. If the rental is residential and is occupied by the taxpayer for at least two years after the conversion (and otherwise meets the requirements), the rental would qualify for the home sale gain exclusion. Thus, the gain, in excess of the depreciation previously claimed on the home, could be offset by the home gain exclusion ($250,000/$500,000 for a married couple filing jointly where the spouse also qualifies).

As with all tax rules, there are certain exceptions to be aware of. Please call our office so we can discuss your particular situation in detail.

You Asked: I have been trying for years to contribute to a Roth IRA. My wife and I have pension plans at work and no existing IRA accounts, and our joint incomes are above the limits to deposit into a Roth account. Is there anything we can do?

Answer: Beginning in 2010, the income limitations for converting a traditional IRA to a Roth IRA will be removed, thus allowing you to open a Roth IRA. If you would like to get a jump on it, you can contribute now to a designated nondeductible traditional IRA for the years leading up to 2010, and then convert those nondeductible traditional IRAs into Roth IRAs. The only conversion tax would be tax on the earnings from those accounts between now and the time the conversion is made. This would allow each of you to set aside about $15,000 (more if you are over 50) that can be converted in 2010.

taxcalendar November 2007 – April 2008

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 $70^1/2$ 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 $70^1/2$ 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 $70^1/2$ 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.