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## Annual Individual Tax Newsletter

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### Tax Update Newsletter for Individuals - 2006

**Thanks to all of you that provided your email addresses.** In an attempt to provide information more efficiently and less costly, we are sending the annual update newsletter via electronic delivery. The newsletter provides an overview of tax law changes for the 2006 tax season as well as reminders of tax issues to be aware of when gathering your documents. The tax preparation community is anticipating many future tax changes due to the recent election results.

**NEW - Mileage Rates** - The standard business mileage rate for the 2006-year is 44.5 cents. This rate has been increased to **48.5 cents** per mile starting January 1, 2007. Mileage for charity and volunteer work remains at 14 cents per mile.

**NEW - Charity** - As of August 17, 2006, taxpayers are required to have receipts, bank records, or written document for **all** charitable contributions. No deductions for cash contributions without receipts; therefore, you will need a receipt if you give cash! Be sure to give us a copy of your receipts for any donations.

**NEW** - All non-cash items (clothing, household items, appliances, etc) must be in good condition or better for all contributions made after 8/17/06. Written documentation is required to take this deduction. Since we have no knowledge of the condition of the items you will be donating, it will be necessary for the taxpayer to place a value on any donated items. Valuations above \$5,000 require an appraisal.

**NEW - Donating Vehicles** - If you give away a vehicle and the fair market value is greater than \$500, you will need written documentation from the charity stating the amount the charity received when they resold your vehicle. You will only be allowed a deduction for the amount received in the sale and not the blue book value! If you donated a vehicle you will need to get Form 1098-C from the charity.

**Donating Appreciated Stock to Charity** - If you purchased stock for \$1.00 per share and the fair market value is now \$10.00 per share, you can avoid paying capital gains on the \$9.00 increase in price by gifting it to a qualified charity. Not only that, you receive a charitable contribution deduction for the fair market value of \$10.00 per share when you only had an out-of-pocket expense of \$1.00 per share. This transaction must be well documented with a letter from the charitable organization and proof of the fair market value on the date that it was gifted.

**NEW - Telephone Excise Tax Refund** - All individuals are eligible for a telephone excise tax refund amount this year. The IRS has established safe harbor rules so it will not be necessary to add up all of the excise tax from your phone bills for the period 2/28/03 to 8/1/06. The safe harbor standard allows for the following refunds:

\$30 for one exemption (an individual)

\$40 for two exemptions

\$50 for three exemptions  
\$60 for four or more exemptions

**NEW - Residential Energy Credit Available for 2006 & 2007** - Taxpayers may claim a credit of up to \$500 for qualifying energy-saving improvements to their principal home, but only \$200 of this credit may be taken for qualifying window expenditures. Energy saving expenditures must be for new items expected to be in use for at least 5 years to include insulation, exterior windows and doors, metal roofs designed to reduce heat loss, energy efficient heat pumps and water heaters, certain furnaces and furnace fans. Please check with manufacturers to verify that your items qualify for this credit. The energy efficient items must be placed in service between January 1, 2006, and December 31, 2007, to qualify for the credit.

**NEW - Option for Direct Deposit of 2006 Refunds** - A new program has been created to allow taxpayers that use direct deposit to divide their refunds in up to three financial accounts. This is to promote more savings and the possibility that a taxpayer might use his or her refund to contribute funds directly into a qualified retirement account.

**NEW - Increased Age to Kiddie Tax** - Any child under the age of 18 as of 12/31/06 who has unearned income (interest, dividends, and investment income) greater than \$1,700 will be taxed at his or her parent's tax rate. Please check with us if you are unsure that your child needs to file an income tax return based on his or her earned or unearned income. It may seem odd, but it is possible that a newborn is required to file a return.

**NEW - IRA and Pension Distributions to Individuals called to Active Duty in excess of 179 days** - The 10% early penalty withdrawal from retirement plans will not apply to a qualified reservist if they were called to active duty for a period in excess of 179 days or an indefinite period. The withdrawal from the qualified pension plan must be made during the period beginning on the date of the order or call to duty and end at the close of the active duty period. This new provision applies for those called to active duty after September 11, 2001, and before December 31, 2007.

**WARNING - Do you have Foreign Income Earnings?** **NEW** - A \$10,000 civil penalty may be imposed on any person who fails to report foreign income. This penalty could increase to \$100,000 and jail time if it is a willful violation. You must let us know if you have any foreign income or money in off shore accounts.

**Charges to your Credit Card** - Deductible expenses such as medical bills, charitable contributions, and business supply purchases can be deductible if you charge them to your general use credit cards (Visa, Master Card, etc) before 12/31/06. This does not apply to specific store credit cards.

**Retirement Contributions** - Contributing to a retirement account through your employer is always a great tax break. The income and earnings are non-taxable in the current year, but become taxable upon withdrawal. Generally, there is a 10% penalty if the money is withdrawn before age 59 1/2.

The maximum deferral for 401(k)s and 403(b)s:

	Under the age of 50	50 or older by December 31
2006 year	<b>\$15,000</b>	<b>\$20,000</b>
2007 year	<b>\$15,500</b>	<b>\$20,500</b>

Check with your HR Department to increase your contribution amounts in January 2007. Please let me know if you decide to do an early withdrawal from a qualified retirement account. You will lose at least 30% and sometimes as much as 50% to taxes on an early withdrawal.

**IRAs** - Putting money into a traditional individual retirement account is a good idea, but can be very tricky. If you are eligible to participate in a retirement plan with your employer or your income exceeds \$75,000 (Married Filing Jointly) or \$50,000 (Single), you may be limited or not eligible to take a deduction for a contribution to a traditional IRA. You may want to make the contribution anyway, but it will be necessary to track the non-deductible amounts on Form 8606. If the non-deductible amounts are not tracked, you could end up paying tax on the money twice.

The Roth IRA has become very appealing because the distributions will not be taxed when withdrawn as long as the money is in the account for at least 5 years and the taxpayer is age 59 ½ at the withdrawal date. You are not eligible to make a Roth contribution once your adjusted gross income exceeds \$160,000 (Married Filing Jointly) or \$110,000 (Single). If you have concerns about the taxation of a distribution or limits for contributions, please contact our office.

The maximum contribution amount for both traditional IRAs and Roth IRAs is \$4,000 if you are under 50 years of age, and \$5,000 if you are age 50 as of 12/31/06. The maximum contribution for the 2007 year remains at \$4,000 (under 50 years of age) and \$5,000 (50 years of age or over).

**Child Credit** - The maximum child credit for 2006 is \$1,000 per child under the age of 17. This credit will not be available to some taxpayers due to their income level.

**Dependent Day Care Credit** - The maximum childcare expenses for one child is \$3,000 and for two or more children is \$6,000. Depending upon a taxpayer's income, the maximum credit for one child could be \$1,050 or \$2,100 for two or more children.

**College tuition** - We now have both a higher education deduction and a higher education credit. The deduction is maximized at \$4,000 and the credit can go up to \$2,000. The tax return must be prepared both ways in order to determine what is the greater tax break to the taxpayer. Taxpayers are not allowed to claim both the deduction and the credit in the same year for the same student. The education expenses must be paid during the year and cover tuition and fees (not books, room, board, or activity fees). There are two available credits -The first is the Hope Credit for first and second year students who attend school at least half time. The second is the Lifetime Learning Credit, which is available for any student. There is no limit to the number of years that the Lifetime Learning Credit can be claimed and it is available to all individuals.

**Did you refinance this year?** Refinancing may increase your taxes. Paying a lower interest rate will decrease your mortgage interest write off, which increases taxable income. Be sure to bring in your refinance settlement sheet for the preparation of your tax return. Any points paid at refinance are considered to be mortgage interest and will be written off over the length of the loan using an amortization schedule. If you had a prior refinance with points, the remaining unamortized points can be taken as a deduction only if you have changed lenders.

**Home Equity Interest** - There are limits on the deductibility of home equity interest. A taxpayer may not deduct all of the interest if the principal amount of the home equity loan is greater than \$100,000. Please let us know if you have a home equity loan, as there are other limitations to this deduction.

**Capital Gains Tax** - The long-term capital gains rate was reduced to 15% on May 6, 2003. For taxpayers in the 15% tax bracket, their capital gains rate will be 10%. Be sure to review your capital gains and losses realized so far this year. If you have net gains, take offsetting losses of equal value to make them tax free. If you have net losses, use them before year-end by realizing a gain. The maximum allowable capital loss in one year is \$3,000. If your loss is greater than \$3,000, the excess is carried forward to future tax years.

**Did you sell any stocks or mutual funds?** You will need to research your purchase price, the number of shares purchased, and the date of purchase. Start with your own records or contact your financial institution for the history of purchases. If this is not possible, the Internet is a great resource - use <http://www.bigcharts.com> to research the basis (purchase price) of your shares.

**Rental Properties** - Owning a rental property will not give you a current-year tax break if your income is greater than \$150,000. Once your adjusted gross income reaches \$100,000, your losses will begin to phase out as a current year deduction. No losses are allowed in the current-year if your adjusted gross income exceeds \$150,000 unless you are in the business of real estate management. The disallowed losses will carry forward until the year that your income drops below \$150,000 or you sell the property. Please contact our offices if you are intending on selling your rental so we can review the tax consequences.

**Tax Tip: Like Kind Exchanges** - To avoid paying capital gains on the sale of your rental, you can engage in

a 'Like Kind Exchange' in which you purchase another rental and swap properties. The capital gains are deferred until you sell the replacement property. It is also possible to rent the replacement property for 3 years and then move into it for the next 2 years as your primary residence so that the exclusion available on personal residences can be used when it is sold as mentioned below under 'Sale of Personal Residence'. Your personal residence or second residence does not qualify for use in the initial Like Kind Exchange.

**Sale of Personal Residence** - In general, if you have both lived in and owned your personal residence for 2 of the last 5 years and the gain is not larger than \$500,000 (Married Filing Jointly) and \$250,000 (Single), then there is no capital gains tax due on the sale. If you have been in the home less than 2 years, you may qualify for a reduced exclusion and still not be subjected to the gains tax. The reduced exclusion is available for medical purposes, changing jobs, and unforeseen circumstances (such as death, divorce, multiple births, and disasters). Please let me know if you are selling your personal residence so we can review the tax consequences.

**Moving** - The moving deduction is available only if you have changed jobs and moved at least 50 miles. The new job and home must be more than 50 miles from the former job and home. Remember to always inform the IRS of a change of address. This can be done by completing Form 8822. The form can be found at the IRS Web site <http://www.irs.gov>.

**Inheritance** - In general, money and assets received through an inheritance are not taxable income. There is an exception for annuities and IRA accounts. If you have received a distribution from an IRA or annuity due to a death, you will most likely be taxed on the income on your individual income tax return. Please contact our office if you inherit an IRA.

**Gifts** - Giving a gift to an individual or family member is not a tax deduction, but instead can cause the individual giving the gift to owe tax. The IRS has limits as to the amounts an individual can give before the taxpayer is required to file a gift tax return and possibly owe gift tax on the money. This amount is \$12,000 for 2006 and 2007. As a taxpayer, you can give up to \$12,000 to any other individual before you are required to file a gift tax return. Keep track of gifts, as they will reduce the taxpayer's unified estate credit.

**Vehicle Clean Fuel Deduction** - Purchasing hybrid vehicles has become very popular in our area of the country due to difficult transportation issues. This type of purchase can provide you with not only tax relief, but possible HOV access as well. Check out our website at <http://www.lascpa.com> for a complete list of vehicles that may qualify for this credit. The maximum credit is available for the first 60,000 vehicles that each manufacturer produces. The Toyota Motor company has reached this threshold for the maximum allowable credit. Verify that the vehicle you are purchasing qualifies for the maximum credit before making any final decisions.

**AMT** - Alternative Minimum Tax is a parallel tax system that is used to make sure that high-income earners are not escaping taxation. The new lower tax rates mean that more taxpayers will be facing this parallel tax system. AMT requires adjustments to the regular taxable income for tax preference items, and this eliminates favorable deductions. The maximum alternative tax rate is 28%, but tax is recalculated at a higher taxable income amount, causing a higher tax bill than expected. If you are subjected to AMT, it will not benefit you to make your 4<sup>th</sup> quarter estimated state income tax payment by December 31<sup>st</sup>. Making this payment in 2006 is usually a good tax tip, but if you are subjected to AMT, state taxes are a disallowed deduction and will not reduce your IRS tax liability.

**Social Security Earnings** - If you are between the age of 62 and full retirement age and are drawing social security benefits, the maximum amount of earnings you can make in 2007 is \$12,960.

The maximum amount that a taxpayer's wages can be taxed for social security purposes in 2007 is \$97,500.

If you are looking toward retirement, go to <http://www.ssa.gov/retire> on the Internet to access the Social Security Retirement Planner, which will walk you through the retirement application process and offer information on issues to consider when applying for benefits. You will find on-line calculators to help you through the process of estimating future earnings based on past and present earnings.

**Head of Household Changes** - Taxpayers are not able to use the Head of Household filing status if they do not have a qualifying child or a child who they could claim as a dependent. If you have a grown child living in your household that is not claimed as a dependent on your tax return, you will not be eligible to use the lower tax 'Head of Household' filing status.

**Electronic Filing** - All tax returns prepared in this office will be filed electronically for 2006. There will be no charge for this service. It will be necessary for the taxpayer to review and approve his or her tax return before we transmit the data electronically to the IRS and the state. We must receive a signed Form 8453 (The IRS e-filing form) and payment for the tax preparation services from the taxpayer before we submit the electronic tax data. We cannot guarantee timely filing if Form 8453 is received in our offices after April 7, 2007. Please be sure we have all of your tax information to us by April 1, 2007 for timely processing.

**Informational Data** - An 'Informational Data Sheet' will be sent to all clients at the beginning of January to assist them in gathering their tax data. This will provide my office current contact information for our data base and assist in preparing accurate tax returns.

**Where is your refund?** You can check on the status of your refund by calling the IRS refund hotline at 800-829-1954 or by going to <http://www.irs.gov>.

### **Privacy Statement**

Federal law requires that once a year I inform you of our Privacy Policy. As you know, we collect certain personal information about you in order to prepare your tax returns. The information is either provided by you or obtained by our office with your permission. No personal information will ever be disclosed about you to anyone except that which is already public by law.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here. The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account.

Procedural, physical, and electronic safeguards will be maintained in compliance with federal standards regarding your personal information. We are committed to retaining your confidence and want to assure you that any information you give us remains safe and confidential.