

Tax Law Changes for the 2007

This Tax Newsletter brings you current status of a number of important tax law provisions that have already expired or are scheduled to disappear at the end of 2007 which may significantly impact your tax bill for this year.

One of the most popular tax breaks set to disappear at the end of 2007 involves state and local sales taxes. If you itemize your deductions, you have the option of deducting your state and local sales taxes instead of your state and local income taxes. This provision benefits many people and more than 11.4 million taxpayers claimed this sales-tax deduction for 2005.

At the end of 2007 the \$250 per educator for the cost of books, computer equipment and other classroom supplies they pay out of their own pockets is an adjustment to income for elementary and secondary school teachers and other qualified educators. More than 3.5 million taxpayers took this deduction for 2005. To be eligible, you must be a kinder-

garten through grade 12 teacher, instructor, counselor, principal or aide for at least 900 hours during a school year.

The alternative minimum tax or AMT is the largest single issue facing taxpayers in 2007. If Congress does nothing to alter the AMT, about 25 million taxpayers will be affected by it for 2007, up from about four million for 2006, according to the latest U. S. Department of the Treasury estimates. The AMT is a separate method of calculating income taxes, with different rules than the regular tax system. Higher AMT exemption amounts expired at the end of last year. While it is anticipated that Congress will take some action to prevent the AMT from spreading rapidly, it is not clear how lawmakers will accomplish this goal. In the recent past, Congress has passed temporary fixes to the AMT which is widely expected to reoccur this year.

For charitable contributions made on or after January 1, 2007 a donor may not claim a deduction

for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record, such as a cancelled check, or a written communication from the charity, such as a receipt or a letter, showing the name of the charity, the date of the contribution, and the amount of the contribution.

While Congress has several tax acts under consideration, none have been passed at this time. As your tax professional, I assure you that I will be keeping a watchful eye on legislation which may affect your tax filings.

If you have concerns or questions about your taxes, our focus should be on how the tax law changes affect you, how the tax law changes can benefit you and what tax planning techniques should be implemented in order to maximize their tax benefit to you.

Motivational Quote

"Speak little, do much.."

Benjamin Franklin (1706-1790)
American statesman, writer, scientist & printer

Tax Calendar for Dec

- Dec 17 – Monthly Payroll Taxes
4th Quarter Corporate Estimated Taxes
- Dec 20 – Texas Sales Tax Due

Retirement Savings and 2007 Tax Law

Older taxpayers can take advantage of a charitable giving provision which is set to expire on December 31, 2007. If you are age 70 ½ or older you can transfer up to \$100,000 directly from an individual retirement account, IRA, to a qualified charity without having to pay income tax on the distribution. This transfer counts toward your required minimum distribution as well as assists you with estate planning.

Much tax savings can be obtained by fully participating in retirement plans available from your employer such as a 401(k) or 403(b) plan. Check with the human resources department where you work to see if you are participating at the maximum level and certainly to the extent the employer will match your contributions.

Business owners can shelter profits from their business in a qualified retirement plan. Sole proprietors can create 401(k) plans and contribute to their retirement while obtaining substantial retirement savings. The maximum annual 401(k) plan contribution through a salary reduction is limited for 2007 to \$15,500. If you are age 50 or older by the end of the year, an additional \$5,000 "catch up" contribution is allowed. However, if you work for an employer who provides participation in a 401(k) and you are also self-employed, the overall elective contribution cannot exceed the annual limit.

If you participate in a 401(k) plan through your employment and you also have a profitable business from self-employment you can use a Simplified Employee Pension plan account, SEP, to shelter business income.

Seniors who continue to have earnings after age 70 ½ can contribute to a Roth IRA. You would be required to have a modified adjusted gross income below \$156,000 on a married filing joint tax return or \$99,000 for single taxpayers in order to make a full contribution of \$4,000. The \$4,000 could be supplemented by an additional \$1,000 as a "catch up" contribution.

Self-employed individuals who do not have medical coverage through an employer or under a spouse's policy can deduct insurance premium costs as an adjustment to gross income. They are not required to itemize their deductions on their tax return. The definition of insurance includes supplemental cancer policies and long-term care insurance subject to age limitations. the organization, if that is the case.

The Home Office An IRS Red Flag?

Another common issue during tax filing season is the eligibility of a home office for a deduction, converting nondeductible personal expenses such as home-owner dues, insurance, utilities, etc., into deductible business expenses.

Qualifying for a home office deduction requires the owner to meet two tests. First, the home office must be the principal place of business for the activity. It is not a requirement that the activity be full-time. A home office is determined to be a principal place of business if it is used for substantial managerial or administrative purposes such as scheduling appointments, ordering supplies and keeping records. There can be no other fixed location for such activities.

Second, the space used must be used regularly and exclusively for the activity. You are not required to dedicate a full room to the activity but the space allotted cannot be used for personal purposes. In 2007, the United States Tax Court did hold that keeping some personal papers in a home office will not void the exclusive use test.

An office in the home deduction cannot exceed the gross income derived from the home-based activity. Any unused losses can be carried forward until used.

Claiming a home office deduction does not eliminate the home sale exclusion of income for a homeowner when the home is eventually sold. Depreciation claimed after May 6, 1997 must be recaptured at 25 percent at the time of the sale of the home.

Will the deduction of a home office cause the Internal Revenue Service to audit the tax return? While there is no statistical evidence to support such conclusions taxpayers should be aware of the requirements to claim an office in home deduction and document the use of such home office. In doing so, the taxpayer may want to discuss insurance coverage with their home owner's carrier. The taxpayer will want to make certain coverage is sufficient to obtain the insurance liability of the office in the home.