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Newsletter Date

Sauppé Tax News

Brought to you by
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Special points of interest:

- Telephone Tax Refund
- Home Improvement Credit
- AMT Issues
- IRA's and Charity
- Education Credits
- Energy Efficient Vehicles

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Telephone Tax Refund

Individuals, businesses, and tax-exempt organizations may be entitled to a tax refund on their 2006 tax return due to a recent Supreme Court ruling. The refund is for federal excise taxes charged on phone bills for the period March 2003 thru July 2006.

For individuals, they may use a set refund amount ($30 to $60 depending on the number of exemptions claimed on the 2006 return). Using this amount will only require completing one line on the tax return—no additional schedules or forms will be required. Alternately, individuals can complete Form 8913 to show the actual amount of federal excise tax paid on their telephone bills for the period in question. This form would then be attached to the 2006 tax return to substantiate the refund claimed. People with two or more phone lines in their home may find the second method more beneficial.

Individuals who do not need to file a 2006 tax return EXCEPT to claim the refund, may file Form 1040EZ-T to claim their refund.

Business and tax-exempts may NOT use the standard amount.

Telephone tax refund for individuals, businesses, and non-profits available on 2006 tax returns.

Instead, they must look at their actual phone bills for April 2006 and September 2006. They must first figure the telephone tax as a percentage of their April 2006 bills and their September 2006 bills. The difference between these two percentages should then be applied to the quarterly or annual telephone expenses to determine the amount of the refund. Form 8913 must be completed and attached to the 2006 tax return to claim the refund. The refund is capped at 2% of total telephone expense for the period for employees with less than 251 employees.

Business and tax-exempts can also document their actual tax charged for the period and claim that amount using Form 8913.

Kiddie Tax Expanded

The Kiddie Tax has been expanded this year to cover income earned by a child up to age 18. This is a change from the previous age of 14 and is effective for all of 2006. This means unearned income of a child thru age 17 will be taxed at the parents' marginal rate if the total unearned income for the child exceeds $1,700. Unearned income includes interest, dividends, and capital gains.

The first $850 of a child's earned income will not be taxed and the second $850 will be taxed at the child's rate.

The child's age is determined based on his age as of December 31, 2006. For example, if your child turned 18 on November 10, 2006, the kiddie tax will not apply for 2006.

Home Improvement Credits Available

During 2006, individuals can make energy-conscious purchases that will provide tax benefits when filling out their tax returns next year. The credit will also be available for purchases in 2007. Manufacturers offering energy efficient items such as insulation or storm windows can assure their customers that their energy efficient

Certain Home Improvements May Entitle You to A Tax Credit in 2006 or 2007

items will qualify for the tax credit if certain energy efficiency requirements are met. A recent tax law change provides a tax credit to improve the energy efficiency of existing homes. The law provides a 10 percent credit for buying qualified energy efficiency improvements. To qualify, a component must meet or exceed the criteria established by the 2000 International Energy Conservation Code (including supplements) and must be installed in the taxpayer's main home in the United States.
The following items are eligible

- Insulation systems that reduce heat loss
- Exterior windows (excluding skylights)
- Exterior doors
- Metal roofs (meeting applicable energy star requirements).

In addition, the law provides a credit for costs relating to residential energy property expenses. To qualify as residential energy property, the property must meet certification requirements prescribed by the Secretary of the Treasury and must be installed in the taxpayer's main home in the United States.
The following items are eligible:

- $50 each for advanced main circulating fan
- $150 for each qualified natural gas, propane, or oil furnace or hot water boiler
- $300 for each item of qualified energy efficient property

The maximum credit for all taxable years is $500 – no more than $200 of the credit can be attributable to expenses for windows. Additionally, the new law makes a credit available to those who add qualified solar panels, solar water heating equipment, or a fuel cell power plant to their homes in the United States. In general, a qualified fuel cell power plant converts a fuel into electricity using electrochemical means, has an electricity–only generation efficiency of more than 30 percent and generates at least 0.5 kilowatts of electricity.

Taxpayers are allowed one credit equal to 30 percent of the qualified investment in a solar panel up to a maximum credit of $2,000, and another equivalent credit for investing in a solar water heating system. No part of either system can be used to heat a pool or hot tub.

The maximum credit for all taxable years is $500

Hybrid Cars Eligible for Tax Credits

The Energy Policy Act of 2005 provides a credit for taxpayers who purchase certain energy efficient vehicles, including qualified hybrid vehicles

To be eligible for the credit, the vehicle must be certified by the IRS as energy efficient. A detailed list of all vehicles that have met this certification can be found at www.irs.gov.

The taxpayer must also *purchase* the vehicle NEW between 1/1/2006 and 12/31/2010, and use it predominately in the United States. No used cars are eligible for the credit.

The credit varies based on the vehicle and is reduced in stages based on when a manufacturer sells 60,000 hybrid vehicles. For example, Toyota/Lexus has already sold more than 60,000 hybrid vehicles (all models). Therefore anyone purchasing a new Toyota or Lexus hybrid during the period October 1, 2006 thru March 31, 2007 can claim only 50% of the full credit. Anyone purchasing a new Toyota or Lexus hybrid during the period April 1, 2007 and September 30, 2007 can claim only 25% of the full credit. Anyone purchasing a new Toyota or Lexus hybrid after September 30, 2007 cannot claim the Alternative Motor Vehicle Credit

AMT and You

You may not have heard about the Alternative Minimum Tax (AMT) but you may find yourself subject to this tax in the not too distant future.

The AMT was first established in 1982 to ensure that every taxpayer paid a minimum amount of tax. The AMT is a separate tax system that applies lower tax rates to a broader base of income. The taxpayer must pay whichever tax is higher—the regular tax or the AMT.

To determine the AMT, the taxpayer must start with his or her taxable income and adjust it for various tax preference items including but not limited to

- Miscellaneous itemized deductions
- State & local taxes, including real estate taxes
- Certain mortgage interest deductions most notably home equity interest
- Tax exempt interest
- Accelerated depreciation
- Personal exemptions
- Stock options

This new income amount (called the Alternative Minimum Taxable Income or AMTI) is then reduced by a fixed dollar amount set by Congress. For 2006, the reduction amount is $62,550 for a married couple filing jointly, $31,275 for married couples filing separately, and $42,500 for single taxpayers. If your AMTI exceeds these exemption amounts, the balance is then taxed at a rate of 26% on the first $175,000 ($87,500 for married filing separately) of income, and 28% on amounts over that threshold.

The reduction amounts of $62,550, $31,275, and $42,500 are only effective for 2006 unless Congress votes to revise them. If Congress does not act, the amounts will drop back to $45,000 for MFJ, $22,500 For MFS, and $33,750 for single filers on 1/1/2007.

Charitable Donation Changes

Charitable donations continue to draw IRS scrutiny. As was the case for 2005, if the claimed value of a donated motor vehicle, boat or plane exceeds $500 and the item is sold by the charitable organization, the taxpayer is limited to the gross proceeds from the sale. The charity is required to provide the donor an acknowledgement of the sales proceeds within 30 days of the sale..

The Pension Protection Act of 2006 added some new restrictions for donations of household goods after August 17, 2006. The items must be in “good” condition or better to be deductible. However, the IRS has not yet determined a definition of “good”. One exception to this rule is for any <u>single</u> item appraised at more than $500. The rule requiring detailed lists of items donated has not changed.

Starting 1/1/2007, all cash donations <u>must</u> have documentation in order to be deducted. This includes an acknowledgement from the charity, a cancelled check, or a bank record, and must show the name of the organization, the date of the contribution, and the amount. Cash given with no receipt <u>cannot</u> be claimed.

Starting 1/1/2007, all cash donations <u>must</u> have documentation in order to be deducted

IRA’s Direct to Charity

Taxpayers age 70 1/2 or older can now direct their IRA sponsor to send their IRA distribution directly to a recognized 501 c 3 organization. The distribution will be tax free, and the taxpayer may not claim a charitable donation for the amount. Having the distribution sent to the charity may benefit the taxpayer indirectly because it will reduce adjusted gross income. A reduction in adjusted gross income may allow the taxpayer to claim more of his medical and/or miscellaneous itemized deductions, and may decrease the tax on social security benefits.

Please note Ohio has not yet indicated how they will handle this tax free distribution on the Ohio return.

Give your IRA directly to a charity tax free.

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Specializing in personal and small business taxes

Tax Tidbits

Audit Rates on the Rise—audit rates continue to rise with Schedule C returns receiving the most scrutiny. In 2004, the face to face audit rate was 0.15%. When correspondence audits (handled simply thru correspondence with the IRS) are included, the rate goes up to 0.77%. That means between 1 and 2 out of every 1000 taxpayers will be subject to face to face audit. The overall business audit rate was 0.19%Pass-thru entities (partnerships, S corporations, and limited liability companies) have an overall audit rate of 0.22%. . Schedule C audit rates range from 2.21% to 3.68% depending on the income level.

Installment Agreement Fees-The IRS now has an online payment agreement application. This online system will allow you to pay your balance due in one of three ways. You can agree to pay the balance due in full at the time of the application. You will save penalties, interest, and fees. You can agree to pay your balance within 120 days. You will pay penalties and interest, but there is no fee for this method. If you cannot pay in full within 120 days, you can request monthly payments. You will be charged penalties and interest as well as a user fee. The fee is presently $43.00 but will increase to $52.00 on 1/1/2007 IF you sign up for automatic withdrawal from your checking account. If you do not sign up for automatic withdrawal, the fee will increase to $125.00 on 1/1/2007. If you default on your agreement and need to reinstate it, or if you need to restructure the agreement, the fee for this will be $45.00 effective 1/1/2007.

Tax Refund Can Now Go Into Three Different Accounts-The IRS has announced that taxpayers may now have their refund automatically deposited into as many as three different accounts. Prior to this, taxpayers could speed up their refund by as much as 3 to 4 weeks by designating direct deposit into one checking or savings account, simply by noting the account information on the 1040 form. This option continues to be available. However, for 2006 returns, taxpayers may complete Form 8888 to report the routing and account numbers for up to 3 different accounts, including IRA accounts. Any client wishing to utilize this new option, must obtain Form 8888, complete it, and send it to our office with their 2006 tax paperwork. The form can be downloaded from www.irs.gov. Of course, receiving a check in the mail is still an option.

Making The Most Of Your Education

Uncle Sam can help pay for college.

There are a number of ways to save on your taxes when you or one of your dependents obtains post-secondary (beyond high school) education. During the first two years of college, you may be eligible for the Hope Credit. This credit is 100% of the first $1100 and 50% of the second $1100 spent for tuition and other qualified expenses (this does NOT include room and board or books unless they must be purchased at the school). The maximum credit each year for each student is $1,650. The Hope credit can only be claimed for two years. If the Hope credit is not available, you may be eligible for the Lifetime Learning credit. This credit is 20% spent for tuition and other qualified expenses. The maximum credit is $2,000 per year per tax return. Again room and board does not qualify.

There are income limitations that may restrict your ability to claim either of these credits.

As of this writing, the tuition and fees deduction that was available to those ineligible for the education credits has expired. However, it is assumed that Congress will reinstate it retroactively to 1/1/2006 before the end of the year. If it is reinstated, up to $4,000 of eligible expenses may be deducted from adjusted gross income.

Distributions taken from Coverdell Education accounts or 529 plans, or scholarships and grants received, may reduce the credit or deduction.

You must have documentation *other than* Form 1098T to substantiate your qualified education expenses.

Please note that education credits *follow the dependency exemption*. In other words, the person claiming the student as a dependent is the ONLY person who can claim education credits for that student on his or her return, no matter who actually paid the education expenses.