TaxTips

Keeping you informed...

Summer 2007

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Save Your Receipts

Optional sales tax deduction extended

Congress has extended the sales tax deduction, allowing people who itemize to deduct either state and local income tax or state and local sales tax. This option is especially beneficial for taxpayers living in a state with no state sales tax. The option is good until December 31, 2007.

You are allowed to deduct the greater of your actual state sales tax paid or an amount the IRS has determined based on your income and the number of exemptions that you claim when you file.

In addition to the amounts provided in the IRS tables, you can also deduct sales tax paid on motor vehicles, boats, motor homes, and aircraft. The IRS has also specified the following additional items, but only if the tax rate on these items is the same as the general sales tax rate in your state:

- Homes (including mobile and prefabricated homes); and
- Home building materials and substantial additions to or renovations of your home.

The sales tax is deductible on the above items only if the state or locality imposes a general sales tax directly on the sale of a home or on the cost of a substantial addition or major renovation, and only if you purchased the materials yourself.

Did You Purchase a New Home This Year?

One-time deduction for mortgage insurance premiums available

If you purchased a home in 2007 and paid premiums for qualified mortgage insurance, you may be entitled to an additional deduction. You personally must have paid the mortgage insurance premiums in connection with the debt you incurred to acquire your residence. Only premiums paid during 2007 qualify.

Qualified mortgage insurance is mortgage insurance provided by the Veterans Administration (VA), the Federal Housing Administration (FHA), the Rural Housing Administration (RHA), or a private mortgage insurance company.

Are You Paying College Tuition?

Deduction is allowed for another year

There are numerous tax breaks available to parents and students who pay expenses for higher education. Some of those tax breaks come in the form of a tax credit, such as the Hope or Lifetime learning credits. These credits are limited to taxpayers with an adjusted gross income that is not more than $57,000 for 2007 ($114,000 if married filing jointly).

If your adjusted gross income is too high to take advantage of the tax credits, you may still get some relief by deducting the costs instead. Recent legislation extended the tuition and fees deduction until December 31, 2007. You are allowed a deduction of up to $4,000 of qualified costs if your adjusted gross income is less than $65,000 ($130,000 if married filing jointly) and $2,000 of qualified costs if your AGI is less than $80,000 ($169,000 if married filing jointly).

Teachers Get a Tax Break

Deduction extended for out-of-pocket costs

Recent tax legislation extended the deduction to December 31, 2007, for out-of-pocket expenses incurred by teachers. If you are an elementary or secondary school teacher, aide, counselor, principal, or other eligible educator who worked at least 900 hours in a school during 2007, you may deduct up to $250 for classroom supplies that you purchased during the year. You may claim the deduction even if you do not itemize deductions. Qualifying costs for the deduction include books, supplies, equipment, computer equipment (including related software and services), and other materials used in the classroom.

Currently, there is no law that allows teachers who home-school their children to take this deduction for supplies they purchase for the classroom.

Renting Your Vacation Home

Understand the rules for deducting expenses

If you receive rental income from renting your vacation home to others, you may deduct certain expenses. These expenses, which may include interest, taxes, casualty losses, maintenance, utilities, insurance, and depreciation, will reduce the amount of rental income that is taxed.

The amount of your deductible expenses depends on how many days you personally use the vacation home. If you are renting to make a profit and do not use the dwelling as a home, your deductible rental expenses can be more than your gross rental income, subject to certain limits. However, if you rent a dwelling that you also use as a home, your deductible rental expenses will be limited.

You are considered to use a dwelling as a home if you use it for personal purposes during the tax year for more than the greater of 14 days or 10 percent of the total days it is rented to others at a fair rental price.

If you use the dwelling for both rental and personal purposes, you generally must divide your total expenses between the rental use and the personal use based on the number of days used for each purpose. However, you will not be able to deduct your rental expense in excess of your gross rental income. If you use a dwelling as a home and rent it for fewer than 15 days, you are not required to report any of the rental income and are not allowed to deduct any expenses as rental expenses. If you itemize your deductions, mortgage interest and real estate taxes are deductible regardless of the rental use.

Energy Efficient Home Improvements

Expenses you incur can save you tax dollars

If you make certain energy efficient improvements to your existing home, you may be entitled to a lifetime tax credit of up to $500. Legislation passed late last year extended the credit for expenses incurred before January 1, 2009. The credit equals the sum of the following two credits:

- A ten-percent credit for energy efficient improvements, such as insulation, exterior windows, skylights, exterior doors, and pigment-coated metal roofs. (The maximum credit allowed for windows is limited to $200.)
- A credit for energy property expenditures in the following amounts: $50 for each advanced main air circulating fan; $150 for each qualified natural gas, propane, or oil furnace, or hot water boiler; and $300 for qualified energy efficient property, such as heat pumps, water heaters, and central air conditioners that meet certain requirements.

When making home improvements, look for the Energy Star label and ask the manufacturer if the items qualify. Items such as appliances and siding do not qualify for the credit. Also, the expenditures must be incurred for items installed in the home that you are currently occupying as your principal residence. If you are in the process of building a new home, you are not entitled to the credit, even though the items you install may be certified as energy efficient.

Casualty Losses in Presidentially Declared Disaster Areas

How to get money in your pocket as fast as possible

If you suffer a loss to your property as a result of a severe storm, flood, fire, or some other sudden and unexpected event, and the area is declared a disaster area by the President, you do not have to wait until you file your return for that year to claim a loss and get some tax money back. A special provision in the law allows you to amend your prior year's tax return and claim a refund based on the tax you paid in the prior year.

You can deduct casualty losses arising in 2007 on your 2006 tax return. If you had a tax liability in 2006, amending your tax return now could bring needed cash to your pocket sooner than if you waited to claim the loss when you file your 2007 tax return.

QUIK TIPS

1 Beginning January 1, 2007, the standard mileage rates for the use of a car (including vans, pickups, or panel trucks) are:

- 48.5 cents per mile for all business miles driven;
- 20 cents per mile for all miles driven for medical or moving purposes; and
- 14 cents per mile for all miles driven for charitable purposes.

2 Are you collecting unemployment benefits? If so, your benefits are taxable. To ease the tax burden when filing your return, you can file Form W-4V and specify the amount that you want withheld from your benefit.

3 If you turn age 70 on July 1, 2007, or later, you are not required to begin your minimum required distributions from your IRA until April 1, 2009. You are not considered to be age 70½ until January 1, 2008. Minimum required distributions from your IRA must begin no later than April 1 of the year following the year you reach age 70½.

4 Each cash charitable contribution you make must now be substantiated with a written receipt or other documentation, regardless of the amount. Unsubstantiated cash contributions are not deductible.

5 Noncash contributions of household items must be in good or better condition to qualify for a deduction. A single household item valued at $500 or more qualifies as a deductible contribution regardless of its condition, provided you obtain a qualified appraisal of the item.

6 Planning to move this summer? Make sure you notify the IRS of your new address by filing Form 8822.

More Options for Funding Your HSA

New rules allow rollovers

You may be allowed to make a one-time transfer of amounts from your health flexible spending arrangement (health FSA) or your health reimbursement arrangement (HRA) to your health savings account (HSA). The amount you can transfer is limited to the lesser of the account balance of your health FSA or HRA as of August 21, 2006, or the account balance of your health FSA or HRA on the transfer date. You are allowed to take advantage of this new rollover option until December 31, 2011.

Also beginning this year, you can withdraw funds from your IRA and transfer them tax-free to your HSA. You are allowed to make this rollover only once during your lifetime. The amount transferred can be up to the maximum deductible HSA contribution for the type of coverage (individual or family) in effect at the time of the transfer. The amount transferred is excluded from your gross income and is not subject to the ten-percent early withdrawal penalty.

Are You Eligible to Receive Social Security Benefits?

Know when to retire and how to preserve your benefits

If you have reached full retirement age, you are able to collect social security benefits while working and still keep your entire benefit. However, because social security benefits are based on the years you make your highest wage, your benefits may go up if you currently have a high-paying job. Social security works as follows:

- If you are younger than age 65 years and 10 months during all of 2007, $1 from each $2 of earnings above $12,960 will be deducted from your benefits.
- If you turn 65 years and 10 months during 2007, $1 from each $3 of earnings above $34,440 will be deducted from your benefits.
- If you are self-employed, count all net earnings as income at the time you receive them, unless you earned the money before becoming eligible for social security, but you didn't collect it until after becoming eligible. For example, Brian is a self-employed house painter who will be eligible for social security benefits on June 1. He painted a house in May and charged the customer $1,000. The customer did not pay Brian for the job until July. Even though Brian received the money after he became eligible to collect benefits, he will not count the $1,000 towards determining whether his income is over the limit because he earned it before he became eligible.
- If you are an employee, only wages you earn at the time count towards the social security earnings limit, not when you actually receive those wages.

Is it wise to begin collecting right away? If you begin collecting benefits before full retirement age, your benefits are permanently reduced for the length of time you draw them. You will collect less money annually, but will collect over a longer period of time, depending on how long you live. If you start to collect benefits at full retirement age, you'll receive the full amount for the remainder of your life. For individuals who have not acquired 40 social security credits and who are able to earn the additional credits needed by working a couple more years, it's almost certainly worthwhile to work until they become eligible.