

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

About This Newsletter

This monthly Newsletter is a free service provided by Gregg Harvey, CPA. It is emailed every month to clients and, starting in April 2007, to members of the Rochester Regional Chamber of Commerce.

This Month's Contents:

With the due date for 2006 individual tax returns right around the corner, this month's Newsletter is largely dedicated to last minute tax filing information. There are also a few notes on what might be coming in 2007.

Due Date For Returns

This year April 15th falls on a Sunday. Normally that would make Monday the 16th the due date. However the 16th is a holiday in some states – it's "Emancipation Day" in D.C. and "Patriots Day" in other places. So the IRS is giving everyone an extra day to file. This was overlooked when forms were printed so many instructions say the 16th, but actually you have until the 17th.

Can't Make The Deadline?

By the April due date, all taxpayers should have either filed a return or a request for an extension of time to file.

You can receive a six-month extension of time to file using Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. You can e-file an extension request using tax preparation software

on your own computer or by going to a tax preparer.

The filing extension will give you extra time to get the paperwork to the IRS, **but it does not extend the time you have to pay** any tax due. You have to make an accurate estimate of any tax due and pay at least 90 percent when you request an extension. You will owe interest on any amounts not paid by the April deadline.

Unable To Pay The Tax Due?

If your return is completed but you are unable to pay the tax due, do not request an extension. Instead, file your return on time and pay as much as you can. The IRS will send you a bill or notice for the balance due and will charge interest and penalties only on the unpaid balance.

If you cannot pay the full amount due with your return, you can ask to make monthly installment payments for the full or a partial amount. Apply for an IRS installment agreement using the IRS's Web-based Online Payment Agreement application. You can find this on IRS.gov. This new Web-based application allows eligible taxpayers or their authorized representatives to self-qualify, apply for, and receive immediate notification of approval.

You can request an installment agreement by submitting a completed Form 9465, Installment Agreement Request, either when you file the return or when you later get a bill from the IRS.

You can also charge your taxes on your American Express, MasterCard, Visa or Discover cards. To pay by credit card,

April, 2007

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contact one of these 2 service providers at its telephone number or Web site and follow the instructions. The service providers charge a convenience fee based on the amount you are paying.

Link2Gov Corporation: 888-PAY-1040 (888-729-1040),
www.pay1040.com

Official Payments Corporation: 800-2PAY-TAX (800-272-9829),
www.officialpayments.com

Last Minute Filers

Here are some general tips for those last minute filers:

- Consider filing electronically instead of using paper tax forms. Choosing to e-file your tax return instead of preparing a paper tax form is the best step you can take to ensure that your return is accurate and complete.
- Put all required Social Security numbers on the return
- Double-check your figures
- Sign your form
- Attach all required schedules
- Send your return or request an extension by the April filing deadline
- When you file a paper return, the numbers to check most carefully on the tax return are the identification numbers — usually Social Security numbers — for each person listed. This includes the taxpayer, spouse, dependents and persons listed in relation to claims for the Child Care or Earned Income Tax Credits. Missing, incorrect or illegible

Social Security Numbers can delay or reduce a tax refund. Note that incorrect Social Security numbers are almost always the most common taxpayer error that the IRS sees.

- People sending a payment should make the check out to “United States Treasury” and should enclose it with, but not attach it to, the tax return or the Form 1040-V, Payment Voucher, if used. The check should include the taxpayer’s Social Security number, daytime phone number, the tax year and the type of form filed.

There Is Still Time To Contribute To An IRA For 2006

If you haven’t contributed funds to an Individual Retirement Arrangement for tax year 2006, or if you’ve put in less than the maximum allowed, you still have time to do so. You can contribute to either a traditional or Roth IRA until the April due date for filing your tax return for 2006, not including extensions.

Be sure to tell the IRA trustee that the contribution is for 2006. Otherwise, the trustee may report the contribution as being for 2007 when they get your funds.

Generally, you can contribute up to \$4,000 of your earnings for 2006 or up to \$5,000 if you are age 50 or older in 2006. You can fund a traditional IRA, a Roth IRA (if you qualify), or both, but your total contributions cannot be more

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than these amounts.

Traditional IRA: You may be able to take a tax deduction for the contributions to a traditional IRA, depending on your income and whether you — or your spouse, if filing jointly — are covered by an employer's pension plan.

Roth IRA: You cannot deduct Roth IRA contributions, but the earnings on a Roth IRA may be tax-free if you meet the conditions for a qualified distribution.

You can file your tax return claiming a traditional IRA contribution before the contribution is actually made. However, the contribution must be made by the due date of your return, not including extensions.

If you report a contribution to a traditional IRA on your return, but fail to contribute by the deadline, you must file an amended tax return by using Form 1040X, Amended U.S. Individual Income Tax Return. You must add the amount you deducted to your income on the amended return and pay the additional tax accordingly.

Last Minute Changes To The Tax Law

Last-minute changes in the law are making this tax season one of the trickier ones in recent years. The main reason is that Congress didn't act until December to extend the life of several popular tax breaks that had expired at the end of 2005. By the time Congress got around to extending those provisions, the IRS had already sent its 2006 tax forms to the printer. Thus the forms don't have lines that mention deductions for state and

local sales taxes, higher-education tuition and fees, or educators' classroom expenses. Instead, you need to follow new instructions on where to claim each item.

Here are some of the major changes that you may run in to:

Sales-tax deduction. If you itemize your deductions, as most upper-income taxpayers do, you can deduct your state and local sales taxes instead of your state and local income taxes. This is an especially important option for many people in states that don't have a state income tax.

But many people who live in other states claim the sales-tax deduction, too. Over 11 million taxpayers took this deduction for 2005. This year, because Congress took so long to extend this option, you should deduct sales taxes on Schedule A, line five even though it's marked "state and local income taxes" and write or enter "ST" on the dotted line to the left of that line.

Higher-education tuition and fees deduction. This deduction, which also was revived by Congress in December, allows up to \$4,000 of tuition and fees paid to a postsecondary institution. You can claim it on Form 1040, line 35 even though that line says "domestic production activities deduction." Write "T" in the blank space to the left of that line entry if you're claiming the tuition and fees deduction. Write "B" if you're claiming both this and the domestic production activities deduction. If you enter B, attach a breakdown showing the amounts for each.

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Phone-tax refund. This is a one-time refund that results from the government's loss of several court cases and basically gives you back excise tax on long-distance and bundled service. On Form 1040, it's line 71: "Credit for federal telephone excise tax paid". In general, you're eligible if you paid for long-distance or bundled phone service billed anytime from March 2003 through July 2006.

There are two ways to calculate the amount. The easy way is to use the standard amount allowed by the IRS, ranging between \$30 and \$60, depending on the total number of exemptions on your return for 2006.

But consider the other option: You can base your claim on the amount of excise taxes you actually paid, assuming you kept good records, and attach Form 8913. In many cases, that will be a larger amount. Caution: This can be complex and time-consuming.

The IRS expects that most of the 136 million regular returns that will be filed this year should be eligible, but about three out of 10 returns filed through early March didn't request it. Some of these filers may not have been eligible but most probably were, making this the most common source of taxpayer error this year.

Donations from IRAs. Under a law enacted last year, someone 70½ or older could arrange to transfer as much as \$100,000 directly from an individual retirement account to a qualified charity without getting taxed on that money. That transfer counts toward your required minimum distribution. This law

was effective for 2006, and it's available again for 2007. Unsurprisingly, charities are urging Congress to make this provision permanent.

Kiddie tax. Thanks to another change enacted last year, a child's investment income may be subject to tax at the parent's rate if the kid was under age 18 by the end of 2006 and had investment income of more than \$1,700. Previously, the rule applied to kids under 14.

Expatriate taxes. If you worked abroad last year a new law will affect you. Since that law passed in May the IRS has issued important new details on housing allowances. This area gets so tricky that it's probably best for you to work with a tax professional unless you are very sure about what you doing tax-wise.

Educators' classroom expenses. This provision enables teachers and other educators in primary and secondary schools to deduct up to \$250 apiece of out-of-pocket expenses for classroom supplies, such as books. This year, you're supposed to claim it on form 1040, line 23 even though that line says "Archer MSA Deduction." Write "E" on the dotted line to the left of that line entry. Or write "B" if you're claiming both this and the Archer Medical Savings Account deduction. If you enter "B," attach a breakdown showing amounts for each.

What Might Be Ahead For 2007

Look for future Newsletters for more details, but one story to follow this year is congressional efforts to close the "tax gap". The IRS estimates that the

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difference between what it collects and what it should collect is about \$290 billion – that is the tax gap.

More audits are probably in the offing. Last year fewer than 1 in 100 returns were examined. Schedule C filers should expect special scrutiny. Compliance has been estimated to be as high as 99% for wage earners because W-2s are filed and employers withhold taxes. But it has been estimated as low as 50% where there is no third party reporting. So it's logical to expect the IRS to go after those types of filers. The IRS is also expected to do more random audits so that they can fine-tune their audit formulas and eventually do a better job of selecting audit targets.

More informational reporting is probably coming. For example, having brokers report basis when a taxpayer sells a security, and more 1099 requirements. Information return penalties are probably going to go up, too.

More regulation of tax return preparers is expected, for those that are not CPAs, tax attorneys, or enrolled agents. They'd have to register with the IRS and pass an exam.

The Alternative Minimum Tax (AMT) will probably see another short-term patch such as extending the higher minimum tax exemptions that expired at the end of 2006 rather than a major overhaul.

Planning To Buy A Honda Hybrid?

If you are planning on buying a new Honda hybrid car this year, best to do it soon. The federal tax credit for hybrids starts phasing out after a manufacturer sells 60,000 units. After that point the credit is cut by 50%. Honda should hit that mark any time now. Right now a Civic is worth a \$2,100 credit and an Accord \$1,300.

For More Information

For more information on anything covered in this Newsletter, please contact me. I provide tax, accounting, consulting, and other business services such as payroll and medical billing.

You can reach me at gregg@greggharveycpa.com, phone 248-650-2960, or cell 586-707-1077. You can also visit my website, greggharveycpa.com.

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