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TAX NEWS & TIPS

MID-YEAR 2007

A Big THANKS!

The tax "season" is always trying. Long hours, new rules, and a few situations I've never encountered. Looking back, I realize how much you helped. You deserve a great big THANK YOU!

Thanks for having your records in order. Thanks for being patient at my busiest time. But, especially – Thanks for the trust and confidence you placed in me. I'll keep working to earn this from you.

After You File - - -

Your return's been filed. No need to worry about taxes for another year.

We all wish it were this simple! There is no rest at IRS. They receive about 130 million tax returns. They scrutinize all of them. This takes a few months. As returns are sifted, problems pop up. Someone changed a digit of their Social Security Number – now it matches yours. The interest reported by your bank does not jive with your tax return. A few refund checks got lost. It takes a while to clean everything up.

Extended Return? If we filed an extension, your return is due by October 15. Any payment was due April 17. IRS will add carrying charges for late payments. I urge you to gather the missing paperwork quickly – a last-minute surprise might be expensive!

Refund Late? IRS says they can't check until 10 weeks after you file, but often are faster. Or try:
1-800-829-4477 – automated help
1-800-829-1954 – refund hotline
The IRS website www.irs.gov has a "Where's My Refund?" link.

Uh-Oh – an IRS Letter!
If you get a letter from IRS, call me. The letter may be confusing. Don't

risk making an even bigger mess – I'll be glad to handle it.

Will You Be Audited? There's no sure way to know. IRS compares returns with W-2s and records from banks and brokers. Computers do the work. Most audits start here. IRS sends you a letter. It shows how much you owe if they are right – it looks like a bill. Don't pay! Send it to me, and we'll see what's what.

When IRS questions anything on your return they call this an "audit". You probably picture an "audit" as a face-to-face meeting with an IRS employee who asks lots of questions. IRS says for 2006 only two out of every nine "audits" were face-to-face meetings. In 1992, more than five of every nine "audits" were face-to-face meetings. Since 2002 IRS has nearly doubled the number of audits, and they'd like to do even more.


Find an Error? If you should find you failed to claim an item on your return, we can file an amended return. You and IRS both have the same time frame to question your return. It's 3 years after the filing deadline. During this period IRS can audit you, but you can also amend your return voluntarily. If you owe IRS you pay the tax plus some interest. If IRS owes you, the same thing applies – you collect the tax savings plus interest.


Protect Your Records. For now, simply put your return, records, receipts, and cancelled checks in a safe place. You might need to dig them out, but the chances are slim.

Older Records. It's a good idea to keep tax returns indefinitely. Also, keep records of investments and properties you still own. Other records – cancelled checks, receipts, bank statements, etc. – keep five years' worth of these for safety. Destroy or shred any older records. Don't toss them in the trash!

Planning For 2007

Here are some of the key changes in store for 2007.

 **Filing Thresholds** inch upward. A single filer pays no tax until income reaches \$8,750. For a couple it's \$17,500. If you'll reach age 65 or older this year, single filers add \$1,300, joint filers add \$1,050 for each spouse of age 65 or older.


 **Popular Deductions Extended through 2007.**
A law late in 2006 gave a reprieve to 3 popular deductions. 2007 is the last year for:

- **Sales Tax** or state income tax – deduct whichever is larger. A big help in states with no income tax.
- **Educator Expenses** up to \$250 of classroom supplies are deductible without itemizing.
- **Tuition deductions** for any family member who takes post-secondary education. Can be lost to high income.

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 **Energy Credits.** Credits for your home are gone after 2007. Get 10% of cost (up to \$500) for:

- Exterior windows or skylights – Maximum \$200.
- Insulation (window films, too) or exterior insulating doors.


Ask the dealer which items have the correct energy ratings.

Also, collect credits up to:

- \$150 for furnaces or water heaters
- \$50 for main circulating fans for heating or cooling.


Even larger credits apply to more expensive changes: Up to \$2000 in credits for:


- 30% of cost for solar electric generators or water heating.

 **Mileage Deductions** are 48.5¢ per mile this year.

Driving for job, business, or rental property counts. This is the simplest

way to get your deduction – easier than tracking all costs and driving for the vehicle. Be sure to keep records of activity and mileage.

 **Child Tax Credit** stays at \$1,000. It's for any dependent child not age 17 by end of 2007 and reduces your tax bill by \$1,000. The credit begins to phase out for couples if income reaches \$110,000 (for single filers it's \$75,000).

 **Retirement Savings** have higher limits in 2007. Here are the maximum figures:

Plan Type	Maximum Contribution	50 & up, may add
401(k), 403(b), or 457	\$15,500	\$5,000
SIMPLE	\$10,500	\$2,500
SEP	\$45,000	N/A
Keogh	\$45,000	N/A
IRA, Roth	\$4,000	\$1,000

Other Changes are minor for most folks. One new law will help buyers

of a new home. For 2007 ONLY – they will be able to deduct mortgage insurance premiums as if they were interest. It's only for new loans and applies only for filers with income below \$100,000 with a phase-out above this income level.

Not a change, but definitely good news: capital gains rates remain low, and most dividends continue to benefit from the same lower rate as capital gains.

Call Me For Help with new items – family changes, large change of income, a move, job change, or new investments. I may be able to find some help for you. Next February will be too late!

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High Deductible Medical Insurance + HSA – Is It For You?

Medical insurance costs keep rising. Fewer employers can afford to give free coverage. The idea of “affordable health care for all” is becoming Wishful Thinking.

There's a new kid on the block, called a Health Savings Account (HSA). It resembles an IRA, but you save for medical costs rather than retirement. Like an IRA there are tax deductions when you put money into the account. Account earnings are tax-free. If the money is eventually spent on health care, the withdrawals are tax-free.

Good News – Guaranteed Deductions. The result – if you pay all medical costs from your HSA account you already received deductions for your medical expenses without the need to itemize your deductions, and without “floors”. The only expense you may not pay from the HSA is the premiums for the insurance.

Bad News – High Deductible Insurance. You may only contribute to an HSA account if you have the right kind of High Deductible Health Plan (HDHP). Until you pay the “deductible” amount each year the insurance company pays nothing. How big is the deductible? To qualify an HDHP needs an annual deductible ranging from

- \$1,100 to \$5,500 for self-only coverage, and
- \$2,300 to \$11,000 for family coverage.

Clearly, if your employer offers better coverage – take it!

For You? Nobody *wants* to pay a large deductible. However, there's peace of mind in knowing *large* costs will be covered by the insurance. More than two million Americans have bought these plans.

Many More Rules. This is not a simple issue. Lots of special rules apply, and I'll list only some of them:

- Portability.** The HSA account is yours. If you meet the eligibility requirement (covered by an HDHP and

no other health insurance) you can put money into your HSA and claim your deduction. In other years you might have a different insurance – if so, you get no contributions or deductions in that year. The account is still yours, and you may still use the funds to pay for non-covered medical expenses. Or simply let the account grow tax-free. You can use the money to pay your Medicare premiums when you turn 65.

- Employers Can Contribute.** Some employers now have HDHPs for their employees. They are allowed to make contributions to the employees' HSA accounts. This makes the plan more attractive.
- Contribution Limits.** For 2007 you may deduct contributions up to \$2,850 for a self-only HDHP, and \$5,650 for family plans. You can add up to \$800 as a “catch-up” contribution if you are age 55 or older. New rules also allow one-time “rollovers” into your HSA from your IRA, or from your employer's Health Reimbursement Account (HRA) or Flexible Spending Account (FSA).
- Distributions** are tax-free if spent for any normal deductible medical expense, except to pay the premiums for the HDHP. Use the money for any other purpose, and you pay income tax and a 10% penalty as well.

Wave Of The Future? Health Savings Accounts first appeared in 2004. Several changes have been made. We can expect more. Congress expects health care costs to continue rising. They think fewer employers will be able to provide full-coverage plans for free. More and more of us will learn to plan our health care needs the same way we plan our retirement.

If you have a full coverage plan from employer, count your blessings. Your days may be numbered.

Is The Tax System Working? Mixed Reviews

Is a tax storm headed our way? There are signs of big changes over the next couple of years. Deficit spending, a growing tax gap, old laws that no longer work well.

2001 Tax Act To Expire.

The big changes in 2001 are part of a "temporary" law. Our 10% brackets, relief from the "marriage penalty", the \$1,000 child tax credit, low capital gain rates, and more are set to expire after 2010. We would return to the tax laws of 2000, with only indexing to help us. The estate tax is set for a one-year repeal, then will return to prior levels. Congress has tackled only a few of these issues. Will they do more?


Meanwhile we see larger budget deficits each year. Looks like a formula for higher taxes.

Tax Compliance Costs

continue to rise. Laws have become so complex we are forced to spend more time and money in keeping up with the changes. A watchdog group called The Tax Foundation said our citizens and businesses spent over 6 billion hours to keep up with the Tax Code in 2005. Their estimate of the cost – \$265 billion!

Alternative Minimum Tax.

This complicated tax, called the AMT for short, is turning into a nightmare. It was originally designed to find wealthy people who loaded up on unusual deductions and credits. It was an "add-on" tax that looked only at income. In 1983 it switched to an "alternative" calculation – pay the higher of your "regular" tax or your "alternative" tax. Changes in tax rates and other laws have made this tax apply to many ordinary folks. As an illustration, unless Congress acts this year, a married couple with \$76,000 of income, no children, and no deductions will pay the AMT on their 2007 return! In 2006 they used Form 1040-EZ – for 2007, they'll need Form 1040 plus Form 6251 to show their extra \$218 of AMT!

 **Tax Freedom Day** is a term used by the Tax Foundation to measure the total taxes we pay. They use statistics on all the taxes we pay, not just income taxes. For 2007, they say the average American had to

work until April 30 to earn enough to pay all taxes. Starting May 1 the earnings can go for food, housing, clothing, and the rest. Be happy you don't live in the United Kingdom, where Tax Freedom Day is June 2.

IRS Having Troubles.

Treasury says the "Tax Gap" is growing wider as tax cheats hide their income. IRS asked for a bigger budget and got it. They hired more auditors and are stepping up audits.

But, the best laid plans of mice and men - - - IRS received approval last year to use private collection

agencies. Their mission – collect overdue taxes already identified by IRS. This leaves IRS free to find even more revenue. In early April, IRS issued a report on the progress of the program. The private collectors already brought in over \$17 million. Sounds good? So far the program is losing money! IRS says they won't recoup the costs to train and monitor the collectors until mid-2008. They admitted they could hire new workers to do the job more cheaply. It seems likely Congress will axe the program this year.

Who Pays The Most?

We've all heard "the rich hardly pay any tax." Is this true? Nope! IRS statistics for 2004 income tax returns might surprise you.

The wealthiest definitely pay the most tax. But, your guess of what is considered "wealthy" may be a shock, too.

Be careful! The chart below needs some thought. The Census Bureau counts *people* – IRS counts *tax returns*. We have 300 million Americans, but only 130 million tax returns. A family might file a single return. Those with very low income are not required to file at all. Few returns come from Americans under age 18.

	All Tax Returns	Top 1%	Top 5%	Top 10%	Top 50%
Number of Returns (millions)	130.4	1.30	6.52	13.04	65.2
AGI (Dollars)	N/A	\$328,049	\$137,056	\$99,112	\$30,122
Total tax (billions)	\$831.9	\$306.9	\$475.2	\$567.3	\$804.5
Share of Income (percent)	100.0	19.0	33.4	44.4	86.6
Tax share (percent)	100.0	36.9	57.1	68.2	96.7

Number of Returns. This row counts only returns with positive income. It is possible to have a return with negative income.

AGI refers to Adjusted Gross Income. It's the bottom number on Page 1 of Form 1040. Not all "income" is included. Tax-exempt interest is not. Social Security income may be absent, or *part* may be included. A business or rental can have negative income.

Total Tax is over \$830 billion. That's how much IRS collects from us. The true figure is higher, because some returns with negative income pay the Alternative Minimum Tax.

Tax Share is surprising. The top 1% of returns generate nearly 37% of all income tax revenue, but had only 19% of all reported income. Also note – the top 50% of returns pay 96.7% of all income tax. The lower 50% of returns pay only 3.3% of all income tax, or about \$26 billion. In truth, the lower 50% *collect* more than they pay, because of the earned income credit, but this credit comes from Social Security taxes, not income tax!

Surprised? Many people with an income of \$100,000 probably consider themselves to be "middle income". IRS would definitely call them "wealthy" and place them solidly in the top 10% of all incomes.

Tips For You

Owe IRS? Some Suggestions.

When you owe the IRS, they put big pressure on you to pay immediately or to set up a payment plan. Watch out! The fee to set up a plan is \$105! If you can pay your balance in three months or less, send what you can now, wait for the next bill, send more, then pay the balance with the third billing. Save the \$105.

If you will need more time, ask for a payment plan. If you agree to have payment debited directly from a checking account, the cost to set up the plan drops to \$52.

IRS charges interest, plus a "late payment" penalty on all balances. Interest is currently 8%. The penalty for paying late adds 6%, but is often cut in half for payment plans.

Watch Your Withholding. For several of you I suggested you alter your withholding. Watch the next check carefully! Does the change agree with the numbers I gave you? Remember the human factor – you might give the correct figures to the payroll office, but somebody has to make the entries. Mistakes happen! Take a good look at your pay stub.

Mutual Fund Investors need to keep careful records. This is not a savings account. You bought stock. When you sell you must report your cost to measure gain or loss. This is easy if you simply buy and hold. But, most investors "reinvest" the

dividends. Each dividend represents another purchase! After a couple of years you have several purchases. Their total is your real investment. Without the monthly records the calculation is impossible.

Gambling Winner? Lucky you! If you won a large enough amount you received a Form W-2G. This means IRS knows about your win – and it's taxable! But, you may deduct your gambling losses – a Good News, Bad News deal:

Good News. You may include any form of losses: casino, lottery, race track, even raffles. You are expected to have a good log or list of gambling activity.

Bad News. Your win is declared, but losses are claimed as an itemized deduction. If you don't already have enough deductibles (\$10,700 for a couple, \$5,350 for single filers) some or all of your losses will be lost. You may claim only losses within the same year, and only up to the amount of your winnings. Even if the loss is fully deducted, you are likely to pay extra tax. This is because you have higher income, which can alter other income and deduction items.

Tax-Free Vacation Money. Going on a summer vacation? You can rent out your own home for up to 14 days while away. Within this time frame, it's legal to pocket the money – no taxes. Many local papers have listings for such rentals. You can likely pay for a good bit of your own vacation. And – it's *legal*.

Over 70½ – IRA To Charity. 2007 is the last year of a tax break for older folks who give to charity. At 70½ you must take a Required Minimum Distribution from IRAs. For your charitable contribution, do this: Have your IRA custodian make your contribution directly to charity from your IRA, and send only the balance of the required distribution to you. You only pay tax on the part of the distribution you receive. Your deduction is automatic – no need to itemize your deductions. You are still credited with having taken your required distribution. Neat.

Blessed are the young, for they shall inherit the national debt.

Herbert Hoover

Your Tax Calendar

June 15	2 nd quarter estimated tax payments due.
July 31	2 nd quarter payroll returns due (Aug. 10 if all deposits were paid). Forms 5500 due for pension or Keogh plans.
Sept. 17	3 rd quarter estimated tax payments due.
Oct. 15	Extended returns for 2006 due.
Today	Be sure to call if you have large changes to income or deductions!

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