TAX NEWS LETTER 2006

January 11, 2007

It really is hard to believe, but it is that time again when we should be thinking about preparing our income tax returns!

For the most part, there are only a few tax law changes for 2006. Then again, as most of you know, the Democrats now control both houses of Congress and therefore we should expect significant new tax legislation for the 2007 (retroactive laws) and 2008 years.

New tax law additions:

- **Federal telephone excise tax refund** - You paid for long distance telephone use.
  - If you kept telephone billings for the period March 1, 2003 - July 31, 2006, you will be eligible to get a refund for the actual excise taxes paid on long distance calls.
  - If you did not keep your bills (and who does!) you will be entitled to a refund based on the number of personal exemptions you claim on your 2006 return. For (1) exemption the refund is $30, (2) $40, (3) $50 and (4 or more) maximum $60.

- **Domestic Production Activities Deduction** - Manufacturing and construction businesses are entitled to a new tax deduction. The deduction is currently 3% (6% in 2007) of net income as limited by 50% of the wages paid its employees.

On-going provisions:

- **IRA deductions** - Income limitation for individuals covered by a separate pension plan have increased significantly. This increase will allow more taxpayers to deduct separate IRA contributions in 2006. The allowed contribution will be $4,000 per person ($5,000 if age 50). In 2008, the deduction allowed will increase to $5,000 ($6,000 if over age 50).

- **Mileage standard rates** –
  - Business increased to 0.485 cents per mile in 2007 up from 0.445 in 2006.
  - Medical or moving rate is 0.20 cents per mile in 2007 and in 0.18 in 2006
  - Charitable remains the same at 14 cents per mile

- **Standard deduction increased for inflation** - $10,300 for married filing jointly ($10,700 in 2007), $7,550 for head of household and $5,150 for single or filing separate.

- **Personal exemptions** - deduction increased to $3,300 in 2006 and $3,400 in 2007

- **Annual gift tax exemption** - increased to $12,000 per donee per year in 2006

- **<u>Energy tax incentives –</u>**
  - 10% tax credit for qualifying expenditures used to reduce energy consumption. $500 maximum credit. Expenditures include those made in 2006 and 2007 as follows:
    - Insulation systems that reduce heat loss/gain
    - Exterior windows (including skylights), doors ($200 max.) and metal roofs
  - Other items include credits for qualified: circulating fans, natural gas or oil furnace, energy efficient property and solar panels
  - Purchase or lease of a "green" vehicle up a maximum income tax credit of $3,400.

- **<u>Maximum capital gain tax rate</u>** remains the same at 15% (5% if you are in a 10% or 15% federal tax bracket) on net long-term capital gains and qualified dividends.
  - **<u>PLEASE NOTE</u>**: a 0% tax rate will replace the 5% (lower brackets) for years after 2007. Therefore, beginning in 2008 there will be <u>no tax</u> on long-term capital gains for low income tax payers.

<u>Tax deduction (allowed) "extended" by year-end legislation:</u>

- State & local <u>sales</u> taxes (higher of the two) continue as "itemized deductions".
- Out-of-pocket expenses paid by school teachers are deductible - limit $250
- Qualified tuition expense deduction paid for a post-secondary college education will be disallowed. Deduction limited to $4,000.

<u>Steve's Tax Corner:</u>

<u>Topic 1: State of Maine Resident Sales Tax Obligations:</u>

As you know, Maine tax law requires that retailers, restaurants, motels and various businesses collect sale tax on products purchased by the public at their business. However, did you know that the law also requires residents to pay the same sales tax on products purchased outside the state? For example, items purchased over the internet or while traveling outside the state (such as in New Hampshire where there is no sales tax) are also subject to State of Maine tax. This tax is more commonly know as a "use" tax. You are not required to pay the tax if the sales tax charged by the other state was of equal or greater amount.

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Steve's Tax Corner:

Topic 1: State of Maine Resident Sales Tax Obligations - continued:

How is the use tax paid? Generally, the tax can paid on your Maine income tax return, Form 1040ME, line 31 (long-from, 2006 returns). As a Maine resident, you have the option of entering three different amounts on this line: (1) the actual tax amount from purchases you made (at a 5% rate), (2) from the "table amount" based on your income level for those who don't keep receipts or (3) $0 in that you made no purchases of our-of-state products. All three responses are acceptable.

Recently, the State of Maine has aired TV ads related to this issue in an effort to get better compliance from its residents. Many high-income individuals also received notices from the state asking them to "come clean" about their out-of-state purchases. What amount you report on your Maine return for the use tax is your business and is not an income tax or return preparation issue. My suggestion is that you report an amount that is honest and accurate to the best of your ability.

Topic 2: Making the Most of Social Security Benefits:

"A Taxing Situation" - Most people don't realize that social security benefits can be taxable on our federal income tax return! Maine (and most states) does not tax these benefits. What makes matters worse is that when and if these benefits are taxable depends a great deal on the amount of "other" taxable income (interest dividends, pension business, wages, capital gains, 1/2 the benefit received, etc) you receive making tax planning very difficult.

Social security recipients are allowed an income exemption of $32,000 if filing jointly and $25,000 if filing single ($0 if separate filing). Therefore, making the most of this exemption is the best tax planning "tool" in avoiding taxation of this benefit. By using a "mixture" of taxable (up to the exemption amount above) and non-taxable (such as Roth IRA income, exempt interest, or personal savings) income, a taxpayer can avoid social security benefits from being taxable at all!

"Whistle while you work" - A few years ago, the Social Security Administration (SSA) created new rules that greatly changed the benefits we receive and when we continue to work. The earliest a person can receive benefits is age 62. Full retirement benefits are ordinarily received once you reach aged 65. However, SSA has now defined the term "full retirement" differently depending on when you were born. For individuals born after 1937, full retirement is aged 66. If after 1960, the age is 67.

In general, SSA will take away $1 of benefit for each $2 you earn above an annual income limits and before or during the year you reach "full retirement". For 2006 the annual limit is $12,480 and in 2007 the amount is $12,960. For years after full retirement, you can earn as much as you want without fear of benefit reduction. In the year you do reach full retirement, there are "transition rules" that determine your benefit amount.

Given the taxation implications noted above, the decision when to "retire" is a complicated issue. For more information on social security go to their website at: www.ssa.gov

I hope this information has been helpful. I look forward to hearing from you again this year!

Sincerely,

Stephen B. Smith, CPA