TAX NEWS LETTER 2007

January 8, 2008

It seems like only yesterday that the tax-filing season ended for 2006 returns! Tax-wise, 2007 is mostly the same as 2006 with a few changes. However, with 2008 being an election year, you can expect significant changes for 2009 and maybe retroactive changes in 2008 as well.

Tax law changes for 2007 and 2008:

- **Charitable donations** - In prior years, the IRS allowed "out-of-pocket" cash donations up to $250 to be deducted without requiring supporting documentation. Beginning January 1, 2007, all charitable donations must now be supported by a written document to be deductible. Written documents include a check written, receipt or letter of acknowledgement.

- **Mortgage insurance premiums** - Mortgage insurance contract premiums paid in 2007 (or pre-paid in 2006 for 2007) are deductible as an itemized deduction on Schedule A (1040). Home mortgage insurance contracts include those on a first or second home and include those from Dept. of Veteran Affairs, Federal Housing Administration, Rural Housing Service and other private qualified contacts. Deductible amounts may appear in box 4 of IRS Form 1098 sent to you.

- **Expiring tax deductions now allowed ("extended") for 2007 by year-end legislation:**
  - State & local sales 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. Deduction limited to $4,000.
  - Residential energy credits for house improvements if made before 2008.

On-going federal tax provisions:

- **IRA deductions** - 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 deduction standard rates** –
  - Business increased to 0.505 cents per mile in 2008 up from 0.485 in 2007.
  - Medical care and moving costs rate is 0.20 cents per mile in 2007 but decreases to 0.19 per mile in 2008
  - Charitable remains the same at 14 cents per mile

- **Standard deduction** - the 2008 married filing jointly deduction is $10,900 ($10,700 in 2007), $8,000 for head of household ($7,850 in 2007) and $5,450 ($5,350 in 200)) for single or filing separate.

On-going federal tax provisions - *continued*:

- **Personal exemption** - 2008 exemption deduction will be $3,500 ($3,400) in 2007.

Maine tax changes -

- **Standard deduction -** $8,900 for joint filers, $5,350 for single, $7,850 head of household and $4,450 for separate filers
- **Personal exemption / dependent deduction** remains the same at $2,850
- **Section 529 plan** - deduct up to $250 for contributions to a beneficiary's account used for educational purposes
- **Educational opportunity credit** - loan payments made for a Maine resident post -graduate student who with an associates or bachelor's degree and stays in Maine to work after college
- **Domicile "Safe Harbor" rules adopted** - For ""snow birds" living in Maine that want to charge residency to a different state (like Florida)

Steve's Tax Corner:

Topic 1: Capital gain tax rates:

As many of you know, a special federal tax rate exists on long-term taxable capital gains. These special rates do not apply to state returns. Long-term capital gains are calculated by subtracting your cost basis (purchase price) of the investment (stocks, bonds, land, etc) sold from its sale price. Also included in this special rate computation are "qualified" dividends you receive from investments reported to you on Form1099-DIV.

To be considered, "long-term" the asset must be owned for twelve months or more on the date of sale. Long-term gains are offset against long-term losses (but not with short-term gains and losses that also can be netted) in the computation of the special tax rate schedules. The maximum net loss that can be deducted on your personal return is $3,000 annually with any unused amounts carried over to the following year, indefinitely. All other income continues to be taxed at the normal tax rates.

The 2007 maximum federal tax rate on net long-term capital gains and qualified dividends income is 15%. However, for individuals in the lowest two tax brackets of 10 or 15%, the capital gain rate is only 5%. Therefore, individuals with taxable income less than $63,100 (joint filers) in 2007 (or $31,850 for single filers) will only pay tax on the gains at the 5% rate.

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Topic 1: Capital gain tax rates- continued:

For years after 2007, the maximum capital gain rate for individuals in the lowest two brackets will be 0%, NO TAX. Therefore, if you have investments and you anticipate that your federal taxable income will be less than $65,100 in 2008 (for joint filers, $32,550 for single) you should consider deferring security sales until 2008 or later.

Topic 2: Alternative Minimum Tax (AMT):

You may have heard that President Bush signed into law a correction to the AMT provisions known as the "patch". Had this law not gone into effect, many of us would be paying more federal tax on 2007 returns. The IRS had also assumed the original legislation would not be corrected. Therefore, its computer software programs will need to be updated, which may delay some refunds.

AMT has been in existence for well over 20 years. The original purpose of AMT was to ensure that taxpayers with special deductions (called "preference items") pay the same amount of tax as other individuals without these same deductions. Simply stated, AMT was meant to "equalize" the tax system.

The AMT is a separate tax calculation that parallels the regular system. The higher AMT amount is paid when it exceeds the regular tax amount. Items such as state and local taxes, additional depreciation for business assets are added back to income. Also, the personal exemption deduction is not allowed. AMT does have a base exemption amount similar to the standard deduction for the regular tax system. Under tax laws passed several years ago, the AMT exemption was to be reduced in 2007 ($62,550 to $45,000 for joint filers) creating the higher AMT. The "patch" legislation restored the joint exemption to $66,250 ($44,350 for single individuals) thus eliminating additional AMT for most taxpayers.

Topic3: Record Retention:

Many of you have called to ask how long tax records need to be kept. Assuming that you have filed your return on time, the IRS statute of limitations (and for most states) is three years. Personal tax returns are due on April 15th. Therefore, each April 15th, a tax year is no longer considered an "open year". Accordingly, tax information can be discarded for years no longer "open".

For example, the current "open" years are 2004, 2005 and 2006. Once April 15, 2008 goes by, the open years will be 2005, 2006 and 2007. Years 2004 and earlier can now be discarded. If you are late in filing a return, the statute of limitations begins it three year "run" when filed.

When returns are filed more than two years late with a refund due you, neither the IRS nor Maine will send you a check for the amount owed.

Topic3: Record Retention - continued:

Please note that some tax information should be kept longer than three years. Information would include carry over items that would affect the preparation of a future return. Typical items would include the following (but not limited to):

- Cost basis (purchase price) of stocks, bonds, land, etc.
- Retirement plan cost basis, if any
- Loss carry over information from rental activities and business investments
- Property and equipment depreciation schedules
- Vehicle cost information used in a business

I have included with this letter a tax checklist, which may assist you in gathering your information.

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

Sincerely,

Stephen B. Smith, CPA