

# Tax Tidbits

If you are a client of Valicenti Advisory Services, Inc., you know that we merged our tax and business services division with that of another tax and accounting business from the Elmira area. With the merger taking place in mid- December 2006, there were some issues that had to be dealt with rather quickly. Other issues were dealt with as we went through the tax season. The staff met and worked with clients to answer any questions and resolve any issues that had formed.

## What to do about AMT

Some of the early numbers regarding tax filings this year are now available. Among them is the fact that approximately 4 million people were stung by the alternative minimum tax (AMT), with affected taxpayers owing up to several thousand dollars more in taxes.

The AMT originally was designed to hit very wealthy people. If Congress does nothing this year, the number of households affected by the AMT will climb to about 25 million, according to estimates by the U.S. Treasury Department. Included in this group will be people earning five figure salaries.

Many popular deductions available under the regular tax system such as state and local taxes, standard deduction and personal exemptions, are not allowed under the AMT. People with large families also may be affected because they lose personal exemptions, which are not recognized under AMT.

Additionally, investors that are impacted by AMT can also end up paying significantly higher tax rates on capital gains and qualified dividends. The top tax rate on long - term capital gains and qualified dividends is 15%, but for investors affected by AMT, the top effective rate can be 21.5% or 22%.

Up until now, Congress has been addressing the AMT issue by enacting one or two - year “patch” fixes by raising the exemption that determines who will be affected. What will Congress do about the AMT this year?

Last May, the exemption amounts were extended for only 2006. Evidencing the seriousness of this issue, the House Ways and Means Committee has formed a special subcommittee to investigate the AMT. The subcommittee held a series of hearings in March 2007 at which testimony from taxpayers, tax practitioners and organizations, such as the American Institute of Certified Public Accountants (AICPA), was presented.

While the individuals and tax preparers offered their stories in dealing with the AMT, the AICPA told the committee that “due to the increasing AMT complexity, increasing AMT impact on “unintended” taxpayers and AMT compliance problems, the AICPA supports repealing the AMT altogether.” The AICPA, however, recognizes that “simply eliminating the AMT would generate a new set of problems given the large loss of revenue that would accompany such a move.”

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May 2007

The AICPA and others recommended a menu of alternative solutions for relief from the AMT burden. Some of the relief items include the following:

- Increase and index for inflation the AMT brackets and exemption amounts and eliminate phase-outs
- Eliminate the standard deduction and personal and dependency exemptions as adjustments to regular taxable income in calculating AMT
- Eliminate state and local income and other taxes, such as real estate taxes, as an adjustment
- Allow tax credits enacted to promote important public goals; such as low-income tax credits, and tuition tax credits, to be credited against AMT liabilities
- Exempt all taxpayers with regular tax adjusted gross incomes under \$100,000 from AMT
- Require review of the impact of AMT on future tax legislation before passage
- Exclude AMT from the estimated tax penalty.

Subcommittee member Mike Thompson, (D- California) commented that it is incredibly important that we “get this thing done.” (resolve the AMT problem). “After hearing the testimony of individual taxpayers,” subcommittee member Earl Blumenauer, (D-Oregon), said he believes that, for the “first time in 11 years, something is going to happen.”

Let’s hope that they restore the AMT back to its intended purpose; that of making

sure that everyone pays his/her share of income taxes.

On March 23, the Senate approved a \$2.9 trillion fiscal year 2008 budget proposal that would provide two years of additional relief from the AMT.

If you know that you may be caught by the AMT for 2007, but probably not in 2008 because your tax situation will change significantly, there are certain things you may want to do. For example, don’t prepay your state and local taxes before December 31, 2007. Instead, wait until early 2008 to pay these taxes. You should also consider deferring tax preparation and investment management fees until 2008.

If you are considering these options and timing your income in order to avoid the AMT, see a tax professional, as these calculations can be quite involved, especially if any of your income is subject to the favorable capital gains rates.

## A Gain or a Loss?

It is May, the grass is starting to grow, gardens need tending and thoughts are turning towards summer vacations and all that comes with those preparations. The furthest thing from your mind is income tax. A possible scenario may be that you have an investment in the stock of a particular company and your broker or money manager calls and tells you that it’s a good time to sell this stock. Based on this advice, you agree to sell and use the proceeds to purchase a new stock for your portfolio. Time passes and, before you know it, Thanksgiving and Christmas whisk by and sportscasters are talking about the next Super Bowl.

You start gathering your documents for tax preparation and you make your appointment with your tax preparer. One of the documents that you give your preparer, a Form 1099-B, outlines the stocks that you sold in the prior year and the amount of money that you received from the sale of those stocks. What it does not tell you or your tax preparer is how much the original stock cost and when you purchased it.

You may not think that it is that important, but having the right information can make up to a 20% difference in how much tax you will pay on the gain on the sale of the stock. Let’s review what a gain or loss on a stock sale is. It is the difference between what you originally purchased the stock for and for what you sold the stock. It may come as a surprise to some people, but even if you reinvest the sale proceeds into another stock, there is still a gain or loss to be reported on your taxes.

As an investor, you should know if you have a gain or loss on the sale of stock in your portfolio when it happens, not next April. If your current money manager is not reporting this information to you at least quarterly, you may need to ask why.

## Saving Energy While Saving Taxes

Effective January 1, 2006, improvements to make your home more energy efficient can mean a federal tax credit. A tax credit will reduce your tax liability dollar for dollar. This is different than a tax deduction, which will reduce your taxable income. Although this credit, available to individual homeowners, is more generous than in the past, it’s a bit more complicated to

calculate. The new law creates a 10% personal tax credit for individuals for the purchase of certain energy-efficient items installed in a principal residence. The maximum amount of tax credit available by category is as follows:

- \$200 for exterior windows (including skylights)
- \$50 for any advanced main air-circulating fan.
- \$150 for any qualified natural gas, propane or oil furnace or hot water heater.
- \$300 for any energy-efficient building property (insulation, exterior doors, etc.)

The lifetime maximum energy credit available is \$500 and the credit is only available for improvements installed by December 31, 2007. Additionally, the new law makes a 30% credit available to those who add qualified solar panels, solar water heating equipment or a fuel cell power plant to their homes, up to a maximum credit of \$2,000.

While the above tax credits are for energy efficient improvements to your principal residence, owners of commercial buildings have their own deductions which are based on an amount per square foot based on the energy savings.

New York State has also offered a tax credit for replacing the existing home heating system in your principal residence in New York State with an *Energy Star* labeled heating system. This credit is available for costs incurred and equipment installed after July 1, 2006, and before July 1, 2007, that are directly associated with the replacement of the existing home heating system.

If you would like additional information to plan your tax and energy savings,

please call our Tax and Business Services Department.

## Funding Higher Education

**O**f great concern to many seeking higher education is how to accumulate the assets to attend and ultimately graduate from college. For both parents and students there are several tax-favored credits and deductions, including the Hope and Lifetime Learning credits and deductions for higher education expenses and U.S. savings bonds interest.

The Hope and the Lifetime Learning credits are subject to income limits. Effective 2006, education credits were reduced if your modified adjusted gross income is over \$90,000 married filing jointly or \$45,000 single. If your income is above \$110,000 married or \$55,000 single, you are not eligible. For both credits, qualifying expenses include tuition and related expenses (books, supplies, equipment, and student activity fees) required for enrollment or attendance at an eligible educational institution.



The Hope credit is 100% of the first \$1,100 and 50% of the next \$1,100 of qualifying expenses, with a maximum credit of \$1,650 per eligible student. The credit is available to students who have not completed the first two years of post-secondary education and

have enrolled in a degree or certification program in an eligible educational institution at least half-time. The Lifetime Learning credit is 20% of the first \$10,000 of qualifying expenses for all eligible students in the family, with a maximum credit of \$2,000 per family. The credit is allowed for any courses, including graduate courses, taken by the student during the year, for any number of years.

Another tax break is the tuition and fees deduction that can reduce the amount of income subject to tax by up to \$4,000. You do not need to itemize your deductions to use this deduction. This deduction may be beneficial if your income is above the limits for the tax credits as you can take this deduction through the end of 2007, subject to income limits.

Keep in mind that these tax breaks are also available if you have a student enrolled in higher education concurrently with a high school education. Only one person may claim the tax savings above, the person who claims the student as a dependent on his/her tax return. Detailed tax planning and preparation of the parents and the student returns are essential.

Additionally, when looking over the various choices of funding college education, one stark reality sets in – the tax credits and deductions have adjusted gross income (AGI) thresholds that prohibit their use for higher income taxpayers. In sharp contrast, however, is the 529 plan created by Congress in 1996. In addition to the lack of AGI limitations with a 529 plan, there are currently even more great benefits to parents and grandparents alike. Please contact our office if you would like to discuss your plans for higher education funding.

## Staying Current in 2007

In 2006, tax laws were passed as late as December 21<sup>st</sup> (and were retroactive to January 1<sup>st</sup>). We continuously monitor pending legislation to stay current on such late changes. Following are some various items that Congress has enacted:

**Deductions** You cannot take a deduction for **clothing or household items** you donate after August 17, 2006, unless the clothing or household items are in good used condition or better. You need supporting documentation from the specific organization(s).

### Alternative Motor Vehicle Credit

For 2007, the list of vehicles that are qualified hybrid vehicles for this credit has been expanded. The tax credit for hybrid vehicles applies for vehicles purchased on or after January 1, 2006, and could be as much as \$3,400 for those who purchase the most fuel-efficient vehicles. An alternative motor vehicle must be new and meet certain requirements.



### Educator Deduction Through 2007

If you are an eligible **educator** (kindergarten through grade 12 teacher, counselor, principal or aide), you can deduct up to \$250 of qualified expenses you paid as an adjustment to gross income, rather than as a miscellaneous itemized deduction.

### Earned Income Credit

The maximum amount of income you can earn and still get this credit has increased for 2007. You may be able to take the credit if your income is as high as \$39,783 (more than one qualifying child), \$35,241 (one qualifying child) or \$14,590 (no children). The maximum amount of the credit has also increased to as much as \$4,716. Additionally, to qualify, you must be at least 25 years of age.

### Mortgage Insurance

**Premiums** Premiums that you pay or accrue for "qualified mortgage insurance" during 2007 in connection with home acquisition debt on your qualified home are deductible as home mortgage interest.

### Standard Mileage Rates for 2007 include:

- Business related mileage, 48 ½ cents per mile.
- Medical and move-related mileage, 20 cents per mile.
- Charitable related mileage, 14 cents per mile.

### Exemption amount increase

The amount you can deduct for each exemption has increased to \$3,400 in 2007. You will lose part of the benefit of your exemptions if your adjusted gross income is above certain amounts, based on your filing status.

### Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2007 is \$97,500. There is no limit on the amount of wages subject to the Medicare tax.



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