

Tax Tidbits

The Progression of Taxation

“**B**ut in this world nothing can be said to be certain, except death and taxes” – Benjamin Franklin, 1789. Taxes go as far back as the ancient Egyptians, when a tax was imposed on cooking oil. Historically, taxes were levied to pay for war. The ancient Greeks would actually issue tax refunds if there were funds left over after a war. In the United States, the Tax Act of 1862 was the first income tax passed and then put in force by President Lincoln. This tax was used to pay for the Federal troops in the Civil War. The starting rate was 3% on income above \$600, which approximates \$11,250 in today’s dollars. The tax was repealed in 1872 and replaced by stiff tariffs. In 1913, along came the 16th Amendment to the Constitution, which gave Congress the authority to tax the citizenry on income. The Internal Revenue Code of 1954 was probably one of the more progressive tax codes with 24 income brackets applying to tax rates ranging from 20% to 91%. Over time, tax rates came down with a range of 11% to 50%, because there were many deductions introduced. The Tax Reform Act of 1986, signed into law by President Reagan, changed everything – eliminating deductions, limiting passive losses, putting in place certain investment incentives and lowering the top tax rate to 28% and raising the lowest rate to 15%.

The current tax environment was brought about by the Economic Growth and Tax Relief Reconciliation Act of 2001. Tax rates start at 10% and climb to 35%. With this law, the top capital gains rate was capped at 15% on long term gains. With average tax rates being reduced so much, the alternative minimum tax (AMT) may affect up to 20 million more taxpayers, as the exemption thresholds have been virtually static for years. Most of the tax law that came into being in 2001 is scheduled to “sunset” by 2011. Then we are supposed to be operating under the pre-2001 rules again. As Ben Franklin said, taxes are certain, but if history proves anything, how we calculate them will be ever changing. Here at Valicenti Advisory Services, Inc., we stay current with tax law changes by attending courses, maintaining research libraries and reading new laws as they are published. We pride ourselves on the services we provide. To those of you who are tax clients, we thank you for the confidence that you have in us.

Remember, the earlier we receive your information, the better we can serve you, so please make your appointment early.

Volume 8, Issue 1
November 1, 2007



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Back to School Tax Breaks:

With the new school year well underway, we remind teachers, parents and students to save all receipts and to keep good records in order to take advantage of various education related deductions and credits on their 2007 federal income tax return. Three key education tax breaks are: a tuition and fees deduction, the Hope credit and the Lifetime Learning credit. All three of these tax breaks are still available regardless of whether eligible taxpayers itemize their deductions. The educator expense deduction of up to \$250 for classroom expenses is scheduled to expire at the end of this year. Congress has not made any decision on extending this tax break.

Deductions reduce the income on which tax is figured. Credits reduce your overall tax. Recordkeeping is very important to help avoid missing any of these deductions or credits at tax time.

Charities: There is a web page you can access if you would like to know what percentage of your charitable contribution pays for a charity's operating expenses. Log on to The Better Business Bureau's Wise Giving Alliance at www.give.org. Click on Charity Reports and choose the charity about which you want to inquire. It lists the purpose of the

program, total program expense, the uses of the funds, and fund raising methods. The website also has a financial report listing the charity's sources of funds and total income. This is a valuable tool when choosing which national charities you would like to contribute to. You have until 12/31/07 to make your charitable contributions for the 2007 tax year.



Dependent Care: If you sent your child to camp this summer, you may be able to claim a dependent care credit. If the camp focused on improving reading, writing or study skills, the cost does not qualify for the credit. The cost of other special day camps, such as soccer or basketball programs, remains eligible for the credit. The child must be under 13 and the expenses must be incurred so that the parent or parents can work. There is no credit for tuition for kindergarten.

New E-mail Scams: The IRS is doing a good job of keeping taxpayers informed of e-mail scams that seem to keep surfacing. The most recent scam tells taxpayers that the IRS has calculated their

“fiscal activity” and that they are eligible to receive a tax refund. The taxpayer receives a page of a website that appears to be the genuine Internal Revenue Service “Where’s My Refund?” page and the taxpayer is asked to enter his/her Social Security number and filing status. The phony web page also asks the taxpayer to enter credit card numbers instead of the exact amount of his/her refund as shown on the tax return. The IRS never sends e-mails to taxpayers advising them of refunds and it never requests financial information. If you should ever receive one of these e-mails, do not open any attachments or click on any links contained in the e-mails. Instead, you should forward the e-mail to phishing@irs.gov and then follow all of the instructions. You can also open www.irs.gov to read about other income tax related e-mail scams that have been discovered.



Enforcement: New rules make return preparers liable for penalties for flawed returns unless there's a better than 50% chance that the position they took is valid. The alternative is that they disclose the questionable item to the IRS in an attached statement. Lawmakers are more likely to toughen rules for individual taxpayers than to ease those for tax pros. A change in reporting standards has raised the standard for the tax preparers above the standard for taxpayers. The potential penalties on a preparer for failure to satisfy high standards could be very severe. They could possibly total up to 150% of fees derived from the return.



“Kiddie Tax” and Financial Aid Pitfalls

For years, wealthy parents could materially decrease their tax bill by transferring investment assets to minor children, thus taxing investment income at the “lower” kids’ tax rates. Congress enacted the “Kiddie Tax”, so that children under age 14 are taxed at the parents’ rate on unearned income above a certain amount. The Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005

increased the age limit to 18. The income tax benefits of shifting assets from parents to children are limited by this law change. This change also nullifies the effectiveness of some traditional financial aid planning strategies.

Before TIPRA, it was common to invest in low income investments (growth stocks or savings bonds), then redeem or sell the investments when the child reached 14.

For students not able to qualify for financial aid, it still makes sense to execute this strategy, but the age limit has changed to 18. Students seeking financial aid may receive significantly lower awards, which would most likely overshadow any possible tax savings.

Students seeking financial aid must file a Free Application for Federal Student Aid (FAFSA) form. The applicant must report his/her income as well as his/her parents income for the previous calendar year and their assets (the applicant’s and their parents) as of the date the application is signed.

According to the formula, approximately 50% of a student’s income is thought to be available to fund college expenses, with parents’ income assessed at rates from 22% to 47%. Additionally, 35% of a student’s assets are considered in this assessment, yet the parents’ assets considered range from approximately 3% to 5%.

With the new tax act, holding appreciated assets until age 18 and then selling them might not only factor into the asset and income FAFSA formula, but drive an income tax liability for the student.

For planning purposes, younger lower-income children with moderately appreciated assets may be in the optimal position for both income tax and financial aid. Sales of appreciated capital assets may be able to be timed to take place from 2008 through 2010, when long term capital gains are tax-free for income normally taxed in the 15% bracket and below the “Kiddie Tax’s” unearned – income threshold, currently \$1,700.

Young children with highly appreciated assets should consider systematic dispositions over a number of years. This strategy may not only spread out income, but it may lessen or avoid the “Kiddie Tax” and it may remove assets and income from financial aid consideration.

(Source: Journal of Accountancy, January 2007)



Projected federal income tax brackets for 2008 compared to 2007 levels:

| Tax Rate | -----Married Couples Filing Joint----- | | -----Most Single Filers----- | |
|----------|--|---------------------|------------------------------|---------------------|
| | 2008 Taxable Income | 2007 Taxable Income | 2008 Taxable Income | 2007 Taxable Income |
| 10% | Not over \$16,050 | Not over \$15,650 | Not over \$8,025 | Not over \$7,825 |
| 15 | 16,050-65,100 | 15,650-63,700 | 8,025-32,550 | 7,825-31,850 |
| 25 | 65,100-131,450 | 63,700-128,500 | 32,550-78,850 | 31,850-77,100 |
| 28 | 131,450-200,300 | 128,500-195,850 | 78,850-164,550 | 77,100-160,850 |
| 33 | 200,300-357,700 | 195,850-349,700 | 164,550-357,700 | 160,850-349,700 |
| 35 | Over 357,700 | Over 349,700 | Over 357,700 | Over 349,700 |

Preparing for Your Preparer

Whether you use a paid preparer or take on the task yourself, there are some basic guidelines to make the endeavor less taxing (excuse the pun):

Keep Good Records

Keeping good records throughout the year is your best defense against the taxman. It provides you with the information you need for interim planning and adjusting withholding and/ or estimates.

Start Early

Starting early to gather your tax info (especially if you failed rule No. 1), will give you a chance to organize your documentation and to obtain any missing information without the stress of bumping up against the deadline.

Be Alert

Even if you use a paid preparer, you are ultimately responsible for your tax return

and the information in it. A general familiarity with the basic tax rules and forms will enable you to review your return with some confidence, catch obvious errors and feel comfortable about what you are filing with the IRS. It is also beneficial in recognizing taxable events throughout the year and adjusting your tax plan accordingly.

Be First On Your Block

Make an appointment with your tax preparer as soon as you have all your documents. This will give him/her time to review your income and expenses and to develop strategies for minimizing your tax liability.

Keep In Touch

You should contact your preparer whenever taxable events (such as purchase or sale of an asset, job change, birth of a child, etc.) occur throughout the year. This will allow you time to take advantage of strategies that may take several months to implement.



Located at the northwest corner of West Church and Columbia Streets with parking in back

Our location at 350 West Church Street has become familiar to our clients. With adequate parking in the back, it is a convenient location to meet with tax preparers to discuss tax questions and solutions.

As a reminder, Church Street is now open to two way traffic.

Please call our office at (607) 733-9022 in order to set up appointments and to speak directly with one of our tax specialists.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.