

Tax Tips

Keeping you informed...

Summer 2006

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Life-Changing Events

Ten reasons for a mid-year review

Things happen throughout the year that may affect your finances and your tax situation. In most cases, it's better to visit your tax preparer as soon as possible so you can discuss taking action to prevent any unpleasant tax consequences. Here are ten good reasons to schedule a mid-year review:

1. A change in your marital status. A marriage or divorce can have a direct impact on the amount of exemptions you can claim and can alter the amount of your refund or balance due.
2. The birth of a child. You cannot claim a child as a dependent unless you have a social security number for that child.
3. The death of a spouse or other family member. If you inherit income, such as an IRA or pension plan, you have options for taking distributions.
4. The sale or purchase of a home.
5. The decision to retire or continue working. Depending on your age and other income, your social security benefits may be taxed or reduced.
6. The sale of investments. Timing a sale to reap the most tax benefit should be decided before taking action.
7. Contributions to a traditional IRA or Roth IRA. There are tax consequences to both options.
8. Charitable contributions. Whether or not you can itemize deductions may determine when it's best to make contributions.
9. Changing jobs. In some cases, your moving expenses are deductible if a new job takes you to a new location.
10. Planning for your child's college education. There are several tax-favored options available for college savings.





Buy a Hybrid Car

Save gas and tax dollars

With the price of gasoline reaching epic amounts, you may be contemplating your transportation alternatives. Purchasing a new hybrid vehicle may be the answer. But which one? Various makes and models are available and each carries a different credit amount.

The tax credit for hybrid vehicles applies to vehicles purchased on or after January 1, 2006, and may be as much as \$3,400 for those who purchase the most fuel-efficient vehicles. The hybrid vehicle certifications* and their credit amounts are:

- 2005 Toyota Prius – \$3,150
- 2006 Toyota Prius – \$3,150
- 2006 Ford Escape Hybrid Front WD – \$2,600
- 2006 Ford Escape Hybrid 4WD – \$1,950
- 2006 Mercury Mariner Hybrid 4WD – \$1,950
- 2006 Toyota Highlander 4WD Hybrid – \$2,600
- 2006 Toyota Highlander 2WD Hybrid – \$2,600
- 2006 Lexus RX400h 2WD – \$2,200
- 2006 Lexus RX400h 4WD – \$2,200
- 2007 Toyota Camry Hybrid – \$2,600
- 2007 Lexus GS 450h – \$1,550

The maximum credits are only available for a limited time. You may claim 100 percent of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records its sale of the 60,000th vehicle. For the second and third quarters, the credit is reduced by 50 percent and in the fourth and fifth calendar quarters, the credit drops to 25 percent. No credit is allowed after the fifth quarter. Be sure to ask the dealer whether the manufacturer has sold 60,000 vehicles.

*More makes and models may become certified for tax credits in the future.

Stock Options

Know when to hold 'em

If you were granted nonqualified stock options (NSO) from your employer, consider your other income before you exercise the options. Try to exercise them during a year when your income keeps you in the lower tax brackets. Why? Once you exercise the options, the difference between the fair market value of the stock on the date of exercise and the amount you paid for the option is included as additional compensation on your W-2. A later sale of the stock is reported as long-term capital gain income provided you held the stock for more than one year.



If you were granted an incentive stock option (ISO), the tax consequences are a bit different. The character of the income depends on when the stock is sold. If the ISO stock is held for at least one year and the ISO was granted at least two years before the sale, the gain upon sale is treated as long-term capital gain. However, a disqualifying disposition occurs if the stock is sold within two years of the grant date or within one year of the exercise date. In this case, the difference between the fair market value of the stock and the option price on the date of exercise is treated as ordinary income and is included in taxable wages on your Form W-2 in the year the stock is sold. The remainder of the gain would be ordinary income or capital gain, depending on how long you held the stock.

ISOs are also subject to an alternative minimum tax (AMT) trap. If you exercise the ISO, but do not sell the underlying stock in the same tax year, the difference between the fair market value on the date of exercise and the option price are included in determining AMT.

If your income fluctuates from year to year, or you are considering retirement, exercising your stock options in a low-income year will save you tax dollars. Careful planning also will help you avoid AMT.



Did You Receive an E-mail From the IRS?

Hit the delete button

There were various e-mail scams circulating this past year that appeared as though they came from the IRS. The e-mails claim you may have a refund waiting for you and all you need to do is provide some information—like your name, address, social security number, and filing status. Some of the e-mails even went so far as to ask for your bank account information so they could credit your refund.

For starters, the IRS never corresponds with taxpayers via e-mail, nor asks you for your bank account information. The scam is a ruse to collect your personal information and steal your identity. Don't fall for it. Delete the e-mail and keep your personal information safe.

Health Savings Accounts

How they can help you

A Health Savings Account (HSA) is an account that you can put money into to save for future medical expenses. There are certain advantages to putting money into these accounts. Funds saved in an HSA and used for qualifying medical expenses are excluded from gross income and thus not subject to taxes.

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QUICK TIPS

1 If you will be age 70½ by December 31, 2006, you are required to begin distributions from your IRA. The rules state that you must begin minimum distributions no later than April 1 of the year following the year you reach age 70½. If your 70th birthday is on July 1, 2006, you are not age 70½ until 2007.

2 If you have a substantial capital loss carryover, consider selling investments that are doing well. The loss will offset any potential gain and will save you tax dollars. Caution: Watch for AMT.

3 Do you own a vacation home? If yes, you can rent the home for less than 15 days and not pay tax on the income.

4 For 2006, you can contribute up to \$4,000 to your traditional or Roth IRA. The additional catch-up contribution for traditional or Roth IRAs increases to \$1,000 if you are age 50 or older.

5 Beginning in 2006, you may be able to treat all or part of your elective deferrals to your §401(k) plan as after-tax Roth IRA contributions. The contributions that you make under this program will be treated as elective deferrals but will not be excludable from your gross income. Ask your employer if this option is available under your retirement plan.

6 When making home improvements, such as replacing doors or windows, look for the Energy Star label. You may be eligible for a lifetime credit of up to \$500 for making qualifying energy saving improvements. However, only \$200 of this credit amount may be for window expenditures. Subject to these limits, the credit equals the sum of the following two credits:

- 1) A ten-percent credit for energy efficient improvements, such as insulation, exterior windows, skylights, exterior doors, and pigmented coated metal roofs.
- 2) A credit for energy property expenditures in the following amounts:
 - \$50 for each advanced main air circulating fan;
 - \$150 for each qualified natural gas, propane, or oil furnace, or hot water boiler; and
 - \$300 for qualified energy-efficient property, such as heat pumps, water heaters, and central air conditioners that meet certain requirements.



You can contribute to an HSA if you meet the following requirements:

- Have coverage under an HSA-qualified “high deductible health plan” (HDHP).
- Have no other first-dollar medical coverage (other specific types of insurance like injury insurance or accident, disability, dental care, vision care, or long-term care insurance are permitted).
- Are not enrolled in Medicare.
- Cannot be claimed as a dependent on someone else’s tax return.

An HSA-qualified “high deductible health plan” (HDHP) is health insurance where you pay all expenses until they reach a high deductible amount. The rules require that the health insurance deductible be a least \$1,050 for self-only coverage and \$2,100 for family coverage.

In addition, annual out-of-pocket expenses under the plan (including deductibles, co-pays, and co-insurance) cannot exceed \$5,250 for self-only coverage or \$10,500 for family coverage.

You, your employer, or both, can make contributions to your HSA each year that you are eligible. You can contribute up to the amount of your HDHP deductible but no more than \$2,700 for self-only coverage or \$5,450 for family coverage. Individuals age 55 and older can also make additional “catch-up” contributions of \$700 in 2006. An HSA is portable, meaning that it remains yours even if you change employers or leave the workforce. It can accumulate year-to-year if not used. If you make a contribution, you can deduct the contribution on your tax return whether or not you itemize deductions.

Distributions from your HSA are tax-free provided they are used to pay qualified medical expenses. If they are not used for qualified medical expenses, they are included in taxable income and are subject to an additional 10-percent penalty. Once you reach age 65, the 10-percent penalty no longer applies.



Save for Your Retirement

A seldom-used credit is about to expire

You may be eligible for the retirement savings contributions credit if you recently made retirement plan contributions of up to \$2,000. The credit is only available through 2006, unless Congress extends it. The credit amount is based on both your filing status and adjusted gross income (AGI). The most you can expect is 50 percent of your contributed amount, up to \$1,000 per individual. See the following table:

Adjusted Gross Income (AGI) Amounts and Allowable Credit Percentage

Married Filing Jointly:

Not over \$30,000 – 50 percent
Over \$30,000 and not over \$32,500 – 20 percent
Over \$32,500 and not over \$50,000 – 10 percent
Over \$50,000 – no credit

Head of Household:

Not over \$22,500 – 50 percent
Over \$22,500 and not over \$24,375 – 20 percent
Over \$24,375 and not over \$37,500 – 10 percent
Over \$37,500 – no credit

All Other Taxpayers:

Not over \$15,000 – 50 percent
Over \$15,000 and not over \$16,250 – 20 percent
Over \$16,250 and not over \$25,000 – 10 percent
Over \$25,000 – no credit