

# *Accounting and Tax Center, Inc.*

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January 19, 2008

Dear Customers and Friends,

I hope the New Year finds everyone well. As a reminder, our web site ([www.accountingandtaxcenter.com](http://www.accountingandtaxcenter.com)) is a good resource for information. There is also a map on the site to guide you to our location.

Again, we have had major tax changes. On May 25, 2007, President Bush signed into law The Small Business and Work Opportunity Tax Act of 2007. This Act had a number of tax provisions, however, the more significant provisions were **increased penalties** for both the taxpayer and tax return preparers. Most importantly is the provision changing the standard for a tax return preparer from a “realistic possibility of success” to “more likely than not”, while the tax payer’s standard remains at “substantial authority”. I know this sounds confusing and it can be. These are terms that refer to the chance a position on a tax return will be sustained by the IRS on an audit. Generally these standards are regarded as follows:

Realistic possibility of success – one in three chance of being sustained on audit.

Substantial authority – a 40% chance of being sustained on audit.

More likely than not – a greater than 50% chance of being sustained on audit.

As you can see, there has been a shift where the standard is higher for a tax return preparer than it is for the tax payer. It is possible, there could arise a conflict situation where the tax return preparer may be required to disclose a position on the return but the tax payer would not be required to disclose. If this should occur, we will discuss this situation in detail with you. We may have to spend additional time preparing your return because of the extra research and analysis necessary to meet the increased standard. Also, we may ask more questions, and require that you provide more documentation to support amounts on your return. We apologize ahead of time for any increased costs or inconvenience this change may require.

Also, on December 26, 2007, President Bush signed the Tax Increase Prevention Act of 2007. The Act provides for a one-year patch of the Alternative Minimum Tax for 2007. Without this patch as many as 13.5 million taxpayers were going to be subject to this tax for the first time. However, since the passage of this Act came so late in the year, the IRS is delaying the tax filing season to reprogram their computers. So if you are required to file any of the following five (5) forms you should not file your return before February 11:

- Form 8863, **Education Credits**.
- Form 5695, **Residential Energy Credits**.
- Schedule 2, Form 1040A, Child and Dependent Care Expenses for Form 1040A Filers.
- Form 8396, Mortgage Interest Credit.
- Form 8859, District of Columbia First-Time Homebuyer Credit.

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The Commonwealth of Virginia now conforms to the Internal Revenue Code as of December 31, 2006, except for:

- The special 30% bonus depreciation,
- The 5-year net operating loss carry-back enacted under the Job Creation and Worker Assistance Act of 2002, and
- As of the writing of this letter, the changes enacted by the above mentioned 2007 laws. Until the Virginia Legislature passes a bill, either **House Bill 912**, **Senate Bill 582**, or other bill to conform Virginia to the Internal Revenue Code through December 31, 2007 and the Governor signs it, **any 2007 law changes are not permitted to be taken on a Virginia return.**

We continue to have two different tax systems, one for the federal tax return and one for the Virginia tax return.

As a result of the above we have made some changes to our Tax Organizer. We believe our Tax Organizer covers tax areas in a more understandable manner, and it has far less pages than the one our software company provides. Still there are many pages, so **please don't be intimidated** by it. If you have difficulty don't worry, just bring your documents and the organizer to your appointment. We will complete it at that time. **PLEASE NOTE – Due to the 2007 law changes we must have a completed Tax Organizer for each client and signed by each client.**

**Please read the Tax Organizer carefully and fill in all of the information requested** and/or supply all of the tax information forms (W-2, 1099, 1098, etc.) that you receive. That information is what allows us to correctly prepare your return. You should begin receiving your tax information forms in late January and early February. Please place them with your tax organizer when you receive them. Once you have received everything, call for an appointment, mail in your information, or call for a pick up.

Remember, a fully completed Tax Organizer can identify more deductions and help you pay only what's legally required. It also helps us prepare your return more quickly, accurately and at **less expense** to you.

As always, thank you and should you have any questions please do not hesitate to call. We welcome questions as they help us both, you to pay the correct amount of taxes and us in the correct preparation of your return.

Sincerely yours,

Charles R. Spencer, President

Enclosures.

## Reminders:

### Charitable Contributions:

The **Pension Protection Act of 2006** [PL 109-280] was passed in 2006. Despite its name, the new law contains a good deal more than changes to the pension rules. **Prime example:** The new law is loaded with provisions affecting clients who donate to charity.

### **New Crackdown on Cash Donations without Receipts**

The new law effectively **ends deductions for out-of-pocket cash donations unless a receipt is obtained** from the recipient organization. For example, a client who simply drops a \$20 bill in the Sunday collection plate will no longer be able to deduct it.

Under prior rules, a deduction for a cash donation had to be substantiated by one of the following:

1. A cancelled check.
2. A receipt (or a letter or other written communication) from the recipient organization showing the name of the recipient, the date of the contribution, and the amount of the contribution.
3. In the absence of a cancelled check or a receipt, other reliable written records showing the name of the recipient, the date of the contribution, and the amount of the contribution.

So under (3), clients who put cash in the Sunday collection plate or in Christmas kettles outside department stores could claim a deduction as long as they kept a log or other written record of their contributions.

**The new law bars this practice by eliminating the third method of substantiation.** Starting with 2007, a deduction for any cash donation is disallowed unless the donor retains a bank record or a written communication from the recipient organization showing the name of the organization and the date and amount of the donation.

### **New Limitation on Deductions for Gifts of Clothing and Household Items**

If a client donates property to a charitable organization, a deduction is generally allowed for the fair market value of the property. The President's Advisory Panel on Federal Tax Reform and the staff of the Joint Committee on Taxation both have concluded that the fair market value-based deduction for donations of clothing and household items present difficult tax administration issues. As recently reported by the IRS, the amount claimed as deductions in tax year 2003 for clothing and household items were more than \$9 billion.

Under the new law, **no deduction is allowed for a charitable donation of clothing or household items unless the clothing or household item is in “good” used condition or better.** The IRS is also given authority to deny by regulation a deduction for any donation of clothing or a household item that has minimal monetary value, such as used socks and used undergarments. **We strongly recommend you take a picture of donated goods and keep it with your receipt.**

Household items include

- Furniture,
- Furnishings,
- Electronics, appliances,
- Linens, and,
- Other similar items.

Food, paintings, antiques, and other objects of art, jewelry and gems, and collections are excluded from the new rules, however, there are additional rules for these items. **Also excluded are clothing or household items if the deduction claimed is more than \$500 and the donor files a qualified appraisal with his or her return.**

While a donor can generally deduct the fair market value of donated property, there are exceptions. One exception applies to donations of tangible personal property (e.g., artwork, coin and stamp collections, jewelry). If you are donating this type of property – please call.

The new rules apply to donations **made after August 17, 2006.**

**IRA Contribution Limits:**

<b>Tax Year</b>	<b>Individual Contribution Limit</b>	<b>Catch-Up Contribution Limit *</b>
2002	\$3,000	\$500
2003	\$3,000	\$500
2004	\$3,000	\$500
2005	\$4,000	\$500
2006	\$4,000	\$1,000
<b>2007</b>	<b>\$4,000</b>	<b>\$1,000</b>
2008 and after	\$5,000	\$1,000

\* If you are age 50 or older by the end of the year for which the contribution is being made.

### **Kiddie Tax:**

Form 8615 - Tax for Children with Investment Income of more than \$1,700, now applies to children **under 18 years old**.

### **Tax Exempt Interest:**

Taxpayers have always been required to report their tax-exempt interest on Form 1040. The IRS now requires payers to include tax-exempt interest in Box 8 of Form 1099-INT, so please include all form 1099-INT's with your tax information for your preparer. Failure to report 1099-INT's will result in a letter from the IRS.

### **Residential Energy Improvement Credit:**

There is a new credit for residential energy improvements. You may be able to take a credit for amounts paid in 2007 to have qualified energy saving items installed in connection with your home. If you made improvements to your home; insulation, exterior windows, exterior doors, metal roof, certain electric heat pump water heaters, electric heat pumps, geothermal heat pumps, central air conditioners, natural gas, propane or oil water heaters, qualified natural gas, propane, or oil furnace or hot water boiler, advanced main furnace circulating fan, photovoltaic, solar or fuel cell property, please let your tax preparer know and provide documentation.

### **Alternative Motor Vehicle Credit:**

Individuals and businesses that buy a brand new hybrid car or truck in 2007 can take advantage of the "Alternative Motor Vehicle Credit." The tax credit applies to new cars and trucks that are certified for the credit by the IRS.

Qualifying vehicles purchased on or after January 1, 2006, will be eligible for a tax credit ranging from \$400 to \$3,400 based on fuel economy. The tax credit is actually a combination of two separate tax credits. The math is complicated, and fortunately you won't have to calculate it. The car manufacturers and the IRS will certify the tax credit amount of qualifying vehicles.

The tax credit may be short-lived, depending on consumer demand for the new hybrid cars and trucks. The dollar value of the tax credit will start to be reduced once a manufacturer sells 60,000 qualifying vehicles. The phase out occurs at the manufacturer level, so popular brands may see their tax credits reduced sooner than less popular brands. Car manufacturers will let you know upfront what the maximum dollar value of your tax credit will be. Your tax credit may be reduced by various limitations.

## **Virginia Penalties and Interest:**

Previously a number of Virginians were un-expectantly hit with new penalties and interest provisions on their Virginia returns. The best advice I can give is to make proper and adequate withholding payments and/or estimated tax payments equal to the tax due and to make them on time and to file and pay any balance due by the Virginia due date of May 1.

### **Extension, Payment, Late Filing Penalties and Interest**

Under the provisions of Virginia law for taxable years beginning on or after January 1, 2005, every individual income tax filer is granted an automatic six-month filing extension (**no application for extension is required**). This does not mean that a return filed within the six-month extension period will not be subject to penalties. However, there are a few changes in the way that penalty charges are applied to returns for taxable years beginning in 2005. **A tax due return may be subject to one or more penalty charges, as well as to the accrual of interest.** A few basics to keep in mind:

- For individual income tax, **penalties** apply only to returns that show a balance of tax due. Individual income tax returns that reflect an overpayment, as well as “zero” returns, are not subject to penalty.
- Depending on when a return is filed and when the tax due is paid the return may be subject to; 1) an **extension penalty**, 2) a **late payment penalty**, or 3) a **late filing penalty**.
  - **Extension Penalty:**
    - To avoid an **extension penalty** charge, however, the filer must pay **at least 90% of the final tax liability by the original due date**.
    - 2% per month or part of a month on the tax due with the return, from the original due date through the date of filing. The maximum extension penalty charge is 12%.
  - **Late Payment Penalty:**
    - 6% per month or part of a month from the due date, or the date filed on extension, until the date the tax is paid, to a maximum of 30% of the tax due.
  - **Late Filing Penalty:**
    - A late filing penalty on any individual income tax return filed more than six months after the due at the maximum rate of 30%. A return that is subject to the late filing penalty at the point of initial assessment will not be subject to either the extension penalty or the late payment penalty.
- A return filed within six months from the original due date may be subject to an **extension penalty** and/or a **late payment penalty**. A return filed within six months of the due date is never subject to a **late filing penalty**.
- A return that is filed more than six months after the due date is subject to the maximum **late filing penalty**. A return filed more than six months after the due date is never subject to an **extension penalty** or a **late payment penalty**.
- **Any balance of tax that is not paid by the due date is subject to the accrual of interest, even if the return is not otherwise subject to penalties.**