

Ten Tax Tips for After January 1, 2008

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1. Contribute to Retirement Accounts

If you haven't already funded your retirement account for 2007, do so by April 15, 2008. That's the deadline for a contribution to a traditional IRA, deductible or not, and a Roth IRA. However, if you have a Keogh or SEP and you get a filing extension to October 15, 2008, you can wait until then to put 2007 money into those accounts. Don't dawdle though.

Making a deductible contribution will help you lower your tax bill this year. Plus, your contributions will compound tax-deferred. It's hard to find a better deal. If you put away \$4,000 a year for 20 years in an investment with an average annual 10 percent return, your \$80,000 in contributions will grow to \$252,000. The same investment in a taxable account would grow to only \$186,000 if you're in the 25% federal tax bracket (and even less if you live in a state with a state income tax to bite into your return).

To qualify for the full annual IRA deduction in 2007, you must either 1) not be eligible to participate in a company retirement plan, or 2) if you are eligible, you must have adjusted gross income of less than \$52,000 or less for singles or \$83,000 or less for married couples filing jointly. (The limit for married couples filing jointly increases to \$85,000 for 2008.) If you are not eligible for a company plan but your spouse is, your traditional IRA contribution is fully deductible as long as your combined gross income does not exceed \$156,000.

For 2007, the maximum IRA contribution you can make is \$4,000 (\$5,000 if you are age 50 or older by the end of the year). For self-employed persons, the maximum annual addition to SEPs and Keoghs is \$45,000 for 2007.

Although choosing to contribute to a Roth IRA instead of a traditional IRA will not cut your 2007 tax bill -- Roth contributions are not deductible -- it could be the better choice because all withdrawals from a Roth can be tax-free in retirement. Withdrawals from a traditional IRA are fully taxed in retirement. To contribute the full \$4,000 (\$5,000 if you are age 50 or older by the end of

2007) to a Roth IRA, you must earn \$99,000 or less a year if you are single or \$156,000 if you're married and file a joint return.

Savings: Your savings will vary. If you are in the 25 percent tax bracket and make a deductible IRA contribution of \$4,000, you will save \$1,000 in taxes the first year. Over time future contributions you make will save you thousands, depending on your contribution, income tax bracket, and number of years you keep the money invested.

2. Make a Last-Minute Estimated Payment

If you didn't pay enough to the IRS during the year, you may have a big tax bill staring you in the face. Plus, you might owe significant interest and penalties, too.

How could that happen? Withholding on your paycheck may be out of whack, or you may have received a big gain from selling stock. According to IRS rules, you must pay 100 percent of last year's tax liability or 90 percent of this year's tax or you will owe an underpayment penalty. If your adjusted gross income for 2006 was more than \$150,000, you have to pay more than 110 percent of your 2006 tax liability to be protected from 2007 underpayment penalties. If your tax payments were a bit light, you may be stuck.

If you make an estimated payment by January 15, though, you can erase any penalty for the fourth quarter, but you still will owe a penalty for earlier quarters, if you did not send in any estimated payments back then. But if your income windfall arrived after August 31, 2007, you can file Form 2210, Underpayment of Estimated Tax, to annualize your estimated tax liability and possibly reduce any extra charges.

A note of caution: Try not to pay too much. It's better to owe the government a little rather than to expect a refund. Remember the IRS doesn't give you a dime of interest when it borrows your money.

Savings: Interest and penalties on tax underpayments.

3. Organize Your Records

Good organization may not cut your taxes. But there are other rewards, and some of them are financial. For many, the biggest hassle at tax time is getting all of the documentation together. This includes last year's tax forms, this year's W-2s and 1099s, receipts, and so on.

If you really want to make tax season go smoothly, use a personal finance software program like Quicken throughout the year so you have easy access to all the information you need.

How do you get started?

- Print out a tax checklist to help you gather all the tax documents you'll need to complete your tax return.
- Keep all the information that comes in the mail in January, such as W-2s, 1099s, and mortgage interest statements. Be careful not to throw any tax-related documents out even if they don't look very important.
- Collect receipts and information that you have piled up during the year.
- Group similar documents together, putting them in different file folders if there are enough papers.
- Make sure you know the price you paid for any stocks or funds you have sold. If you don't, call your broker before you start to prepare your tax return. Know the details on income from rental properties. Don't assume that your tax-free municipal bonds are completely free of taxes. Having this type of information at your fingertips will save you another trip through your files.

Savings: Hours of your time right off the bat. To complete your return easily and accurately use our TaxExpress services.

4. Find the Right Forms

You won't find all of them at the post office and library. Instead, you can go right to the source online. View and download a large catalog of forms and publications at the Internal Revenue Service's Web site or have them sent to you by mail. You can search for documents by number or date back to 1990.

The IRS also will refer you to a private site that lists state government sites where you can pick up state forms and publications.

Savings: Hours of your time and the hassle of running around town.

5. Itemize

It's easier to take the standard deduction, but you may save a bundle if you itemize, especially if you are self-employed, own a home, or live in a high-tax area. It's worth the bother when your qualified expenses add up to more than the 2007 standard deduction of \$5,350 for singles and \$10,700 for married couples filing jointly. Those amounts increase to \$5,450 and \$10,900 respectively, for 2008.

Many deductions are well known, such as ones for mortgage interest and charitable donations. Taxpayers, however, sometimes overlook miscellaneous expenses, which are deductible if they tally up to more than two percent of adjusted gross income when they are combined. These deductions include tax-preparation fees, job-hunting expenses, business car expenses, and professional dues.

Remember that you can deduct sales tax paid in 2007 is deductible if it is greater than the amount of state and local income tax paid. IRS tables give you a certain amount to claim for sales taxes paid, based on your income and household size. If you kept your receipts all year, you can compare the total sales tax paid to the table amount and claim whichever is greater. Even if you claim the sales tax amount from the IRS tables, you can add sales tax paid on vehicles or boats purchased during the year to the table amount, except to the extent the sales tax rate on these items is more than the general sales tax rate.

If you live in a state with a high income tax like California or New York, you will probably be better off claiming a deduction for state and local income tax rather than sales tax paid. If you're a resident of a state with no income tax at all, like Washington, Texas or Florida, the sales tax deduction can save you a lot of tax dollars when you itemize.

You can also deduct the portion of medical expenses that exceed 7.5 percent of your adjusted gross income.

Savings: Potentially thousands of dollars.

6. Don't Shy Away From a Home Office Deduction

The eligibility rules for claiming a home-office deduction have been loosened to allow more filers to claim this break. People who have no fixed location for their businesses can claim a home office deduction if they use the space for administrative or management activities, even if they don't meet clients there. Doctors, for example, who consult at various hospitals or plumbers who make house calls can now qualify. As always, you must use the space exclusively for business.

Many taxpayers have avoided the home office deduction because it has been regarded as a red flag for an audit. If you legitimately qualify for the deduction, however, there should be no problem.

You are entitled to write off expenses that are associated with the portion of your home where you exclusively conduct business (such as rent, utilities, insurance, and housekeeping). The percentage of these costs that is deductible is based on the ratio of the square footage of the office to the total areas of the house. A middle-class taxpayer who uses a home office and pays \$1,000 a month for a two-bedroom apartment and uses one bedroom as a home office can easily save \$1,000 in taxes a year. People in higher tax brackets with greater expenses can save even more.

One home-office trap that used to scare away some taxpayers has been eliminated. In the past, if you used 10% of your home for a home office, for example, 10% of the profit when you sold did

not qualify as tax-free under the rules that let homeowners treat up to \$250,000 of profit as tax-free income (\$500,000 for married couples filing joint returns). Since 10% of the house was an office instead of a home, the IRS said, 10% of the profit wasn't tax free. But the government has had a change of heart. No longer does a home-office put the kibosh on tax-free profit. You do, however, have to pay tax on any profit that results from depreciation claimed for the office after May 6, 1997. It's taxed at a flat 28%. (Depreciation produces taxable profit because it reduces your tax basis in the home and, the lower your basis, the higher your profit.)

Savings: A typical deduction easily can run into thousands of dollars.

7. Provide Dependent Taxpayer IDs on Your Return

Be sure to plug in Taxpayer Identification Numbers (usually Social Security numbers) for your children and other dependents on your return. Otherwise, the IRS will deny the personal exemption of \$3,400 for each dependent and the \$1,000 child tax credit for each child under age 17.

Be especially careful if you are divorced. Only one of you can claim your children as dependents, and the IRS has been checking closely lately to make sure spouses aren't both using their children as a deduction. If you forget to include a Social Security number for a child or if you and your ex-spouse both claim the same child, it's highly likely processing of your return (and any refund you're expecting will come to a screeching halt while the IRS contacts you to straighten things out.

Of course, if you make enough money, the benefits disappear anyway. The 2007 phase-out range for the personal exemption begins at \$234,600 for married couples filing jointly, \$156,400 for single filers and at \$195,500 for heads of households. Those amounts will change to \$240,000, \$160,000 and \$200,000 respectively, for 2008.

The \$1,000 child tax credit begins to phase out at \$110,000 for married couples filing jointly and at \$75,000 for heads of households.

After you have a baby, be sure to file for a Social Security card right away so that you have the number at tax time. If you don't have the number you need by the tax filing deadline, the IRS says you should file for an extension rather than sending in a return without a required Social Security number.

Savings: Hundreds, possibly thousands, of dollars, depending on the number of dependents and your income.

8. File and Pay on Time

If you can't finish your return on time, make sure you file Form 4868 by April 15, 2008. Form 4868 gives you a six-month extension of the filing deadline to October 15, 2008. On the form, you need to make a reasonable estimate of your tax liability for 2007 and pay any balance due with your request.

Timely requesting an extension is especially important if you end up owing tax to IRS. If you file and pay late, IRS can slap you with a late-filing penalty of 4.5 percent per month of the tax owed and a late-payment penalty of 0.5 percent a month of the tax due. The maximum late filing penalty is 22.5 percent and the late-payment penalty tops out at 25 percent. By filing Form 4868, you stop the clock running on the costly late-filing penalty.

Savings: Interest and penalties.

9. File Electronically

Electronic filing works best if you expect a refund. Because the IRS processes electronic returns faster than paper ones, you can expect to get your refund three to six weeks earlier. If you have all your documents in order, go ahead and file electronically in January using our TaxExpress services. If you have your refund deposited directly into your bank account or IRA, you will wait even less time.

There are other advantages besides a fast refund. The IRS checks your return to make sure that it is complete, which increases your chances of filing an accurate return. Less than one percent of electronic returns have errors, compared with 20 percent of paper returns. The IRS also acknowledges that it received your return, a courtesy you don't get even if you send your paper return by certified mail. That means you protect yourself from the interest and penalties that accrue if your paper return gets lost.

If you owe money, you can file electronically and then wait until the federal tax filing deadline to send in a check along with Form 1040-V. You may be able to pay with a credit card or through a direct debit.

- With a credit card, expect to pay a service charge of as much as 2.5 percent.
- With direct debit, you may delay the debiting of your bank account until the actual filing deadline.

Savings: Peace of mind.

10. Decide If You Need Help

If you feel uncomfortable doing your taxes on your own, especially when they are complicated enough to require the 1040 long form and some additional schedules. You can talk to a tax professional with TaxExpress.