

Tax Time Topics

Consumer Alert!

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Credit Counseling

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By Edward Tonini, Director of Education.

“I’m proud to be paying taxes in the United States. The only thing is, I could be just as proud for half the money.”

Arthur Godfrey (as quoted in *Lower Your Taxes—Big Time!* by S. Botkin)

It’s that time again. A modern proverb says that taxes are as unavoidable as death. Apparently many people have taken those words as a challenge. The National Research Program of the IRS (Internal Revenue Service) estimates tax fraud in America to be more than \$300 billion annually (Source: www.irs.gov/pub/irs-utl/ntafy2004annualreport.pdf). That’s nearly as much as the national debt annually! Perhaps a better understanding of taxes, as well as information on ways to minimize the burden will help.



Why We Have To Pay Taxes

Modern taxation in America owes its legal authority to the 16th Amendment to the Constitution (ratified in 1913). Today, the IRS offers the following quote from Oliver Wendell Holmes to explain taxes: **“Taxes are what we pay for a civilized society.”** The IRS publication, *Why Do I Have To Pay Taxes*, points out the legal justification for taxes and refutes some arguments commonly used to rationalize not paying taxes. You can read the whole document online at <http://www.irs.gov/pub/irs-pdf/p2105.pdf>.

Show Us The Money

The pie chart below, from IRS publication 2105, indicates how the federal government uses our tax money to maintain our civilized society.



Be Scam Aware

Instant Refunds, Rapid Refunds, 24-hour Refunds, and the like, are nothing more than costly refund anticipation loans. It’s a bad deal: you’ll pay a processing fee and finance charges totaling \$40 and up, you’ll have paperwork to fill out for the loan, and first-time customers usually have limits on the maximum amount they can get back right away. It just doesn’t make sense to pay the equivalent of triple digit interest rates to get your money a few weeks, or possibly only a few days, earlier.

There are better options:

- **File electronically.** This method of filing will cut the wait from four to eight weeks down to about three weeks. The section “Where To Get Help” below describes ways to get

your taxes filed electronically and about 70% of taxpayers can get this done online for free.

- **Direct Deposit.** Having your refund deposited directly into your bank account will cut your wait down another week. Most people who file electronically and choose direct deposit will get their refund in about two weeks.
- **Alternate Financing.** Consider asking a friend or relative for a short-term loan. If you’ve earmarked the refund for a store purchase, check to see what in-store financing terms are offered. If you can’t delay the purchase, shop lenders for the lowest interest rate. Even a bad idea like a cash advance on a credit card would give you a lower APR than a rapid refund.
- **Choose to wait.** It may be counter to media advertising today, but the most sensible course of action is to spend *only after* you have the funds and can afford it.

Return Preparer Fraud and Identity Theft. The IRS warns against dishonest tax return preparers who typically promise big refunds. They advise being “choosy

Contents On Back

- Ways To Lower Taxes
- Common Mistakes
- Where To Get Help
- To Find Out More



when it comes to disclosing personal information.” Anyone doing your taxes has access to enough personal information to withdraw funds from your accounts, make charges to your credit cards, or apply for loans in your name. Some identity thieves even pretend to be from the IRS (when in doubt, call the IRS to confirm a contact). Ultimately, no matter who prepares your return, you are responsible for its accuracy and for any tax bill.

Ways To Lower Taxes

Here are some legitimate ways that can lower a tax bill:

Contribute to Retirement Accounts.

If your employer offers a retirement savings plan (401k, 403b) it's wise to contribute the most you can afford before April 15. The maximum contribution for 2005 is \$4000. If your employer matches any portion of your contribution, it's free money to you. If you are self-employed, you can contribute to an SEP or Keogh. A traditional IRA can lower a tax bill and let the money grow tax-free until it's withdrawn. A Roth IRA will not lower a tax bill but it will let the money grow tax-free and won't be taxable when withdrawn at retirement. Help in planning for retirement is probably available without charge from the company that manages your employer-based retirement savings plan. Otherwise, your bank or credit union may have a retirement specialist that can assist you.

Don't Overlook Any Deductions.

If you itemize, you may be able to get a bigger deduction than the standard deduction. Consider the following:

- **If you own a home**, your property taxes, mortgage interest, and refinancing costs are a source for deductions.
- **Charitable contributions.** For a single donation of \$250 or more, a receipt is required, but for a smaller amount a cancelled check will suffice. You can also deduct the fair market value of goods you donate but you should keep documentation (such as a list of items - signed by the charity). Many people

don't realize they can deduct expenses (such as transportation costs) for work they do for a charity.

- **Medical Expenses.** If you're self-employed, your health insurance premiums, prescribed medicine, and doctor bills may be deductible. If you're not self-employed these costs will have to exceed 7.5% of your AGI (adjusted gross income) in order to give you any tax benefit.
- **Education Expenses.** If you're a student with an AGI under \$65,000 you can deduct up to \$4,000 for higher education expenses. If you're an educator, you can deduct up to \$250 for teaching materials that you purchased out of pocket. You can also see if you qualify for the Hope Credit or the Lifetime Learning Credit. If the education is related to your present career, you may be entitled to a deduction.
- **Clean fuel deduction.** If you have purchased a new energy-efficient vehicle, you may be entitled to a deduction. To find out which vehicles qualify, visit www.irs.gov.
- **Investment and tax-related expenses.** This can include professional fees, and the cost of computer software or hardware purchased for that purpose.
- **Casualty deductions.** If the area where you live was declared a disaster area by the president, you can claim your losses. See "Victims of Disaster" below.

Earned Income Tax Credit. This federal tax credit is available to low-income working individuals and families. It is refunded to qualified taxpayers after their taxes have been paid. The basic income requirements are: under \$37,263 for families with two or more children; under \$33,030 for families with one child; under \$13,750 for families or individuals with no qualifying children. If you know that you'll qualify, you may want to increase your paycheck by requesting an Advanced Earned Income Tax Credit from your employer. To determine if you qualify for this credit, click on the "EITC Assistant" link at www.irs.gov or call 1-800-829-1040.

If you will owe, make certain your return is received before April 15 to avoid any interest or penalty charges.

Common Mistakes

- ✗ Not using a refund to pay down debt
- ✗ Bad math (addition/subtraction errors)
- ✗ Unsigned return
- ✗ Missing or incorrect Social Security #
- ✗ Sloppiness (hand-written returns must be legible)
- ✗ Missing income (income reported for you by someone else that's not on your return)
- ✗ Losing track of an investment's original value or basis
- ✗ Being vague (such as lumping interest from different sources together)
- ✗ Forgetting about interest or dividends
- ✗ Losing receipts (keep deductible receipts and checks for at least 3 years)
- ✗ Incorrectly valued contributions (donated items should be valued at what they might cost at a thrift store)
- ✗ Getting a large refund (Why give the government an interest free loan? If your refund is large, consider adjusting the withholding on your W-4)

Where To Get Help

Free IRS Publications. IRS Publication 17, *Your Federal Income Tax*, is designed to assist with individual tax preparation (www.irs.gov/pub/irs-pdf/p17.pdf). Publication 910, *Guide To Free Tax Services*, identifies available IRS tax material and services and how to get them. Internet, telephone and fax services, and tax tips are covered in this guide (www.irs.gov/pub/irs-pdf/p910.pdf). IRS forms and publications can be obtained online at www.irs.gov or by calling 1-800-TAX-FORM (829-3676). The IRS customer service line is 1-800-829-1040.

Free Online Filing. If your AGI is less than \$50,000, you are eligible for free tax preparation software and electronic filing. Go to www.irs.gov and click on the "Check Out Free File" link.

Victims of Disaster. The IRS "is working to provide appropriate relief and assistance to victims of Hurricanes Katrina, Rita and Wilma." If you are a hurricane victim and need help with tax matters, please call 1-866-562-5227. Or go to www.irs.gov and click on "Help For Hurricane Victims."

Professional Help. If your situation is too complex for online filing or software, paid help is available in varying degrees of expertise and cost. The IRS offers "Helpful Hints When Choosing a Return Preparer" at www.irs.gov/newsroom/article/0,,id=134094,00.html.

To Find Out More



- *Taxes 2006 For Dummies* (E. Tyson, et al. Wiley Publishing Inc. 2005)
- *Your Income Tax 2006* (J.K. Lasser. John Wiley & Sons, Inc. 2005) JK Lasser tax tips online at www.taxact.com/tax-tips/index.asp.
- *Think Twice About 'Instant' Refunds* (J.B. Bernstel) - www.bankrate.com/bnm/news/advice/19990410b.asp.
- *15 Tax Mistakes To Avoid* (C.E. Brodrick) - www.bankrate.com/bnm/news/advice/20000316a.asp.