2007-08 Federal Tax Law Change Supplement

Includes a summary of changes affecting tax years 2007 and beyond

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PERSONAL EXEMPTIONS

Inflation Adjustments for personal exemptions and phase-out thresholds

	2007	2008
Exemption	3,400	3,500
Phase-Out AGI		
Single	156,400	159,950
Head of Household	195,500	199,950
Joint	234,600	239,950
Married Separate	117,300	119,975

STANDARD DEDUCTION

The basic standard deduction for married persons filing jointly remains at double the amount for singles through 2008; it was scheduled to decline to merely a percentage of the standard deduction for singles in 2005. The basic standard deduction for joint returns will be twice the standard deduction for single returns for taxable years 2005 through 2010. Absent any further law change, it will revert to 167% in 2011. The standard deductions for 2007 and 2008 are:

	2007	2008
Single	5, 350	5,450
Joint	10,700	10,900
Married Separate	5,350	5,450
Head of Household	7,850	8,000
Blind & 65+ Jt	1,050	1,050
Blind & 65+ Others	1,300	1,350

ITEMIZED DEDUCTIONS

Phase-Out Thresholds

	2007	2008
Married Separate	78,200	79,975
Others	156,400	159,950

MARRIAGE PENALTY RELIEF PENALTY - BASIC STANDARD DEDUCTION

Instead of being twice the amount of the single rate, the standard deduction for joint filers has historically been 167% of the single amount and was part of the so-called marriage penalty. Congress, in the 2001 Act, scheduled an increase in the standard deduction for joint filers to begin in 2005 and reaching twice the amount of the single deduction in 2009. Then, as part of Bush's tax reduction, the 2003 Act accelerated the implementation of the 200% factor – if only temporarily, for tax years 2003 and 2004, which was scheduled to revert to 174% in 2005.

This Tax Act sets the percentage to 200% for years 2005 through 2008, which means that combined with prior law that percentage remains at 200% through 2010. Absent of any further law change, it will revert to 167% in 2011.

CAPITAL GAINS & DIVIDENDS BARGAIN EXTENDED FOR TWO YEARS

Set to expire after 2008, the capital gains rates have been extended by Congress through 2010. In addition, the "zero" tax rates now apply to three years rather than only one.

As part of a 2003 tax package, Congress reduced the preferential tax rates on capital gains from 10% and 20% to 5% and 15% respectively, with the lower rates applying to taxpayers in the 15% and under tax brackets. The 5% rate will drop to 0% in 2008, which was to be the last year for the temporarily reduced rates. These lower rates apply to both the regular tax and alternative minimum tax (AMT).

Under the 2006 legislation, these rates were extended through 2010.

Tax Bracket	Capital Gains Rates	
	2006 – 2007	2008 – 2010
0 -15%	5%	0%
25% and Above	15%	15%

Capital gains rates apply to profits from the sale or exchange of capital assets held longer than one year or inherited. Capital assets include corporate stocks, bonds, unimproved real property, rental property and taxable gain from the sale of a home. They don't apply to the portion of gain attributable to depreciation, which is generally taxed at a higher rate.

"Zero" Tax Rate Extended - Under the prior legislation, the "zero" percentage rate only applied to 2008. By merely extending the sunset date of the prior act, Congress is effectively allowing the "zero" rate for three years, 2008 through 2010. Taxpayers in the 15% or lower tax brackets holding appreciated stock should consider a planned disposition of the stock over the three-year zero-tax-rate period.

Qualified Dividends Extended - The legislation also includes a provision that taxes qualified dividends at capital gains rates through 2010. Under prior law, qualified dividends were scheduled to receive this special treatment only through 2008.

SOCIAL SECURITY

Year	**2007**	**2008**
Taxable Earnings	97,500	102,000
Max FICA	6,045.00	6,324.00
Max SE	12,090.00	12,648.00
Earnings Limits	12,960	13,560
Minimum Earnings	1,000	1,050
Nanny Tax Threshold	1,500	1,600

UPDATED CALIFORNIA SDI RATES

Year	**2006**	**2007**	**2008**
Tax %	0.08	0.06	0.08
Max Wages	79,418	83,389	86,698
Max Tax	635.34	500.33	693.58

SECTION 179 EXPENSING

As a stimulant for business growth, Congress has temporarily increased the Sec. 179 expense deduction amount limit from what would have normally been $25,000. The higher, inflation-adjusted amount was extended through 2010 by the Small Business and Work Opportunity Act of 2007.

For 2008, the inflation-adjusted deduction is $128,000 and provides small businesses the ability to take a big deduction for all or part of their office equipment, furniture, computers, machinery, and other “personal property” items purchased during the tax year. This is in lieu of depreciating (spreading the cost) of the property over several years.

This deduction does not apply to land or buildings or for improvements to buildings. In addition, the deduction amount is reduced if more than $510,000 in equipment is purchased in 2008. Keep in mind that this tax break cannot be used to generate a loss on an individual return.

Year	2006	2007	2008	2009	2010
Jt, HH, S	108,000	125,000	128,000	*	25,000
MS	54,000	62,500	64,000	*	12,500
E-Zone	145,000	160,000	163,000	*	60,000

* Inflation Adjusted

NEW RULES FOR THE DOMESTIC PRODUCTION DEDUCTION

The purpose of the domestic production deduction is to encourage domestic (i.e., within the U.S.) manufacturing and other production activities. The tax incentive is in the form of a tax deduction equal to 3% of the net income from eligible activities. The deduction percentage increases to 6% for 2007 through 2009 and then jumps to 9% after 2009. As with all tax incentives, it comes with a number of complicated limitations and qualifications. In an effort to simplify this deduction, Congress included new provisions in a recent tax law change, and the IRS issued final regulations and procedures for the deduction.

What is a qualified production activity? The following are some common eligible activities: (1) the sale or rental of tangible personal property, including computer software, manufactured, produced or grown in the U.S., (2) the construction of real property in the U.S., and (3) the performance of engineering or architectural services in the U.S. in connection with real property construction projects in the U.S. Qualified production activities do not include purely sales activities or purely service activities except for construction, engineering and architectural services.

Deduction limitations – The deduction cannot exceed 50% of the “W-2” wages paid to employees during the year, and it cannot exceed the taxpayer’s taxable income for the year. An individual’s deduction is limited to modified adjusted gross income rather than taxable income. In a recently-passed tax law change, the “W-2” wages for purposes of this limitation are limited to wages properly allocated to the qualified production activity.

Who receives this deduction? Generally, the deduction is allowed to all taxpayers including individuals, corporations, farm cooperatives, estates and trusts. The deduction is passed through to owners of partnerships, S-corporations and cooperatives, allowing them to deduct it on their own returns. Prior law included a special limitation for a partnership or S-corporation owner that was removed by a recent new tax law.

Example of how the deduction is determined – ABC, Inc. produces widgets in the U.S. that it wholesales to other retailers. The company's revenue from the sale of the widgets is $2 million with a manufacturing cost of $750,000. ABC, Inc. also has $1 million of income from widget repair services. The total "W-2" wages for the year were $400,000 of which $150,000 is properly allocated to the widget manufacturing costs and the balance used to provide the repair services. The deduction would be determined as follows:

Qualified Production Activity Income (widget sales)	$2,000,000		
Cost of Manufacturing the Widgets Sold	<$ 750,000>		
Net Income	$1,250,000		
3% of the Net Income		$ 37,500	
Wages attributable to the Widget Production	$ 150,000		
50% of Wage Limitation		$ 75,000	
Domestic Production Deduction (lesser of the two)			$ 37,500

Of course, the deduction on ABC Inc.'s tax return will be limited to the company's taxable income. This example is rather a simplistic illustration of how the deduction is determined. In actual practice, inventory, cost of goods, determination of qualified production wages, etc., all have rules, procedures and complications of their own. However, the deduction can be very beneficial and well worth the added accounting. In fact, most taxpayers who qualify for the deduction are required to claim it, even if the administrative costs of applying the law and regulations outweigh the benefit of claiming the deduction.

EXTRA IRA CONTRIBUTIONS – VICTIMIZED EMPLOYEES

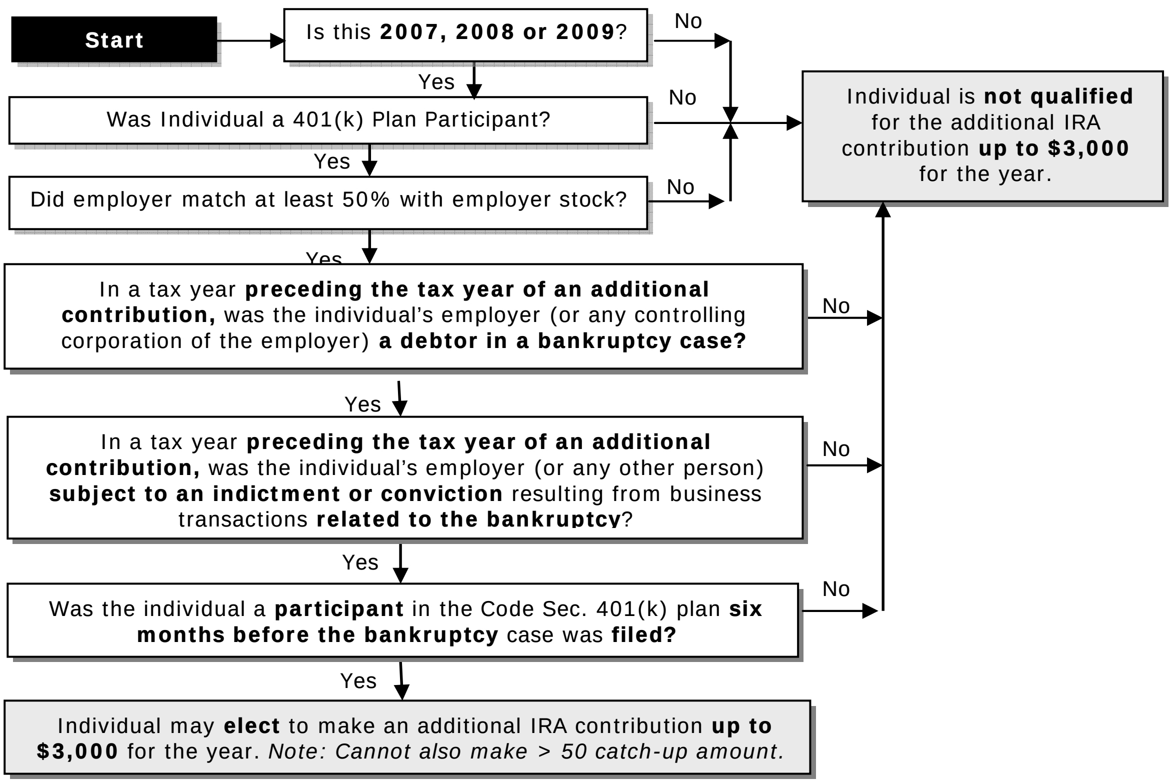
For the 2007, 2008 and 2009 tax years, a class of taxpayers termed "applicable individuals" can elect to make **additional** IRA contributions of up to **$3,000 per year**. A taxpayer is in the applicable individual class if:

- The individual was a **participant in a Code Sec. 401(k)** plan under which the **employer matched at least 50%** of employee contributions to the plan with employer stock.
- In a tax year **preceding the tax year of an additional contribution,** the individual's employer:
    - (1) (or any controlling corporation of the employer) **was a debtor in a bankruptcy case;** and
    - (2) (or any other person) was **subject to an indictment or conviction** resulting from business transactions related to the bankruptcy.
- The individual was a **participant** in the Code Sec. 401(k) plan on the date that is **six months before the bankruptcy** case was **filed.**

An applicable individual who elects to make additional IRA contributions of up to $3,000 a year **can't make IRA catch-up contributions** that apply to individuals **age 50 and older**.

AGI Phase-Out – Although the new law is silent on the deductibility AGI phase-out, based on its placement into Sec. 219, it is likely that this extra contribution would receive the same treatment as the catch-up allowance for individuals age 50+ (i.e., the phase-out for deductibility would apply and contributions could be designated as nondeductible.)

This provision is designed to help taxpayers whose employers were involved in Enron-type scandals.



COMBAT PAY RETROACTIVELY "APPROVED" FOR IRA CONTRIBUTIONS

In legislation recently passed by Congress, excludable (tax-free) combat pay is treated as compensation for purposes of making an IRA contribution. This change is retroactive to 2004 and provides some interesting possibilities for military taxpayers.

For recipients of excludable combat pay in 2004 and 2005, the new law provides a three-year window to make an IRA contribution for either or both tax years, provided they otherwise meet the normal IRA contribution qualifications. This includes spousal contributions. The three-year period began on May 29, 2006.

This new law gives rise to some interesting tax strategies:

- Taxpayers with little or no taxable income might consider making a nondeductible contribution to a Roth IRA, which provides a tax-free benefit in the future.
- Taxpayers who are qualified to make a deductible IRA contribution can make the contribution retroactively and then amend their returns for a refund.
- Taxpayers who are limited in making a deductible contribution or a Roth contribution might consider making a nondeductible traditional IRA contribution and then converting the nondeductible traditional IRA to a Roth IRA in 2010, when the Roth conversion AGI

limits have been removed. At that time, only the pre-conversion earnings will be taxable.

Because of the three-year window for making up prior-year contributions, contributions could be made after the statute of limitations for refunds has expired for the tax year. However, the new law does allow a refund if the claim is filed before the close of the one-year period beginning on the date that the contribution is actually made.

MUSICIANS GET A NEW TAX BREAK

Prior to the 2006 Tax Act, copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property held by a taxpayer whose personal efforts created the property received no special tax treatment.

Under this new legislation, and at the election of the taxpayer, the sale or exchange of musical compositions or copyrights of musical works created through the taxpayer's personal efforts is treated as the sale of a capital asset. Thus, if otherwise qualifying, the sale would be taxed at the more favorable capital gains tax rates. For calendar-year taxpayers, this provision applies for sales or exchanges in tax years 2007 through 2010.

See the previous section entitled "Capital Gains & Dividends Bargain Extended for Two Years" for the capital gains tax rates.

AMORTIZATION OF EXPENSES FOR CREATING OR ACQUIRING MUSIC

The Act provides that for any tax year beginning after Dec. 31, 2005 and before Jan. 1, 2011, a taxpayer may elect to amortize (deduct) over a five-year period trade or business expenses: (a) paid or incurred to create or acquire a musical composition (including words), or a copyright to such property; and (b) that are otherwise properly capitalized. The five-year period begins with the month in which the composition or copyright is placed in service.

The five-year amortization election doesn't apply to expenses:

- That are qualified creative expenses which aren't required to be capitalized under the uniform capitalization rules;
- To which a simplified procedure applies;
- That are amortizable Section 197 intangibles; or
- That, without regard to this provision, would not be allowable as a deduction.

The election is to be made in a time and manner specified by the IRS, and it applies to all musical property placed in service for the tax year.

FOREIGN-EARNED INCOME EXCLUSION

The Tax Increase Prevention and Reconciliation Act of 2005 include four significant changes to the Sec. 911 foreign-earned income and housing exclusions:

- **Exclusion is now Inflation-Adjusted** – The exclusion of $80,000[(1)] is inflation-adjusted beginning in 2006.

- **Housing Allowance Base Amount** – Taxpayers are allowed to deduct as a housing allowance the excess of their actual housing costs over a base amount. The base amount is 16% of the annual exclusion limitation amount.
- **Housing Exclusion Limit** – The housing exclusion is limited to 30% of the taxpayer's earned income exclusion for the year less the base amount.
- **Marginal Tax Rates** – Prior to 2006, an individual's tax rates on other income was based on his or her taxable income after the allowable exclusions. However, beginning in 2006, the excluded income will be included for purposes of determining the marginal tax rates applicable to the other income.

Tax Year	**2006**	**2007**	**2008**
Max Exclusion	82,400	85,700	87,600
Housing Daily Base Amt	36.12	37.57	38.30(***)
Housing Annual Base	13,184	13,712	14,016
Housing 30% Cap	24,720	25,710	26,280
Max Housing Exclusion	11,536	11,998	12,264

* Inflation adjusted beginning in 2006
** The housing exclusion is now capped at 30% of the earned income exclusion, except in what is deemed to be high-cost areas (see IRS tables), in which case the Cap is increased for the specific area..
*** Leap Year (366 days)

UNREASONABLE POSITION

A tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to an "unreasonable position" (defined below) must pay a penalty for each return or claim equal to the **greater** of:

- **$1,000** or
- **50% of the income derived** (or to be derived) by the tax return preparer for preparing the return or claim (Code Sec. 6694(a)(1), as amended by Act § 8246(b)).

A position is "unreasonable" if:

- The tax return preparer knew (or reasonably should have known) of the position,
- There was not a reasonable belief that the position would more likely than not be sustained on its merits, and
- The position was not disclosed as provided in Code Sec. 6662(d)(2)(B)(ii), or if the position was disclosed, there was no reasonable basis for the position. (Code Sec. 6694(a)(2), as amended by the 2007 Small Business and Work Opportunity Act § 8246(b))

This change is effective for returns prepared after May 25, 2007 with some transitional relief for returns, amendments and refund claims due on or before 12/31/07; to 2007 estimated tax due on or before 1/15/08 and to 2007 employment and excise tax returns due on or before 1/31/08. *(IRS Notice 2007-54)*

WILLFUL OR RECKLESS CONDUCT

A tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to an "unreasonable position" (defined below) must pay a penalty for each return or claim equal to the **greater** of:

- **$5,000** or
- **50% of the income derived** (or to be derived) by the tax return preparer for preparing the return or claim (Code Sec. 6694(a)(1), as amended by Act § 8246(b)).
- If the unreasonable position penalty was also imposed, the willful or reckless conduct penalty is reduced by the unreasonable position penalty.

"Willful or reckless conduct" is conduct by the tax return preparer which is a:

- Willful attempt to understate the tax liability on the return or claim, or
- Reckless or intentional disregard of rules or regulations. (Code Sec. 6694(b)(2), as amended by Act § 8246(b))

Effective for returns prepared after May 25, 2007; no transitional relief is available for the willful/reckless conduct penalty.

DEFINITION OF A TAX RETURN PREPARER

The definition of a tax preparer has been broadened to include preparers of income, estate, gift, employment, excise tax and exempt organization returns. (Code Sec. 7701(a)(36), as amended by Act § 8246(a)(1)). The term "income tax return preparer" has been replaced with "tax return preparer."

TRANSITIONAL RELIEF – NEW PREPARER PENALTIES

In Notice 2007-57, the IRS has announced transitional relief with respect to amendments made to Code Sec. 6694 by the Small Business Act of 2007. The transitional relief, which is effective as of May 25, 2007, will apply to:

- Returns, amended returns and refund claims due on or before December 31, 2007,
- 2007 estimated tax returns due on or before January 15, 2008, and
- 2007 employment and excise tax returns due on or before January 31, 2008.

HOME MORTGAGE DEBT FORGIVENESS RELIEF

Under the prior law, **which can still apply**, the discharge of indebtedness was included in a taxpayer's income in the year the debt was discharged. There also are certain exceptions to this rule. Two exceptions which apply to a taxpayer's home are:

- Title 11 bankruptcy cases (Code Sec. 108(h)(3)) and

- Insolvent debtors (Code Sec. 108(a)(1)(B)).

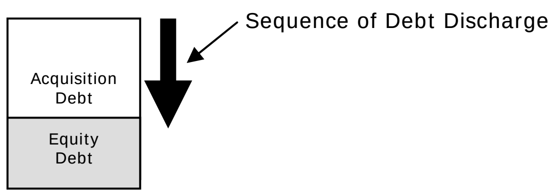
In both exceptions, the taxpayer must reduce their tax attributes, including basis in property, by the amount of excluded discharged debt. Tax attributes generally include loss carryovers.

New Law – Under a retroactive provision of the Mortgage Relief Act of 2007, taxpayers are generally allowed to exclude up to $2 million ($1 million for MS) of qualified principal residence acquisition debt on the taxpayer's qualified principal residence discharged on or after January 1, 2007 and before January 1, 2010. The basis of the taxpayer's home is reduced by the excluded amount, but not below zero. In some circumstances, this could result in a higher gain on the home sale, which may or may not be fully excludable under the home sale exclusion rules.

Caution – The exclusion does not apply to a taxpayer's designated 2nd (vacation) residence. Use the same rules that apply to home sale rules to determine if the home is the taxpayer's principal residence or a second home.

Caution – The exclusion only applies to the discharge of qualified principal residence acquisition debt. Thus, equity debt is not included as part of the exclusion. Acquisition indebtedness of a principal residence is indebtedness incurred in the acquisition, construction, or substantial improvement of an individual's principal residence that is secured by the residence. It includes the refinancing of debt to the extent the amount of the refinancing doesn't exceed the amount of the refinanced indebtedness. (Joint Committee on Taxation, JCX-86-07)

If any loan is discharged, in whole or in part, and only part of the loan is qualified principal residence indebtedness, the mortgage forgiveness exclusion applies only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before the discharge) which is not qualified principal residence indebtedness. Thus, where there is a mixed loan (part acquisition and part equity debt), the sequence of forgiveness is treated as applying to the acquisition debt first and then to the equity debt.



The exclusion doesn't apply to the discharge of a loan:

- If the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the taxpayer's financial condition.
- Of a taxpayer in a Title 11 bankruptcy. (Code Sec. 108(h)(3))

An insolvent taxpayer (other than one in a Title 11 bankruptcy) can elect to have the mortgage forgiveness exclusion not apply and can instead rely on the exclusion for insolvent taxpayers. Thus, where a taxpayer has significantly tapped the equity in the home, and has a significant amount of debt discharge that does not qualify for the exclusion, it may be to their advantage to forgo the mortgage relief exclusion and instead use the insolvent taxpayer exclusion.

HOME SALE EXCLUSION LIBERALIZED FOR SURVIVING SPOUSE

Under the pre-Mortgage Relief Act law, the up-to-$500,000 exclusion is available only if a husband and wife file a joint return for the year of sale. Thus, if the home is sold in a year after the year of a spouse's death—when a joint return would no longer be allowed to be filed—the surviving spouse can only get a maximum home sale exclusion of $250,000.

New law - The Mortgage Relief Act, effective for sales and exchanges after Dec. 31, 2007, allows surviving single spouses to qualify for the up-to-$500,000 exclusion if the sale occurs no later than 2 years after their spouse's death, and the requirements for the $500,000 exclusion under Code Sec. 121(b)(2)(A) were met immediately before the spouse's death. (Code Sec. 121(b)(4), as amended by Act § 7(a)).

Note: Keep in mind that the surviving spouse, depending upon the state of residence and the manner in which title is held, will have a 50% or 100% step up (or step down) in basis of the home as a result of the spouse's death.

MORTGAGE INSURANCE PREMIUM DEDUCTION EXTENDED

The Mortgage Relief Act extends the rules treating qualified mortgage insurance premiums as deductible qualified residence interest for three years. Previous legislation had established this deduction for 2007 only. Thus, they apply if the amounts: (1) are paid or accrued before Jan. 1, 2011; (2) aren't properly allocable to any period after Dec. 31, 2010; and (3) are paid or accrued with respect to a mortgage insurance contract issued after Dec. 31, 2006. (Code Sec. 163(h)(3)(E)(iv), as amended by Act § 3)

To be deductible, the premiums must have been paid in connection with acquisition debt for a mortgage insurance contract issued after Dec. 31, 2006. It must be for a qualified residence (first and second homes) and the premiums must have been paid or accrued after Dec. 31, 2006 and before Jan. 1, 2011.

The deductible amount of the premiums phases out ratably by 10% for each $1,000 (or fraction thereof) by which the taxpayer's AGI exceeds $100,000 (10% for each $500 (or fraction thereof) by which a married separate taxpayer's AGI exceeds $50,000).

Qualified mortgage insurance means mortgage insurance provided by the Veterans Administration (VA), Federal Housing Administration (FHA), or Rural Housing Administration (RHA), and private mortgage insurance, as defined by Sec. 2 of the Homeowners Protection Act of '98 (12 U.S.C. 4901), as in effect on Dec. 20, 2006. Prepaid premiums for mortgage insurance other than that provided by the VA or RHA are not fully deductible in 2007 but must be amortized over the period to which they apply. The unamortized balance is not deductible if the mortgage is paid off before the end of its term.

EXCLUSION FOR MEMBERS OF QUALIFIED VOLUNTEER EMERGENCY RESPONSE ORGANIZATIONS

The Mortgage Relief Act provides, effective for tax years beginning after Dec. 31, 2007 and before Jan. 1, 2011, an exclusion from gross income to members of qualified volunteer emergency response organizations for any:

(1) Qualified state or local tax benefit; and

(2) Qualified payment (Code Sec. 139B(a), as added by Act § 5(a))

A Qualified State or Local Tax Benefit - is any reduction or rebate of state or local income, real property, or personal property taxes on account of services performed by individuals as members of a qualified volunteer emergency response organization. (Code Sec. 139B(c)(1)) Unlike qualified payments, there is no cap on the amount excludable. However, the amount of state or local taxes taken into account by a taxpayer in determining his Schedule A deduction for taxes is reduced by the amount of any qualified state or local tax benefit. (Code Sec. 139B(b)(1))

A Qualified Payment - is a payment (whether reimbursement or otherwise) provided by a state or political subdivision on account of the performance of services as a member of a qualified volunteer emergency response organization. The amount of these payments considered "qualified," and therefore excludable, is limited to $30 multiplied by the number of months during the year that the taxpayer performs such services. (Code Sec. 139B(c)(2)) The expenses paid or incurred by the taxpayer in connection with the performance of services that he may deduct as a Schedule A charitable contribution are allowed only to the extent they exceed the amount of excluded qualified payments. (Code Sec. 139B(b)(2))

Limited Qualified Payment Exclusion - The maximum exclusion for qualified payments in a year is $360 ($30 × 12 months). However, this exclusion apparently isn't a simple $30 a month allowance. Rather, the payments are determined on a yearly basis ($30 × number of months of service). Thus, a taxpayer who serves for 12 months could exclude $360 received during the year even if it was received all in one month (for example, in the first or last month of the year).

A Qualified Volunteer Emergency Response Organization - is any volunteer organization which is: (1) organized and operated to provide firefighting or emergency medical services for persons in the state or its political subdivision; and (2) required (by written agreement) by the state or political subdivision to furnish firefighting or emergency medical services in the state or political subdivision. (Code Sec. 139B(c)(3))

TEACHER'S CLASSROOM EXPENSES

As part of the Tax Relief and Health Care Act of 2006, the $250 tax deduction for out-of-pocket costs incurred to purchase books, supplies and other classroom equipment by elementary and secondary school teachers and certain other school professionals is retroactively restored for 2006 and extended through 2007. However, Congress failed to pass the extender legislation before their December 2007 recess. Thus, it is not known at the time this material was prepared whether this deduction will be extended for 2008. The deduction is taken "above-the-line," so that it is deductible even for those taxpayers who do not itemize their deductions.

DEDUCTION FOR HIGHER EDUCATION EXPENSES

As part of the Tax Relief and Health Care Act of 2006, the tax deduction for qualified higher education expenses is retroactively restored for 2006 and extended through 2007. Thus, individual taxpayers will be allowed to deduct up to $4,000 of higher education expenses instead of claiming the Hope or Lifetime Learning tax credits. However, Congress failed to pass the extender legislation before their December 2007 recess. Thus, it is not known at the time this material was prepared whether this deduction will be extended for 2008.

401(k) CONTRIBUTION LIMITS

Year	2007	2008
Taxpayer < 50	15,500	15,500
Taxpayer 50+	20,500	20,500

Note: For 2008, there was no adjustment for inflation; thus, the 2008 contribution limits remain the same as they were for 2007.

IRA CONTRIBUTION LIMITS

2001 legislation increases the annual IRA contribution limit slowly through 2008 and indexes the limit for inflation in $50 increments for years after 2008. For individuals who have attained the age of 50 before the close of the taxable year, the deductible amount is increased by a specific amount. (See table below.)

Year	Contribution Limits	
	Under Age 50	Age 50 and Over
2006 through 2007	4,000	5,000
2008	5,000	6,000
2009 and after	Inflation Adjusted	

TRADITIONAL IRA PHASE OUT FOR ACTIVE PARTICIPANTS

Active participants in qualified plans must limit their IRA deductions when their AGI reaches certain "threshold levels." If the AGI is below the "threshold," even an active participant may deduct an IRA contribution within the IRA limits described above. The phase-out threshold levels for active participants are:

Filing Status	2005	2006	2007	2008
S, HH	50,000	50,000	52,000	53,000
Jt, SS	70,000	75,000	83,000	85,000
MS	0	0	0	0
Delta– Single	10,000	10,000	10,000	10,000
Delta – Married	10,000	20,000	20,000	20,000

DESIGNATED ROTH CONTRIBUTIONS ARE SUBJECT TO FICA

The Technical Corrections Act of 2007 clarifies that wage treatment applies also to elective deferrals that are designated as Roth contributions. (Code Sec. 3121(v)(1)(A), as amended by TCA § (8)(a)(2))

LOW-INCOME SAVER'S CREDIT

Current tax law includes a provision where a low-income taxpayer's contributions to an IRA or other qualified plan are supplemented by the "Saver's" credit. This credit is available to any taxpayer age 18 and older that is not a full-time student or a dependent of another taxpayer. The credit is 50, 20 or 10 percent of the first $2,000 of retirement plan contributions, and phased out after $50,000 of income for joint filers, $37,500 for those filing head of household and $25,000 for all others. The AGI income limitation will be indexed after 2007.

2007 Phase Outs

Modified Adjusted Gross Income						Applicable percentage
Joint return		Head of household		Others		
Over	Not over	Over	Not over	Over	Not over	
$ 0	$ 31,000	$ 0	$ 23,250	$ 0	$15,500	50
31,000	34,000	23,250	25,500	15,500	17,000	20
34,000	52,000	25,500	39,000	17,000	26,000	10
52,000		39,000		26,000		0

2008 Phase Outs

Modified Adjusted Gross Income						Applicable percentage
Joint return		Head of household		Others		
Over	Not over	Over	Not over	Over	Not over	
$ 0	$ 32,000	$ 0	$ 24,000	$ 0	$ 16,000	50
32,000	34,500	24,000	25,875	16,000	17,250	20
34,500	53,000	25,875	39,750	17,250	26,500	10
53,000		39,750		26,500		0

Modified AGI - Adjusted gross income will be determined without regard to Code Sec. 911 (foreign earned income exclusion and foreign housing exclusion or deduction), Code Sec. 931 (exclusion of income from American Samoa, Guam, or the Northern Mariana Islands), and Code Sec. 933 (exclusion of income from Puerto Rico). *(Code Sec. 25B(e))*

QUALIFIED PLAN TO IRA ROLLOVERS OK'D FOR NON-SPOUSE BENEFICIARIES

For distributions **after 2006**, direct rollovers of distributions from an eligible retirement plan (e.g., a qualified plan) of a deceased employee to a non-spouse beneficiary's IRA are permitted. However, a plan is not required to offer direct rollovers of distributions to a non-spouse beneficiary ***(IRS Notice 2007-7, Q&A 14)***, and many plans may not have been revised to reflect this change. So don't assume that a distribution will automatically qualify for rollover to a non-spouse beneficiary. If the non-spouse beneficiary receives a distribution from a plan, it is not eligible for rollover; the transfer must be trustee-to-trustee. The rollover is treated as an eligible rollover distribution, and distributions from the beneficiary's IRA are subject to the RMD rules that apply to inherited IRAs of non-spouse beneficiaries: distributions must begin immediately; they cannot be delayed until the non-spouse beneficiary turns age 70½.

CAUTION - The distribution is still subject to RMD rules for inherited IRAs. The account needs to be set up as an "inherited IRA" (aka "beneficiary IRA") with the decedent as the owner and the inheritor as the beneficiary (example: "Tom Smith as beneficiary of John Smith"). What's really changed is that the beneficiary can get the funds transferred from the decedent's qualified plan into an account that he or she has more control over. There **IS NO** provision allowing postponement of the withdrawal until the beneficiary reaches age 70 1/2 as there is when a spouse inherits.

The change applies to amounts payable to a beneficiary under a:

- Qualified retirement plan or
- Code Sec. 403(b) (Tax-Sheltered Annuity) annuity or
- A governmental Code Sec. 457 plan (deferred compensation plans of state and local governments and tax-exempt organizations).

To the extent provided by IRS, the change applies to benefits payable to a trust maintained for a designated beneficiary to the same extent it applies to the beneficiary. The IRA must be set up with the trust identified as the beneficiary ***(IRS Notice 2007-7, Q&A 16)***.

PLAN NOW FOR 2010 ROTH CONVERSIONS

Beginning in 2010, under the previously-enacted legislation, the income and marital status restrictions that limit the ability of a taxpayer to convert a traditional IRA to a Roth IRA have been removed, leading to some interesting and very advantageous tax and estate planning strategies.

Under prior law, an individual was allowed to convert a traditional IRA into a Roth IRA if the taxpayer's adjusted gross income (AGI) for the year (without the income from the converted IRA) was $100,000 or less. The $100,000 limit is figured without regard to required minimum distributions from an IRA. Although the income is taxable, the 10% early withdrawal penalty does not apply.

Beginning in 2010, the new legislation:

(1) Eliminates the $100,000 modified AGI limit on conversions of traditional IRAs to Roth IRAs, and

(2) Permits married taxpayers filing a separate return to convert amounts in a traditional IRA into a Roth IRA. Under prior law, married taxpayers who filed separate returns were restricted from making conversions.

Special 2010 Income Inclusion Rule: *For conversions made in 2010, the taxpayer can choose to elect to:*

- *Include the income in the 2010 return, or*
- *Include one-half of the conversion income in 2011 and one-half in 2012.*

Note: 2010 is the last year for the current "low" tax rates unless Congress extends them in future legislation.

Income from conversions made in a year after 2010 will be taxable in the year of the conversion. There are also a number of special rules regarding early distributions with respect to conversions.

Looking Ahead - There are some interesting strategies a taxpayer can employ to convert nondeductible traditional IRA contributions to a Roth IRA, thereby funding the more favorable Roth IRA.

- **Strategy** - Taxpayers who have employer plans and are restricted from making deductible traditional IRA contributions because of income level can make nondeductible traditional IRA contributions in the four tax years leading up to 2010, and then convert those nondeductible traditional IRAs to Roth IRAs with virtually no tax since they were nondeductible. Only the earnings would be taxable. Taxpayers who are prohibited from making Roth IRA contributions because their income exceeds the limit may also benefit from this strategy.
- **Strategy** - Using the same strategy above, even a taxpayer who can make a deductible contribution can elect to make it nondeductible, providing the same result as above.
- **Strategy** – Generally, rollovers are thought of as transfers from a qualified plan to an IRA or from one IRA to another IRA. However, beginning in 2002, the law has allowed the taxable part of an IRA to be rolled (or transferred) to other qualified plans, including 401(k) plans, 403(a) and 403(b) annuities and 457 governmental retirement plans (assuming the plan will accept the IRA funds). For taxpayers who have mixed IRAs (including both deductible and nondeductible contributions), this provides a means to segregating the taxable and nontaxable amounts and then later converting the nontaxable portion without paying any conversion tax (except on any interim earnings). Thus, the taxable portion can be rolled into a qualified plan, leaving the nontaxable portion in the IRA where it can be converted to the Roth IRA.
- **Strategy** - More aggressive taxpayers with the financial resources to pay the rollover tax might also consider rolling (or transferring) the funds from a qualified plan into a traditional IRA and then converting the traditional IRA to a Roth IRA.

Keep in mind that to minimize the conversion tax requires careful planning and strict adherence to the conversion rules.

RECORDKEEPING FOR CASH DONATIONS

Prior to this law change, for cash contributions less than $250, taxpayers were only required to have a contemporaneous record of the contributions. Under the new tax law taking effect in 2007, and effective for tax years after 2006, for contributions of money, <u>regardless of the amount</u>, applicable recordkeeping requirements are satisfied only if the donor maintains as a record of the contribution a:

- Bank record or
- Written communication from the donee showing:
  - The name of the donee organization,
  - The date of the contribution, and
  - The amount of the contribution.

CAUTION!

The recordkeeping requirements may not be satisfied by maintaining other written records. This means that unless the charitable organization provides written communication, cash donations put into a "Christmas kettle," church collection plate, and pass-the-hat collections at youth sporting events will not be deductible. Donations made by a debit or credit card can be substantiated by a bank record.

TAX-FREE DIRECT IRA DISTRIBUTIONS FOR CHARITY

Recent legislation introduced a new and interesting tax twist for the 2006 and 2007 tax years by allowing taxpayers age 70½ or over to make IRA distributions directly to a qualified charity. Any amount not exceeding $100,000 can be directly distributed to the charity. The key to benefiting from this provision lies in the fact that the distribution: (1) is not included in the taxpayer's income for the year, (2) counts toward the taxpayer's minimum required distribution for the year, and (3) does not count as a charitable contribution for the year. Here is how taxpayers can benefit from this new provision:

- By making a contribution directly from the IRA, taxpayers are able to exclude the amount they contributed from their income for the year, which is essentially the same as deducting the contribution without itemizing their deductions.
- This technique also lowers a taxpayer's adjusted gross income (AGI) for other tax breaks pegged at various AGI levels, such as medical expenses, passive losses, etc., allowing them greater benefits from the AGI limited deductions.
- For taxpayers receiving Social Security (SS), the taxability of the SS is also based on income. Thus, excluding the portion of the IRA distribution directly distributed to the charity can reduce the taxable portion of the SS.
- Taxpayers who wish to make very large contributions (up to the 100,000 limit) can do so with IRA funds that would have otherwise been taxable to them.

Example: *Retired couple (both over 70 ½) file a joint return. Their income consists primarily of RMD from their IRA accounts totaling $35,500, both of their SS incomes totaling $28,000, and $2,000 of investment income. They are very active with their church and make a $14,000 contribution each year. They have no other income or deductions. Compare the 2006 results with and without a qualified charitable distribution:*

IRA (RMD) Distributions	*$35,500*	*<14,000>*	*$21,500*
Taxable SS Incomes ($28,000 Total)	*12,375*		*2,750*
Investment Income	*2,000*	Qualified charitable distribution	*2,000*
AGI	*49,875*		*26,250*
Church Contribution/Std Deduction	*<14,000>*		*<12,300>*
Personal Exemptions	*<6,600>*		*<6,600>*
Taxable Income	*$29,275*		*$7,350*
Tax	*$3,636*		*$ 735*

In this example, instead of making a charitable contribution, the taxpayer made a qualified charitable distribution of $14,000, lowering their AGI, reducing their taxable SS and then using the standard deduction. Result: Tax savings of $2,901.

We want to stress that a qualified charitable IRA contribution must be directly distributed to the qualified charity. Otherwise, the distribution is taxable as income, and the charitable deduction would be taken on the taxpayer's itemized deductions subject to all the normal limitations. Please call this office before attempting to execute this strategy.

RECORDKEEPING REQUIREMENTS – PAYROLL CHARITABLE CONTRIBUTIONS

The Pension Protection Act of 2006 added Code Sec. 170(f)(17), which subjects taxpayers claiming a charitable contribution deduction for cash, check or other monetary gifts made in tax years beginning after August 17, 2006 to new recordkeeping requirements. Thus, to substantiate a deduction in 2007, a taxpayer is required to maintain a bank record or written communication from the donee showing the name of the donee organization, the date of the contribution and the amount of the contribution. This replaces the former contemporaneous requirements for contributions of $250 or more.

The IRS has provided guidance (IR-2006-186; Notice 2006-110) for charitable contributions made by payroll deductions under these rules. The requirements are satisfied if the taxpayer retains a pay stub, Form W-2 or other employer-furnished document that indicates the amount withheld for payment to the donee organization, along with the pledge card or other document prepared by or at the direction of the donee organization that shows the name of the donee organization. To substantiate a contribution of $250 or more made by payroll deduction, the pledge card or other document prepared by the donee organization also must include a statement to the effect that the organization does not provide goods or services in whole or partial consideration of any contributions made to the organization by payroll deduction.

Taxpayers may rely on the notice until revised regulations incorporating the recordkeeping requirements of Code Sec. 170(f)(17) are issued and effective.

SALES TAX DEDUCTION

The tax break allowing individual taxpayers to choose between deducting state income tax or sales tax, whichever provides them the best benefit, is retroactively restored for 2006 and extended through 2007. However, Congress failed to pass the extender legislation before their December 2007 recess. Thus, it is not known at the time this material was prepared whether this deduction will be extended for 2008.

AMT PATCH APPLIED FOR ANOTHER YEAR

Congress has been promising alternative minimum tax (AMT) relief or reform for some time. However, the two houses of Congress have been unable to reach a consensus on what to do with the AMT. Unable to resolve the issue of AMT reform, Congress, for the second year in a row, has applied a one-year patch problem for 2007.

The one-year AMT patch increases the AMT exemption amounts, thereby avoiding a huge tax increase for an estimated 23 million taxpayers. The legislation also allows certain personal tax credits to be deducted for one more year.

2007 AMT Exemption Amounts (before phase out)

Unmarried Taxpayers	$44,350 (up from $42,500 for 2006)
Married Filing Jointly & Surviving Spouse	$66,250 (up from $62,550 for 2006)
Married Filing Separately	$33,125 (up from $31,275 for 2006)

Under this one-year patch, the sum of the following credits may offset both regular tax and AMT:

- Dependent care credit;
- Credit for the elderly and permanently and totally disabled;
- Mortgage credit;
- Child tax credit;
- Hope and Lifetime Learning credits;
- Adoption credit;
- Saver's credit;
- Non-business energy property credit for energy-efficient improvements to a principal residence;
- Residential energy efficient property credit for photovoltaic, solar hot water, and fuel cell property added to a residence; and
- First-time D.C. homebuyer credit.

Caution: These changes represent a one-year patch to the AMT and, without further legislation, will create a significant tax increase for many taxpayers in 2008.

KIDDIE TAX AGE BUMPED UP AGAIN

Beginning in 2008, the Small Business Act expands the Kiddie Tax rules to apply to children through age 18, and children over age 18 but under age 24 who are full-time students—if their earned income doesn't exceed one-half of the amount of their support. (Code Sec. 1(g)(2)(A), as amended by Small Business Act § 8241(a))

To avoid the negative affects of the Kiddie Tax, it has been a popular higher-education funding tax strategy for parents to transfer appreciated capital assets, such as stock, to a child to be sold after the child was out from under the Kiddie Tax rules – initially age 14, then age 18 after the 2006 rules change. This strategy looked to be especially attractive for years 2008 through 2010 when the tax rate for long-term capital gains (and qualified dividends) drops to zero for taxpayers in the 15% or lower marginal rate. Parents of unmarried children age 18 to 23 who are full-time students expected that the children would also be able to enjoy the lower capital gains rates.

However, Congress has essentially closed this loophole by subjecting children through age 18 and full-time students age 19 to 23 to the Kiddie Tax rules beginning in 2008. Another change to the rules may prevent some of these older children from falling into the Kiddie Tax trap; if the child's earned income exceeds one-half of the child's support, the Kiddie Tax rules won't apply.

Because of these impending changes, a parent may want to reconsider any planned transfers of income-generating stocks, bonds, and other investments to children age 18, or those age 19-23 who are full-time students. However, placing or moving a child's funds into investments, such as the following that produce little or no current taxable income, can help avoid the Kiddie Tax, at least in the years until the investments need to be sold or redeemed to pay for the education expenses:

- **U.S savings bonds** – Interest can be deferred until the bonds are cashed.
- **Tax-deferred annuities** - Interest can be deferred until the annuity is surrendered.
- **Municipal bonds** – Generally produce tax-free interest income (may be taxable to the state).
- **Growth stocks** - Stocks that focus more on capital appreciation than current income.

- **Unimproved real estate** – That provides appreciation without current income.
- **Family employment** - If the family has a business, that family business could employ the child. The child's earned income is not subject to Kiddie Tax and will generate a deduction for the family business (assuming the wages are reasonable for work actually performed). The child's earned income can offset the standard deduction for a dependent and the excess income will be taxed at the child's rate (not the parent's). In addition, the child would also qualify for an IRA, which provides additional income shelter.

EIC AND COMBAT PAY

The election to have excluded combat pay counted as income for purposes of calculating the earned income tax credit (EIC) is extended through 2007 by the Tax Relief and Health Care Act of 2006. Thus, for tax years 2004 through 2007, a taxpayer may elect to treat combat pay that is otherwise excluded from gross income as earned income for purposes of the EIC.

Thus, military personnel can elect in 2004 through 2007 to include combat pay as earned income for purposes of the earned income credit. Whether it will be advantageous to make this election depends on the level of the taxpayer's earned income. In some cases, adding combat pay to other earned income will increase the amount of the credit. But for taxpayers whose earned income is in the phase-out range, increasing earned income by the combat pay amount will reduce (or could totally eliminate) the credit.

However, Congress failed to pass the extender legislation before their December 2007 recess. Thus, it is not known at the time this material was prepared whether this provision will be extended for 2008.

VEHICLE MILEAGE RATES

The table below reflects Inflation Adjustments for years 2006 and 2007.

	BUSINESS		PERSONAL		
Year	**Business Rate**	**Depreciation Element**	**Moving**	**Medical**	**Charity**
2007	48.5	19.0	20.0	20.0	14.0
2008	50.5	21.0	19.0	19.0	14.0

HYBRID VEHICLE TAX INCENTIVES

The hybrid vehicle tax credit (available through 2009) is made up of two separate credits:

- The increased fuel economy credit, ranging from $400 to $2,400, and
- The lifetime fuel savings credit, ranging from $250 to $1,000.

Thus, the maximum credit available is $3,400 — the more fuel-efficient the vehicle, the higher the credit. Since these are tax credits, they directly offset regular income tax and generally provide a larger overall tax benefit. However, they cannot be used to offset the Alternative Minimum Tax (AMT). In addition, the full credit only applies to the first 60,000 vehicles produced by each manufacturer. Thus, before a taxpayer purchases a hybrid vehicle, they need to:

(1) Make sure that they are not in the AMT and can benefit from the credit,

(2) Verify the amount of credit available for the vehicle being purchased, and

(3) Make sure the credit is not limited because the manufacturer has exceeded the 60,000 car limit.

The following is a list of vehicles qualifying for the credit. Note that Toyota reached the 60,000 vehicle limit in the third quarter of 2006. Thus, beginning in the fourth quarter of 2006, the credit will be reduced by 50% for vehicles purchased from 10/1/06 to 3/31/07. From then onwards, the credit will only be 25% of the otherwise allowable amount between 4/1/07 through 9/30/07. No credit will be given for Toyota vehicles purchased 10/1/07 and later.

HYBRID & ALTERNATIVE FUEL CREDITS – (Updated through 12/31/07)

		MODEL YEAR CREDIT (100%)			
MFG	MODEL	2005	2006	2007	2008
Ford	Escape Hybrid 2 WD	2,600	2,600	2,600	3,000
	Escape Hybrid 4 WD	1,950	1,950	1,950	2,200
	Mercury Mariner Hybrid 4 WD	---	1,950	1,950	2,200
	Mercury Mariner Hybrid 2 WD				3,000
GM	Chevrolet Silverado (2WD) Hybrid Pickup	---	250	250	
	Chevrolet Silverado (4WD) Hybrid Pickup	---	650	650	
	Chevrolet Tahoe Hybrid (2WD & 4WD)	---	---	---	2,200
	GMC Sierra (2WD) Hybrid Pickup	---	250	250	
	GMC Sierra (4WD) Hybrid Pickup	---	650	650	
	GMC Yukon Hybrid (2WD & 4WD)	---	---	---	2,200
	Saturn Vue Green Line	---	---	650	1,550
	Saturn Aura Hybrid	---	---	1,300	1,300
	Malibu Hybrid	---	---	---	1,300
Honda	Accord Hybrid AT & Nav1 AT	650	1,300	1,300	
	Accord Hybrid AT [1]	---	650	---	
	Civic GX [2]	4,000	4,000	4,000	
	Civic Hybrid (SULEV) MT	1,700	---	---	
	Civic Hybrid (SULEV) CVT	1,700	2,100	2,100	2,100
	Insight CVT	1,450	1,450		
	Honda FCX (Hydrogen Powered)	12,000	12,000		
Toyota	Lexus RX400h 2WD or 4WD	---	2,200	2,200	
	Lexus GS 450h	---	---	1,550	
	Toyota Camry Hybrid	---	---	2,600	
	Toyota Highlander 2WD or 4WD	---	2,600	2,600	
	Toyota Prius	3,150	3,150	3,150	
Nissan	Altima	---	---	2,350	2,350
Mazda	Tribute 2WD Hybrid				3,000
	Tribute 4 WD Hybrid				2,200

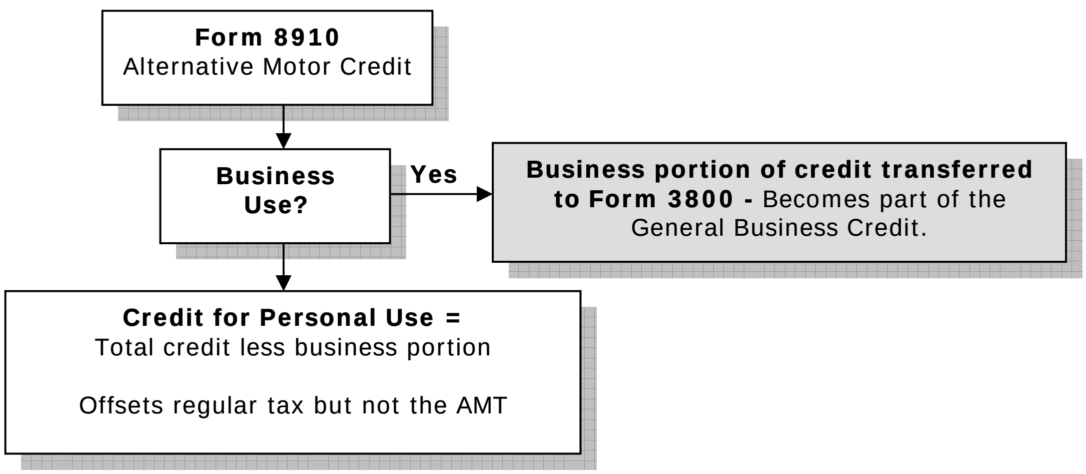
[1] Without updated control calibration [2] Alternate Fuel Credit – Natural Gas

Manufacturers That Have Reached the 60,000 Vehicle Limit – The following two manufacturers have reached the 60,000 vehicle limit; as a result, the credit for those two manufacturers must be phased out as noted:

- **Toyota Motor Corporation** - reached the 60,000 vehicle phase-out threshold in 2006. Therefore, taxpayers who purchased Toyota and Lexus hybrids during 2007 must **reduce** the otherwise allowable credits as follows; purchased before April 1, 2007 – 50% Reduction, purchased after March 31, 2007 but before October 1, 2007 – 75% Reduction and purchased after September 30, 2007 – No credit allowed!

- **American Honda Motor Company** - reached the 60,000 vehicle phase-out threshold in the third quarter of 2007. Honda hybrid vehicles purchased before Jan. 1, 2008 qualify for the full credit. For Honda hybrid vehicles bought on or after Jan. 1, 2008, and on or before June 30, 2007, the credit is 50 percent of the otherwise allowable credit amount. Taxpayers buying vehicles on or after July 1, 2008, and on or before Dec. 31, 2008, can only get 25 percent of the credit.

Note: The credit is allocated between the personal and business portions of the credit. The business portion of the credit is treated as part of the General Business Credit.



HOME ENERGY CREDITS

For 2007, individuals can qualify for nonrefundable tax credits that fall into two distinct categories: (1) Energy-saving improvements to an existing home, and (2) Residential energy-efficient property. The credits are not phased out at higher-income levels, but are not deductible against the Alternative Minimum Tax. Since the manufacturer will certify the materials that come with their products, the taxpayer does not have to determine whether a home improvement creates or saves energy.

■ ***Energy-Saving Improvements Credit*** – CAUTION: **This credit expires after 2007** - For energy-efficient building envelope components installed in or on a taxpayer's principal residence. The improvement's original use must commence with the taxpayer and can reasonably be expected to remain in use for at least 5 years. The two sub-categories are:

- o **Building envelope components –** These include insulation material or system, exterior windows (including skylights), exterior doors, and metal roofs with appropriate pigmented coatings. These items qualify for a credit of 10% of their cost, subject to an overall lifetime maximum credit of $500, of which only $200 of the $500 limit can be from windows and skylights. The IRS has clarified that a building component that provides structural support or a finished surface, such as drywall or siding, does *not* qualify for the credit.

- **Qualified energy property –** NOTE: **This credit is expires at the end of 2008 -** These items qualify for a 100% credit subject to the overall lifetime $500 credit limit and item limits noted below:
  - Electric heat pump water heater, electric heat pump, geothermal heat pump, central air conditioner, and natural gas, propane, or oil water heater meeting specific standards. Only $300 of the cost is credit-eligible.
  - A qualified natural gas, propane, or oil furnace or hot water boiler. Only $150 of the cost is credit-eligible; or
  - An advanced main air-circulating fan. Only $50 of the cost is credit-eligible.

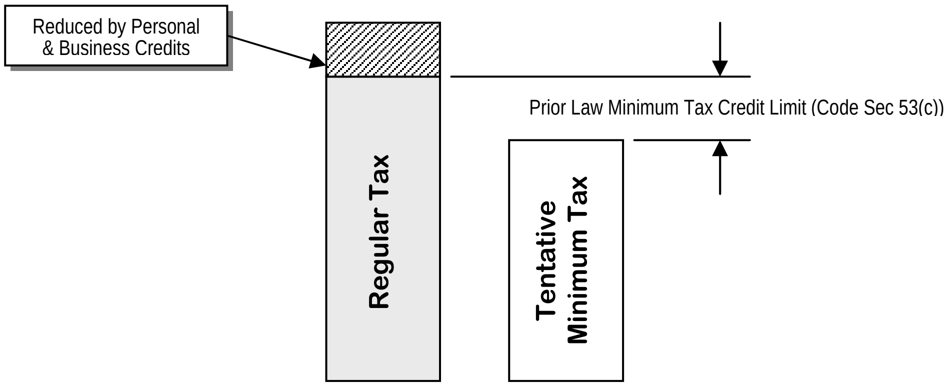
■ ***Solar Power or Fuel Cell Credit*** - This credit is available for the purchase of qualified solar power systems or fuel cells to create electricity.

- **Solar water heater -** For use in the taxpayer's main home or second residence and at least half of the energy used is derived from the sun. The credit is 30% of the qualified property's cost, limited to a maximum credit of $2,000.
- **Solar energy electric generating equipment** – For use in the taxpayer's main home or second residence. The credit is also 30% of cost, limited to $2,000.
- **Qualified fuel cell property** - A fuel cell power plant that generates electricity by electrochemical means and has a 30% generation efficiency that is installed on the taxpayer's primary residence. The credit is $500 for each 0.5 kilowatt of capacity with no maximum.

REFUNDABLE AMT TAX CREDIT PROVISIONS

This provision, effective beginning in 2007, allows individuals to take advantage of a refundable credit with respect to certain long-term unused AMT credits existing prior to January 1, 2013. The annual credit amount, subject to a phase out, is the greater of (i) the lesser of $5,000 or the amount of the long-term unused AMT credit, or (ii) 20 percent of the amount of the long-term unused AMT credit. Most likely to benefit are individuals subject to the AMT because of exercising incentive stock options more than three years prior to the credit carryforward year, where the value of the stock declined after the exercise. However, they are not the only taxpayers who may qualify for the revamped credit.

Under pre-Act law – to the extent an individual's AMT liability is caused by deferral adjustments (such as incentive stock options), a credit may be carried forward to a later year where the tentative minimum tax is less than the individual's regular tax. The minimum tax credit for a tax year was limited to the excess of: (a) the individual's regular tax liability for the tax year to which the credit was being carried, reduced by the sum of his nonrefundable personal credits and business-related income tax credits for the year, over (b) his tentative minimum tax (i.e., AMT before deducting regular tax) for the year. The credit was nonrefundable—i.e., any minimum tax credit in excess of the above-described limitation could not be refunded. However, the "excess" could be carried forward (but not back) indefinitely.



New law **–** Beginning in 2007, the Act provides that if an individual has a "long-term unused minimum tax credit" for any tax year beginning before Jan. 1, 2013, the amount determined under the Code Sec. 53(c) limit on the minimum tax credit for the tax year can't be less than "the AMT refundable credit" amount for that tax year. **Thus, the minimum tax credit allowable for the tax year is the greater of the AMT refundable credit amount or the amount of the credit otherwise allowable.** This credit is subject to a phase out and is refundable to the extent it exceeds the regular limitation credit.

AMT Refundable Credit Amount - The "AMT Refundable Credit Amount" (Code Sec. 53(e)(2)(A)) as amended by the technical corrections act of 2007 is the greater of:

(1) $5,000;

(2) 20% of the long-term unused minimum tax credit; or

(3) The AMT refundable credit amount (if any) for the prior year– before any reduction by reason of AGI.

Note:
This provides a taxpayer with an AMT refundable credit amount of at least $5,000 for a tax year, provided the individual's long-term unused MTC is at least $5,000.

WORKSHEET

1. Long-Term Unused Minimum Tax Credit.. ________
2. Statutory Amount .... $ 5,000
3. Enter 20% of Line 1.. ________
4. Prior Year's AMT Refundable Credit Amount.... ________
5. Larger of Line 2, 3 or 4 .... ________
6. **AMT Refundable Credit Amount** (Smaller of Line 1 or 5)....... ________

The **"long-term unused minimum tax credit"** for any tax year is the portion of the minimum tax credit determined under Code Sec. 53(b) (i.e., the excess of the ANMT* for all earlier tax years over the minimum tax credit for those years) attributable to the ANMT for tax years before the third tax year immediately preceding the tax year. For this purpose, credits are treated as allowed under Code Sec. 53(a) on a first-in, first-out (FIFO) basis. Refer to the Form 8801 in the prior years' returns for the carryover amounts.

Long-Term Credit Carryover

A. Unused credit carryover from ALL prior years……………….………………………..…. ________
B. Unused credit carryover from the 3^{rd} prior year…. ________
C. Unused credit carryover from the 2^{nd} prior year…. ________
D. Unused credit carryover from the 1^{st} prior year…. ________
E. Total unused credit from 1^{st}, 2^{nd} and 3^{rd} prior years (Sum B, C, D) ……….. <________>
*F. **"Long-Term Credit Carryover"**…………………………………………………….……… ________*

**ANMT = "adjusted net minimum tax," the AMT paid for the year reduced by the AMT that would have resulted if the only preferences and adjustments were the exclusion preferences, plus certain other amounts.*

> ***Example:*** *Taxpayer has a long-term unused minimum tax credit of $100,000 from a year 5 years prior to the current tax year. For the current tax year, the taxpayer's regular tax is $80,000; his tentative AMT is $65,000. For years prior to 2007, the taxpayer would have only been able to reduce his regular tax down to the tentative AMT and as a result would have been only able to use $15,000 of the credit.*
>
> ***For 2007, we compute his AMT refundable credit as follows:***
>
> *1. Long-Term Unused Minimum Tax Credit…………………………………….. $100,000*
> *2. Statutory Amount …………………..………………….. $ 5,000*
> *3. Enter 20% of Line 1…………………………………….... $ 20,000*
> *4. Prior Year's AMT Refundable Credit Amount…. $ 0*
> *5. Larger of Line 2, 3 or 4 ……………………………………………………………. $ 20,000*
> *6. **AMT Refundable Credit Amount** (Smaller of Line 1 or 5)……. $ 20,000*
>
> ***For 2008, we compute his AMT refundable credit as follows:***
>
> *1. Long-Term Unused Minimum Tax Credit* ($100,000 - $20,000)*………...$ 80,000*
> *2. Statutory Amount …………………..………………….. $ 5,000*
> *3. Enter 20% of Line 1…………………………………….... $ 16,000*
> *4. Prior Year's AMT Refundable Credit Amount…. $ 20,000*
> *5. Larger of Line 2, 3 or 4 ……………………………………………………………. $ 20,000*
> *6. **AMT Refundable Credit Amount** (Smaller of Line 1 or 5)……. $ 20,000*
>
> *Thus, in our example, the AMT refundable credit would continue to be $20,000 a year until the entire $100,000 has been used up. Had the initial amount of unused long-term carryover been $50,000, then the taxpayer would have been able to use only $10,000 a year until it was used up. If the unused long-term carryover had been $20,000, then the taxpayer would have been able to use $5,000 a year ($5,000 is larger than 20% of $20,000) until the carryover is used up. This can become more complicated if the taxpayer has unused carryover from multiple prior years.*

Phase Out - The AMT refundable credit amount is reduced by the applicable percentage under Code Sec. 151(d)(3)(B) (i.e., the percentage reduction in the personal exemption amount) for an individual whose adjusted gross income for a tax year exceeds the threshold amount at which the deduction for personal exemptions phases out. For this purpose, AGI is determined without regard to Code Sec. 911 (foreign earned income exclusion for U.S. citizens or residents living abroad), Code Sec. 931 (exclusion of income for bona fide residents of American Samoa), and Code Sec. 933 (exclusion of income of residents of Puerto Rico).

AMT Refundable Credit Phase-Out Computation

L. Regular tax AGI for the current year.. ________

M. Filing Status phase-out AGI (from table below) .... ________

N. Line L less Line M (but not less than zero) .... ________

***Note:** if Line N is zero, skip lines O and P and enter the amount from Line K on Line Q*

O. Line N divided by $2,500 ($1,250 if MFS) and rounded up to the next higher integer amount.. ________

P. Phase-out amount (Line K x Line O x .02) .... ________

Q. AMT Refundable Credit (Line K less Line P) .... ________

Filing Status	Phase-Out AGI
Married Filing Jointly	$234,600
Head of Household	$195,500
Unmarried Taxpayers	$156,400
Married Filing Separately	$117,300

Note: These AGI figures are for the 2007 tax year.

For this purpose, the taxpayer's AGI is determined without regard to the exclusions for foreign-earned income (Sec. 911), Residents of American Samoa (Sec 931) or Residents of Puerto Rico (Sec. 53(e)(2)(B)).

Although the *post-2006* rules do not apply specifically to the AMT treatment of incentive stock options (ISO), the legislative history of this new rule indicates it was the primary reason for the change.

DEFERRAL items of preference that can create an AMT Credit include:

- Qualified small business stock,
- Incentive stock option preference,
- Large partnerships adjustments,
- Adjusted gain or loss,
- Post-1986 depreciation adjustments,
- Passive activities ,
- Loss limitations,
- Circulation expenses differences,
- Long-term contract preferences,
- Mining cost differences,
- Research and experimental costs,
- Installment sales (pre-1987),
- Intangible drilling costs preferences and
- Depreciation (pre-1987).

DC FIRST-TIME HOMEBUYER CREDIT

The tax break allowing first-time homebuyers in the District of Columbia to claim a tax credit of up to $5,000 on the purchase price of the home is retroactively restored for 2006 and extended through 2007.

RESEARCH AND DEVELOPMENT (R&D) CREDIT

The research and development (R&D) credit is restored for 2006 and extended for 2007. In addition, for tax years ending after 2006, the new law enhances the credit by (1) increasing the rates of the alternative incremental credit and (2) creating a new alternative simplified credit that does not use gross receipts as a factor (so that newer businesses can access the credit).

WORK OPPORTUNITY TAX CREDIT (WOTC)

Under the Small Business Act, the welfare-to-work credit was eliminated and combined with the WOTC, beginning with 2007, and effective for individuals beginning work for the employer after May 25, 2007, the Act added to the WOTC-eligible groups a broadened and redefined category called "designated community residents." Code Sec. 51(d)(1) and Code Sec. 51(d)(5))

The first-year wage maximum on which the credit is based is increased to $12,000 for wages paid to qualified disabled veterans hired after May 25, 2007. Code Sec. 51 (b)(3)

Credit Amount - Under Code Sec. 51, employers may elect to claim a WOTC for a percentage of first-year wages, generally up to $6,000 per employee, for hiring workers from one of several targeted groups. First-year wages are wages paid during the tax year for work performed during the one-year period beginning on the date the target group member begins work for the employer. **Sunset Date:** Eligible individuals must begin work before 9/1/2011.

ENVIRONMENTAL REMEDIATION COSTS

The election to expense (currently deduct) environmental remediation costs associated with cleaning up certain hazardous sites is restored for 2006 and extended for 2007, and for post-2005 expenses, the definition of an eligible contaminated site is expanded to include sites contaminated by petroleum products.

LEASEHOLD IMPROVEMENTS AND RESTAURANT PROPERTY

The accelerated write-off for certain leasehold improvements and restaurant property (depreciation over 15 years instead of 39 years) is extended through 2007.

NEW ENERGY-EFFICIENT HOMES TAX CREDIT

The tax credit for builders of new energy-efficient homes is extended through 2008. The credit applies to manufactured homes meeting a 30% energy reduction standard and other homes meeting a 50% standard.

ENERGY-EFFICIENT COMMERCIAL BUILDINGS

The deduction for energy-efficient commercial buildings meeting a 50% energy reduction standard is extended through Dec. 31, 2008.