2007 Federal Tax Changes and Reminders

It is time to think about compiling the tax information needed to file your 2007 tax return. There are a number of items discussed below that should help you get ready and plan for the future.

Dependency

When children graduate from high school and get jobs or go off to college, at some point they will no longer be dependents. A child must meet the following conditions to be considered a dependent: The child must be under the age of nineteen or under age twenty four and a full time student for at least five months during the year; the child must be a US citizen, a resident alien or a resident of Canada or Mexico; the child must live with the parent for more that half the year (temporary absences such as college are ignored); and the child must not provide more than half of his or her own support.

Even though a parent provides a home for the child while in college, the financial aid and loan responsibility may enter into the determination of support provided by the child.

In the year that the child graduates from high school or college, it is important to look at the earnings for the entire year to determine support. Even though the child has lived at home and been a full time student for five months, his or her total yearly income could be high enough to have provided more than half of his or her own support.

Kiddie Tax

This year marks a big change in Kiddie tax rules. Kiddie tax is the name of the way of determining the tax a child will pay when the child has unearned income (interest, dividends, capital gains, royalties etc.) of $1,700 or more and is under the age of eighteen. Previously Kiddie tax applied to children under the age of fourteen. In 2008, the age will rise to match the age of dependency. It will apply to children under the age of nineteen or full time students under the age of twenty four.

Kiddie tax rules apply the parents tax rate to the excess unearned income of the child over $1,700. The income up to that point is subject to a standard deduction and generally a ten percent tax rate.

The importance of this change is that the child who has savings, especially through trust funds or other means, probably will be paying a larger tax than he or she would otherwise be accustomed to. Form 8615 (Tax for Children under the Age of 18 with Investment Income of More than $1,700) should be used to compute this tax. In addition, parents who want to shift income to the child through gifts of stock or other investments may need to seek advice before making the transfer.

Expiring Tax Breaks

Congress passed legislation during 2006 that extended or made permanent certain tax breaks. One tax issue that has not been addressed yet is Alternative Minimum Tax (AMT). In the year 2007, the AMT exemption will decrease to pre-2001 tax act level. This could mean that you will be subject to AMT this year when you have not been subject to it in the past. If you have been subject to it in the past, it can mean you will pay more AMT. The difference between the pre-and post- exemption is about $16,000. This could mean an additional $4,000 in AMT in 2007.

The Energy Credit has been extended through 2008. Also the tuition deduction and the maximum $250 Educators deduction have been extended through 2007.

Capital Gains

The capital gains rates have been very attractive since 2001. The maximum capital gains rate is normally fifteen percent unless you are in the fifteen percent tax bracket. For those whose tax bracket is fifteen percent or lower, the maximum capital gains rate is five percent. In 2008 the five percent rate decreases to zero percent. The reduced rate will continue through 2010. If you have flexible income, this may be the time to choose to sell property to take advantage of this rate. As the tax law stands now, the lower capital gains rate of fifteen percent will be in existence through 2010. After that, rates are scheduled to return to the twenty percent/ten percent limit in effect before the 2001 change. Remember also that dividends will be taxed at ordinary income rates rather than capital gains rates after 2010. Now is the time to consider capital gains planning before it is too late.

HSA

Health Savings accounts are becoming an increasingly popular choice for individuals and companies seeking medical coverage. The savings account is available to taxpayers who have an HSA qualified high deductible medical plan. These plans generally offer health insurance at a more affordable rate. Once the insurance plan is in place, a health savings account (HSA) may be obtained. The HSA allows the taxpayer to contribute a certain dollar amount each year through which medical expenses, not covered by insurance, can be paid. The tax-savings feature is that the contribution is currently deductible even if it has not been spent yet. The account will grow tax free as long as monies in the account are spent for medical expenses. If a taxpayer reaches age sixty five, the monies may be withdrawn for non-medical purposes, such as an IRA, without penalty. Like the IRA, the taxpayer will pay taxes at that time on the amount not used for medical care.

The maximum that may be contributed in 2007 for a family plan is $5,650 and $2,850 for a single plan. In addition, the year the plan begins, the maximum contribution may be made regardless of the time of the year the account is opened.

Retirement Decisions

As the end of the year approaches, you are asked to make pension fund contribution decisions as well as flex spending, cafeteria, dependent care and other deferral decisions. Congress has made permanent the increases in pension and IRA contributions. This year, you may contribute up to $4000 into a regular or Roth IRA. The maximum amount that can be contributed to a 401K for 2007 is $15,500. If you are fifty or over you may qualify for catch-up contributions. This could be up to $5,000 depending on the type of plan.

The savers credit has been made permanent as well. This means that tax payers with income not more than the following amount may qualify for up to a fifty percent credit on the amount placed in IRA's or qualified pension plans: single individuals, $26,000; head of household, $39,500; and married couples, $52,000 (as indexed for 2007)

Information Disclosure

IRS rules are pretty specific. The rules prohibit disclosure of your tax return information to anyone other than you *unless* you have authorized the release. This includes sharing your information with one of your children, your lawyer, mortgage company, etc.

This is the law and was passed to protect your privacy and prohibit unauthorized disclosures. If you want your tax return information shared with anyone, you will need to provide written authorization. The authorization must specifically authorize the disclosure of *tax* information, the applicable years, who it must be disclosed to, who is disclosing the information and contain your signature. A general authorization to disclose financial information, may not be sufficient. Caution: Once the requested information is disclosed to the person or company you authorized to receive it, there is no control over what the person or the company does with the information. Again these IRS restrictions on disclosure are for your protection.

Everyone in the office wishes you all a Happy Holiday season, thanks you for your past business, and looks forward to meeting you in our brand new offices in 2008