

**ILLINOIS CPA SOCIETY  
CHICAGO SOUTH CHAPTER  
PALOS COUNTRY CLUB  
PALOS PARK, ILLINOIS  
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**2007 Individual Income Tax Update**

I. Changes Affecting 2007 Tax Returns

A. Top Two Marginal Tax Brackets Remain at 33% and 35% and are Indexed (Widened) for Inflation

	<u>33% Bracket Starts</u>	<u>35% Bracket Starts</u>
1. Unmarried	160,850	349,700
2. Joint return	195,850	349,700
3. Married Separate	97,925	174,850
4. Head/Household	178,350	349,750

B. Middle Two Tax Brackets Remain at 25% and 28% and are Indexed (Widened) for Inflation

	<u>25% Bracket Starts</u>	<u>28% Bracket Starts</u>
1. Unmarried	31,850	77,100
2. Joint return	63,700	128,500
3. Married Separate	31,850	64,250
4. Head/Household	42,650	110,100

C. Bottom Two Tax Brackets Generally Indexed (Widened) for Inflation

1. 10% bracket ranges from -0- to \$7,825 (up from \$7,550) for unmarried and married filing separately, from -0- to \$15,650 (up from \$15,100) for joint returns, and from -0- to \$11,200 (up from \$10,750) for head of household.
2. 15% bracket ranges from \$7,825 to \$31,850 (up from \$7,551 to \$30,650) for unmarried and married filing separately, from \$15,651 to \$63,700 (up from \$15,101 to \$61,300) for joint returns, and from \$11,201 to \$42,650 (up from \$10,751 to \$41,050) for head of household.

D. Higher Personal Exemption and Standard Deductions

1. Personal exemption is \$3,400 (Up from \$3,300)
2. Standard deductions for 2007:
  - a. Unmarried - \$5,350 (Up from \$5,150)
  - b. Married filing jointly - \$10,700 (Up from \$10,300)
  - c. Married filing separately - \$5,350 (Up from \$5,150)
  - d. Head of Household - \$7,850 (Up from \$7, 550)
3. Personal Exemptions phase out for adjusted gross incomes over:
  - a. Unmarried - \$156,400 (Up from \$150,500)
  - b. Married filing jointly - \$234,600 (Up from \$225,750)
  - c. Married filing separately - \$117,300 (Up from \$112,875)
  - d. Head of Household - \$195,500 (Up from \$188,150)
  - e. Maximum Phase-Out - The phase-out can not reduce your personal exemption by more than 2/3. (same as 2006) Thus, everyone will receive at least \$1,133 per exemption – what a deal!!

E. Higher Income Levels for Phase-Out of Itemized Deductions

1. Phase-out is 3% of the excess of AGI over the following thresholds:
  - a. Unmarried and Head of Household - \$156,400 (Up from \$150,500)
  - b. Married filing jointly - \$156,400 (Up from \$150,500)
  - c. Married filing separately - \$78,200 (Up from \$75,250)
  - d. Phase-out can never be more than 80% of the itemized deductions
2. The phase-out continues to phase-out
  - a. For 2006 and 2007 the calculated reduction amount is reduced by one-third (1/3). Thus, it is 2/3 of what it was in 2005.
  - b. For 2008 and 2009 the calculated reduction amount is reduced by two-thirds (2/3). Thus, it will be 1/3 of what it was in 2005.
  - c. After 2009 there is no phase-out and no reduction amount.

F. Self-Employed Health Insurance Deduction Remains at 100% of Premiums.

- G. Standard Deduction of Dependents Remains the Same for 2007
1. Equals the greater of \$850 or the dependent's earned income plus \$300 but not more than the regular standard deduction amount
- H. Age 65 or Blind Amounts Remain the Same for 2007
1. Increased standard deduction of \$1,050 (Married) or \$1,300 (Unmarried or Head of Household) for age 65 or blind were \$1,000 and \$1,250 in 2006.
  2. Above means no benefit if taxpayer itemizes deductions
- I. Business Mileage Rate Changes
1. 2007 rate is .485 per mile.  
2006 rate was .445 per mile.  
2008 rate is .505 per mile.
  2. Charitable mileage rate remains at .14 per mile.  
2008 rate remains at .14 per mile.
  3. Medical and moving mileage rates are .20 per mile.  
2006 rate was .18 per mile.  
2008 rates decrease to .19 per mile
- J. Child Tax Credit Remains at \$1,000 per child.
1. Eligibility rules remain the same
    - a. Under age 17 at December 31, 2007
    - b. Citizen or resident of the U.S.
    - c. Did not provide over ½ of their own support.
    - d. Meets the relationship test
  2. Credit phases out for high adjusted gross income (Phase out amounts remain the same as in 2006)
    - a. \$ 75,000 for unmarried and head of household
    - b. \$110,000 for married filing jointly
    - c. \$ 55,000 for married filing separately

3. An Additional Child Tax Credit, which is refundable, may be available where the regular credit exceeds the tax liability. See Form 8812.

K. Low Long-Term Capital Gains Rates Still in Effect

1. For 2007, the capital gains rate for taxpayers whose regular tax rate is 15% or under remains at 5% and the capital gains rate for taxpayers whose regular tax rate is above 15% remains at 15%.
2. Remember that special capital gains rates of 25% (unrecaptured Section 1250 gains) and 28% (collectibles) also still apply.
3. Planning opportunities continue to abound for the time being.
4. For 2008, the 5% capital gains rate drops to -0- <yes, I said -0->

L. Qualified Dividends Still Taxed at Capital Gains Rates

1. These are taxed at capital gains rates <15% if a 25% or higher regular tax rate would otherwise apply> and at 5% if a regular tax rate lower than 25% would otherwise apply
2. Qualifications are as follows:
  - a. Paid by a U.S. or qualified foreign corporation
  - b. Do not fall into certain categories such as capital gain distributions, tax-exempt organization, farmers cooperative, ESOP, money market, etc.
  - c. Stock must have been held at least 60 days during the 120 day period that begins 60 days before the ex-dividend date (90 and 180 days for preferred stock)
3. Pass-through from partnerships, fiduciaries, S-corporations, etc will generally retain their character.
4. For 2008, the 5% dividend rate drops to -0- <yes, I said -0->

- M. The Hope Credit and the Lifetime Learning Credit Remain the Same, and the Income Limits Rise
1. The Hope Credit is for the first two years of post-secondary education only and is based on 100% of the first \$1,100 of qualified education expense and 50% of the next \$1,100 of qualified education expense. The maximum credit is \$1,650.
  2. The Lifetime Learning Credit is for all years of post-secondary education and for courses to acquire or improve job skills. The qualified tuition and related expense maximum remains at \$10,000 and, applying the 20% credit rate, the maximum credit remains at \$2,000.
  3. The credit phase-out range is modified adjusted gross income between \$47,000 and \$57,000 (Up from \$45,000 to \$55,000 in 2006) for unmarried and head of household and \$94,000 to \$114,000 (up from \$90,000 to \$110,000 in 2006) for married filing jointly.
  4. **PLANNING OPPORTUNITY**: If the parent claims the child as a dependent, only the parent may claim the education credit. If, however, the parent is eligible to claim the child as a dependent but chooses not to do so, the child may claim the education credit even if the tuition and expenses were paid by the parent. In such a case, the child may not also claim a personal exemption and so it may be lost. This may not be of any concern if the parent has high income since the phaseout of the dependency exemption for high income taxpayers may mean that the exemption was partially lost anyway.
- N. Child and Dependent Care Credit Amounts and Limits Remain the same as 2006.
1. This is for work-related care expenses and is in addition to the Child tax credit discussed at J. above.
  2. The maximum credit can be as much as 35% and the maximum adjusted gross income amount that qualifies for the highest rate is \$15,000.
  3. The dollar limit on the amount of qualifying expenses is \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals.
  4. A qualifying individual is a dependent under age 13 for whom you are entitled to claim a dependency exemption, or a dependent or spouse who is physically or mentally incapable of caring for himself or herself.

O. Adoption Credit Changes

1. The maximum adoption credit is now \$11,390 (up from \$10,960).
2. The adoption of a child with special needs allows a \$11,390 credit (subject to income phase-out) even if qualified expenses are less than \$11,390.
3. The credit phases out for AGI over \$170,820 (up from \$164,410).

P. Retirement Savings Plans Changes

1. Traditional IRA changes

a. You can deduct all of your allowable contributions to a traditional IRA (if you are not covered by an employer plan and you file a joint return) even if your spouse is covered by a plan, subject to the modified AGI limit of \$156,000 (Up from \$150,000) A partial deduction is allowed for \$156,000 to \$166,000 (Up from \$150,000 to \$160,000)

b. Allowable modified AGI limits for testing deductibility if you are covered by an employer plan are increased for 2007.

- (1) Unmarried phaseout is \$52,000 to \$62,000 (Up from \$50,000 to \$60,000)
- (2) Married filing jointly phaseout is now \$83,000 to \$103,000 (increased from \$75,000 to \$85,000)
- (3) Married filing separately phaseout is \$0 to \$10,000 (unchanged from 2006). However, if living apart the entire year, the unmarried phaseout range applies.

2. Contribution and Elective Deferral Limits

a. IRA's (Traditional and Roth)

- (1) \$4,000 (Same as 2006)
- (2) Additional \$1,000 if age 50 by year-end (same as 2006)
- (3) Contributions can be divided between Traditional and Roth as long as the overall limits are not exceeded
- (4) 2008 limits are \$5,000 (Up from 2007) and \$1,000

b. Elective Deferrals under 401 (k) and 403 (b) Plans

- (1) \$15,500 (up from \$15,000)
- (2) Additional \$5,000 if age 50 by year-end (same as 2006)
- (3) 2008 limits are \$15,500 and \$5,000 (same as 2007)

- c. Elective Deferrals under SIMPLE Plans
  - (1) \$10,500 (Up from \$10,000)
  - (2) Additional \$2,500 if age 50 by year-end (same as 2006)
  - (3) 2008 limits are \$10,500 and \$2,500 (same as 2007)

- 3. **Planning Idea** – Thoughts on high income taxpayers making non-deductible IRA contributions now and converting to Roth IRA's in 2010

Q. Higher Education Tuition and Fees Deduction Receive a Reprieve under Extender Legislation Signed in Late December, 2006 – But Only Through 2007!!

- 1. These are allowed as a Page 1 (adjustment to gross income) deduction as long as a Hope or lifetime learning credit is not claimed for the student.
- 2. These should be considered where education credits are not allowable due to income limitations.
- 3. Maximum deduction is \$4,000 (same as in 2006) for tuition and required fees.
- 4. Maximum \$4,000 deduction is only allowed if modified adjusted gross income does not exceed \$65,000 (\$130,000 for joint returns) but a \$2,000 maximum deduction is available where modified adjusted gross income does not exceed \$80,000 (\$160,000 for joint returns).
- 5. This deduction is claimed on Line 34 of the tax return and new Form 8917 is required.

R. Educator Expense Deduction Also Receives a Reprieve for 2007.

- 1. Allows a deduction of up to \$250 for educator expenses as a Page 1 adjustment to gross income.
- 2. Claim this deduction on Line 23 of the tax return.

S. Estimated Tax Safe Harbor for 2007.

- 1. These apply if 2006 adjusted gross income was more than \$150,000 (\$75,000 if married filing a separate return for 2006).
- 2. Required payments must have been at least the smaller of 90% of the expected 2007 tax (regular rule) or 110% of the tax shown on the 2006 tax return in order to avoid an estimated tax penalty.

3. For tax year 2008, the safe harbor payment for the above high income taxpayers remains at 110% of the 2007 tax liability.
4. Where 2006 adjusted gross income was less than the amounts in #1 above, the required payments must be at least the smaller of 90% of expected 2007 tax (regular rule) or 100% of the tax shown on the 2006 tax return.

T. Earned Income Credit Increases and Changes

1. Earned income credit increases
  - a. \$2,853 with one qualified child (Up from \$2, 747)
  - b. \$4,716 with more than one qualified child (Up from \$4,536)
  - c. \$428 without a qualified child (Up from \$412)
2. Maximum earnings allowed increases
  - a. \$33,241 (\$35,241 for married filing jointly) with one qualified child (Up from \$32,001)
  - b. \$37,783 (\$39,783 for married filing jointly) with more than one qualified child (Up from \$36,348)
  - c. \$12,590 (\$14,590 for married filing jointly) without a qualified child (Up from \$12,120)
3. Maximum amount of investment income for eligibility is now \$2,900 (up from \$2,800)

U. Sales Tax Deduction Also Receives a Reprieve for 2007

1. Allows a deduction for general sales tax where the amount is greater than state income taxes paid.
2. Claim this deduction on Schedule A, Line 5b.

V. Self-Employment Tax Increases

1. The 2007 self-employment tax rate of 12.4% applies to the first \$97,500 of net earnings from self-employment (Up from the 2006 amount of \$94,200)

2. An additional 2.9% Medicare tax is payable on all net earnings from self-employment.
3. The taxable wage base increases to \$102,000 for 2008.

W. Section 179 Business Asset Expensing Election Increases

1. \$125,000 amount for 2007 is an increase from \$112,000 for 2006.

X.. Alternative Minimum Tax Exemption Amounts Increase Thanks to the “Patch”  
Signed on December 20, 2007.

1. Unmarried - \$44,350 (Up from \$42,500)
2. Married filing jointly - \$66,250 (Up from \$62,550)
3. Married filing separately - \$33,125 (Up from \$31,275)

Y. Tax Return Filing Changes

1. IRS has changed the filing locations for several areas.
2. Extensions of time to file are once again for 6 months (to October 15, 2008) and are automatic.
  - a. Use Form 4868
  - b. Does not extend the time for payment of tax. Interest will be due on tax payments not made by April 15, 2008 and a late payment penalty will apply if 90% of the tax liability was not paid by April 15, 2008.

Z. Qualified Charitable Distributions from IRA’s for 2006 and 2007

1. Available for individuals age 70-1/2 and over
2. Limit is \$100,000 per year
3. Distributions are not included in income and there is no deduction
4. Can be used to satisfy annual Minimum Required Distributions
5. Donation must be made by IRA trustee
6. Often results in lower tax due to reduced adjusted gross income which causes less Social Security benefits to be taxable, less deduction and exemption phaseouts, etc.
7. This has not been extended to 2008 – Yet.

- AA. Charitable Deductions for Clothing and Household Items are Subject to the Fashion Police and Cash Contributions are on the Endangered Species List
1. No deduction is allowed unless the clothing or household items are in “good used condition or better.”
  2. No deduction is allowed for cash contributions unless the taxpayer has a statement from the charity showing:
    - a. The name of the charity, the date contributed, and the amount given.
    - b. A bank record of the contribution will suffice if under \$250.
- BB. Special Tax on Child’s Unearned Income
1. Must use Form 8615 to figure the tax for a child under age 18 with unearned income of more than \$1,700 (same as 2006)
  2. Parent can file Form 8814 and elect to report the child’s income on the parent’s tax return.
  3. For 2008, the age is raised to under 19, or under 24 if a full-time student.
- CC. Residential Energy Credits are Available
1. The nonbusiness energy property credit applies to improvements made to your main home such as insulation, exterior windows, exterior doors, etc.
  2. The residential energy efficiency property credit applies to items such as solar water heating or fuel cell property
  3. Claim these credits on Form 5695
- DD. New Vehicle Tax Credits
1. Alternative motor vehicle credit is claimed on Form 8910
  2. Alternative Fuel Vehicle Refueling Property credit is claimed on Form 8911.
  3. Qualified electric vehicle credit no longer available.

EE. New Deduction for Qualified Mortgage Insurance

- 1.. Must be paid in connection with home acquisition debt for homes acquired after 2006.
2. The amount which can be deducted is reduced by 10% for every \$1,000 by which the taxpayer's adjusted gross income exceeds \$100,000 (\$50,000 for married filing separately)
3. The deduction is available through 2010.

FF. Mortgage Forgiveness Debt Relief is Passed

1. Debt relief and forgiveness is generally gross income but this has now changed due to new legislation.
2. Debt relief on acquisition indebtedness for the taxpayer's principal residence is now not gross income.
3. The basis of the residence must be reduced by the amount of the forgiveness.
4. This provision is available through 2009.

GG. Survivor's Home Sale Exclusion Liberalized

1. The \$500,000 limit now does not end as of the end of the year in which the spouse dies. It is extended to two years from the date of death.
2. The step-up in basis to fair market value on one-half of a jointly owned residence still applies.

HH. Professional Preparer Penalties Increase and the Minefield Gets Larger

1. Under old law there was a "first tier" penalty of \$250 for preparing a return resulting in an understatement due to an undisclosed position for which no "realistic possibility" of being sustained on the merits existed and a \$1,000 penalty for preparing a return with "willful or reckless conduct."

2. The new law increases the first tier penalty to the greater of \$1,000 or 50% of the tax return fee and the second tier penalty to the greater of \$5,000 or 50% of the tax return fee.
3. The new law also moves the goalposts by changing the standard from “realistic possibility” to “more likely than not.”
4. The new penalty changes apply to tax returns filed after May 25, 2007.

## II. 2008 Changes

- A. Standard Mileage Rate is .505 Per Mile for Business Miles, .19 Per Mile for Medical or Moving Miles, and .14 per Mile for Charity Miles.
- B. Safe Harbor Estimated Tax Payments are 110% of 2007 Taxes if AGI Exceeds \$150,000 (\$75,000 for Married Filing Separately).
- C. Social Security Tax Wage Base Increased to \$102,000.
- D. Retirement Plan Contribution Limits.
  1. IRA contributions increase to \$5,000 (\$6,000 if age 50 or older)
  2. Limits on elective deferrals (401(k), 403(b), etc.) remain at \$15,500 (\$20,500 if Age 50 or older) and the limit on SIMPLE plans remains at \$10,500 (\$13,000 if age 50 or older).
- F. Failure to Further Extend (or Expand) Current Exemption Amount Plunges More Taxpayers into the Dreaded Alternative Minimum Tax??
- G. Phase-out Amounts for Itemized Deductions and Personal Exemptions are Scheduled (But Will They?) to be Reduced Again.
- H. Capital Gains Tax Rate and Tax on Qualified Dividends for 15% or Lower Regular Tax Brackets is Now -0-, None, Nada, Zilch !!!!

**PHILIP J. GREENBLATT, CPA JD**  
 1955 Raymond Drive  
 Suite 111  
 Northbrook, IL 60062  
 Phone 847-205-9666  
 FAX 847-559-0138

**e-mail: [taxlaws18@aol.com](mailto:taxlaws18@aol.com)**  
 Three First National Plaza  
 Suite 1400  
 Chicago, IL 60602  
 Phone 312-855-0441  
 FAX 312-236-1587