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2007 TAX LAW CHANGES & UPDATES

Alternative Minimum Tax (AMT)

This has become two of the most unbearable words in the tax lexicon. Congress created an alternate way to calculate the tax due for all returns with Adjusted Gross Income exceeding 45,000 (\$33,750 for Single Individuals) for 2007. This is a reduction from the \$62,550/\$42,500 exemptions in 2006 unless Congress passes a last minute bill which is before the Senate at the time this newsletter was written. This will cause many more of us to pay the AMT in 2007.

Essentially, it allows you deductions for your home mortgage and charitable contributions and nothing else. Deductions for State Income taxes, property taxes, business expenses, personal exemptions as well as credits for children, childcare or other credits are ignored. Then the tax is calculated at a flat rate of 26-28% on all income in excess of \$45,000. If this exceeds your regular tax, you pay the higher amount.

This will affect you if you have significant capital gains, investment or employee business expenses. If you have significant capital gains this year or plan to claim a significant amount of investment or business expenses on Schedule A, please call us before accelerating deductions as part of your year-end tax strategy.

Donations – Changes for 2007

Congress changed the rules on cash contributions. Effective January 1, 2007, you must have a written record to claim any donation on your return. You must now have a receipt from the charity or, if the donation is under \$250, a cancelled check or credit card receipt will be sufficient. No longer will the IRS accept an estimate for cash contributions which means that loose offerings at church are no longer allowed.

Congress modified last year the deduction for non-cash contributions of clothing and household items, to those items in "good used condition". Effectively, the IRS is tired of finding under-shorts and socks on the donation list which are not useable once worn. While this should not affect most of us, take a picture of the items given away to prove that they are in good used condition.

By the way, never leave your non-cash contributions in one of the bins that are unmanned. If you don't receive a receipt, you will not get a deduction. If you are in the 30% combined Federal and State brackets, each \$1,000 of value equals \$300 of additional cash in your pocket!

The Kiddie Tax – Additional Increase to Age 23

Congress changed the age to 18 for the Kiddie Tax and increased it again to age 23 for children in college where they do not provide more than half of their own support for the year. The Kiddie tax is a rule that requires children under the age of 18 (24 if in school) to pay tax at their parent's tax rate when their investment income exceeds \$1,700 for 2007. Prior to 2006 the Kiddie Tax went away at age 14.

There is also the ability now for the Alternative Minimum Tax to affect children when investment income is more than \$6,300 over their earned income if the earned income is under \$33,750.

Energy Credits for 2007 – Buildings & Autos

Congress passed an Energy Act in 2005, which applies to Home Energy Construction & Improvements, and vehicles.

The Energy Credit available for homes is capped at \$200 for energy related improvements to your home for exterior doors, windows and insulation. There is a lifetime cap including the above of \$500 for installing qualifying heat pumps, furnaces and hot water boilers. These credits continue only until the end of 2007.

The credits available for purchasing or leasing alternative fuel or Hybrid vehicles is basically gone for Toyota and Lexus and the credit for Honda vehicles will start to fade in 2008 as the 60,000 vehicle is projected to be sold before the end of 2007. The credit varies by vehicle from \$400-\$2,400 per vehicle. Go to the dealer to identify how much credit is available for each vehicle. Before you rush out to purchase these vehicles, be aware that it may take 5 or more years to recoup the additional cost of one of these vehicles over what you would pay for a traditional vehicle and if you are affected by the Alternative Minimum Tax, the credit does not help you.

Sec. 179 Equipment Write-Off

Small Businesses who purchase less than \$500,000 of equipment are allowed to write-off up to \$125,000 worth of equipment for 2007. This still includes trucks or SUV's with a gross vehicle weight (loaded weight) of 6,000 lbs or more, with a cap of \$25,000. Be aware that Congress has a bill before them which if passed would disallow any Section 179 write off for SUV's under 14,000 pounds, which means that the only vehicles for which the immediate write off will be available will be heavy duty trucks and cargo vans.

Remember that you will only get a write-off for the business use percentage, not 100% of the truck or SUV and only to the extent that you have a profit in your business. Even if one does not claim the quick write-off of a qualifying truck or SUV, the vehicle can be written off over 5 years in its entirety, with no limitations rather than \$16,000 maximum over the first 5 years. While this is available for your Federal return, some states limit or do not allow this quick write-off.

Capital Gains Rates May Never Be Lower!

Congress reduced long-term capital gains rates four years ago for stocks, bonds, mutual funds, real estate and business assets and these rates are in effect through 2007. Long-term capital gains are taxed at a maximum rate of 15% (5% if you are in the 15% bracket) and applies to installment sale payments as well.

I cannot emphasize enough that these are the lowest rates we have ever seen for capital gains and who knows what can happen with a change in Congress. Take advantage of these low rates to sell assets which have gains and which you are ready to sell. Don't hold back on selling just because you will be taxed as we never know how long we have these low rates. If you have significant losses, they can be used to lower your total tax. However, if your losses are small, try the strategy discussed in the tax planning section.

Art, antiques, gems, stamps, coins and other collectibles are still taxed at a 28% maximum rate and depreciation recapture on real estate is taxed at up to 25%.

Maybe Not!

While Congress reduced the tax on long-term capital gains, they still left intact the law relating to the Alternative Minimum Tax (AMT).

If your income exceeds 45,000 (\$33,750 for singles) and includes a significant amount of capital gains and dividend income taxed at the 15% rate, you may be subject to the AMT. These thresholds will drop significantly in 2007 unless there are some last minute changes to the tax law, which could mean a higher AMT.

When income exceeds \$150,000 (\$112,500 for singles), certain exemptions begin to phase out and you will more than likely pay the Minimum Tax.

IRS Mileage Rate Up for 2007

The IRS mileage rate for 2007 is 48.5 cents per mile and in 2008 increases 50.5 cents. Medical and moving mileage is 20 cents, but drops to 19 cents per mile in 2008. Charitable mileage remains at 14 cents per mile for 2007 and 2008.

Have You Considered a HSA?

Congress created a medical deduction like an IRA which allows us to claim a deduction for medical expenses above the line. It does require some extra steps that may be worthwhile looking into.

It will allow you to deduct preventive care and over-the-counter medicine and supplies (i.e. Band-Aids and Aspirin). It does require you to have a medical insurance plan, either through your employer or purchased on your own, with a deductible of at least \$1,100 for an individual, \$2,200 for a family and is not available for those participating in Medicare.

The concept is to allow you to invest in an IRA like account (HSA) an amount equal to your deductible, with a cap of \$5,500 (\$11,000 for a family) in 2007. This amount is available for you to reimburse yourself for almost any medical expenses except for health insurance premiums and a number of insurance companies and banks have teamed up together to make these HSA's work smoothly.

The maximum amount one can contribute to an HSA is \$2,850 for an individual or \$5,650 for a married couple. A positive aspect of this is that money contributed to the HSA can be carried over to future years, with no limits and if you turn 65 and begin participating in Medicare, you can withdraw the funds like an IRA. If, however, funds are withdrawn before age 65 for any purpose other than medical expenses, it is not only subject to tax, but also a 10% penalty as well.

Look at www.hsainsider.com for good information about HSA including costs and deductibles of some specific plans. Compare the savings on the reduced premiums for your health insurance with the added cost you will be responsible for with the higher deductibles.

IRA/Retirement Plan Reform

All or part of your federal tax refund may be direct deposited into a qualifying IRA account. In addition, you can now make a donation directly from an IRA to a charity, but you will not be able to claim a deduction.

Employers are now offering Roth 401(k) plans which will operate similar to a Roth IRA. There are some real advantages to Roth IRA's and Roth 401(k) plans should operate on a similar basis. Your earnings will grow on a tax free basis and will not ever be taxed on the growth if you hold the fund for at least 5 years and withdraw the funds after you are 59 ½. If you need to withdraw funds for college tuition or to purchase a new home before age 59 ½, you can withdraw original contributions without tax or penalty, so long as you do not withdraw any of the earnings.

The maximum contribution to a Roth or Traditional IRA remains at \$4,000 for 2007 (2008-increases to

\$5,000). If you are not currently contributing to a Roth IRA, begin thinking very seriously about it. If you are over 50, you can increase the maximum contribution to your IRA by an additional \$1,000.

If you are in a 401(k) plan, a 457 plan, or a 403(b) plan, your maximum contribution is \$15,500. If you are over 50, you can add \$5,000 to the maximum contribution (no changes for 2008).

Contributions to a profit sharing plan for small businesses is now 25% of compensation or 100% of an employee's earnings, up to a maximum of \$45,000 (\$46,000 in 2008) if a "Defined Contribution" Plan is established.

Employees participating in a SIMPLE IRA can contribute up to \$10,500 from their paychecks for 2007. Those ages 50 and older can increase this amount by \$2,500 (no changes for 2008).

IRS Audits & Notices

The IRS and many states are sending out a lot of notices trying to collect additional taxes. If you receive any notices, please fax or scan and send us a copy of the notice before you call. We can usually tell very quickly what the issue is if we have the notice in front of us and it saves all of us time.

Where do you Fit?

Was your AGI in excess of \$100,000? If so you were in the top 10% of tax filers and paid 70% of the income tax burden. The top 5% earned \$145,000 and the top 1% earned \$365,000 and paid 60% and 39% respectively of the income tax burden. The bottom 50% of filers paid just 3.1% of the total tax burden.

TAX PLANNING STRATEGIES

Tax planning should be done throughout the year, not solely at year end. Unless you will be impacted by the AMT (in which case the recommendations are usually reversed), it is often beneficial to accelerate all possible deductions into the current year.

Contribute the maximum possible to a 401-K plan, Tax Sheltered Annuity, Deferred Compensation Plan, SEP and/or IRA (preferably Roth IRA). Those who acquaint themselves with our philosophy of Financial Planning understand the long-term value of investing the maximum possible in such a plan. An added plus is that your employer will often match your contributions. This can double your contribution and maximize your future earnings.

In fact, you should contribute to a Roth IRA even if you have a 401K, SEP or 403b plan at work. Unless your income exceeds \$101,000 for a single individual

(\$159,000 for a married couple) or you file as married filing separate, take advantage of the Roth IRA.

Shift income to children when taxable income exceeds \$65,100 for a married couple (\$43,650 for singles). Children under 18 can earn \$1,700 of unearned income (i.e. interest, dividends, and capital gains) before having to pay tax at their parent's rate. Children under 18 can also be paid a wage from their parents business (proprie-torship only) and earn up to \$5,450 without paying taxes as long as they have no unearned income. In addition their parents need not pay social security or unemployment taxes on those earnings.

Don't forget about the ability to make gifts, now at \$12,000 (\$24,000 for couples) per year to as many individuals as you desire.. This provides a way to transfer assets to your children. You also have a combined lifetime estate and gift tax exemption up to \$2,000,000, in addition to the annual \$12,000 gift.

Be aware, there is a potential conflict with shifting income to children. If you are trying to qualify for college scholarships or loans, 35% of a student's assets must be considered available to pay tuition and reduces the ability to qualify for grants and low interest loans. Less than 6% of parents' assets are considered.

Alternate Capital Gains and Capital losses. Sell Stocks with gains one year and those with losses in different years, so long as the losses are no more than \$3,000 and you are in the 25-35% brackets. Capital losses up to \$3,000 can be written off against ordinary income taxed at maximum rates. Capital gains on the other hand are taxed at a maximum rate of 15%.

If you have significant capital losses, then take those losses in a year with significant capital gains so that you can realize the benefit of the losses. This way you will be allowed to deduct losses equal to the amount of capital gains in that year, plus \$3,000. If the stock is worthless, sell it to an unrelated party for \$1 and document the sale. Do not repurchase the same stock within 30 days, as the loss will not be allowed.

Sell real estate on the installment sale method if you want to receive cash from the sale. Installment sales require only that you receive payment in at least two different years. You are taxed on the profit prorated by the cash received in any year. Be aware that in the year of sale, cash received includes more than the net cash you received. Also any depreciation recapture is taxed in full in the year of sale. One caveat to be aware of—if Congress changes the capital gains tax rules, all capital gains received after the date of the change will be taxed under the new rate.

Don't sell real estate, Do a tax-deferred exchange. A tax-free exchange can postpone tax on the sale of real estate until you sell the property received in the exchange. There are strict time requirements and limits

on how you must handle debt and the proceeds from the sale. In addition it will cost \$1-3,000 in Accommodator and Professional fees to handle the exchange.

Accelerating Deductions

Consider the following **unless you will be affected by the alternative minimum tax.**

Pay your January 1 mortgage payments for your home and rental properties by Christmas to enable the lender to receive and record the payment by December 31. Unless the lender receives and records the payment by December 31, they will report the payment of interest in the following year.

Accelerating contributions from next year into this year can be a very profitable move. This is one area Congress has never really touched, other than requiring receipts from the charity. Take full advantage of donating to your favorite charity. This includes the clothing and other goods that should be donated by December 31. Do remember to obtain a receipt for any food or clothing donated.

Bunch your medical expenses every other year unless they exceed 7.5% of your AGI by a significant amount each year. For example, if you are making payments for orthodontia work, prepay as much as possible in the current year.

Prepay next year's property taxes by December 31, if they are due within the first four months of the year.

If miscellaneous deductions exceed 2% of your AGI, (i.e. \$1,000 for an AGI of \$50,000) accelerate all possible expenses into the current year. Most of our clients have sufficient job related expenses, investment deductions and other deductions (including job-search expenses, continuing education and tax preparation fees) to make it well worth your while to accelerate those expenses into this year.

Pay 4th quarter state income tax estimates by December 31. This estimate is due on January 15. By paying 15 days early, you receive a deduction a year earlier. This does not apply to the Federal estimate.

THIRD-PARTY SERVICE PROVIDERS

To keep you current with developments at Clement & Associates, we are notifying our clients that we use third-party service providers by our firm to provide professional services for our clients. If you should have any questions concerning this disclosure, please feel free to contact Steve and we will be happy to answer any questions you may have. This notice is in compliance with professional standards established by the American Institute of Certified Public Accountants (AICPA Professional Standards ET Sections 191.224-.225 & 291.023-.024).

IS YOUR E-MAIL ADDRESS CORRECT?

During tax season, Steve will usually return e-mails when he cannot return phone calls due to the time constraints of his appointment schedule. Please make sure we know your current e-mail address when you return your appointment card or the next time you call us if we do not currently have it on file or it has changed. You can reach us at the following e-mail addresses:

Dawn Henry	(Appointments, status of returns)	Receptionist@clementcpa.com
Pattie Hagen	(Accounting/Tax questions, missing info.)	Pattie@clementcpa.com
Jeremy Craig	(QuickBooks Accounting & Business Tax Returns	Jeremy@clementcpa.com
Steven Clement	(Tax/QuickBooks®/Financial planning questions)	Steve@clementcpa.com

WEB PAGE AND CHECKLISTS

Have you checked out our web page at www.clementcpa.com lately. We now have an interactive worksheet for Non-Cash Contributions and other helpful checklists under Tax Tools. We are also sending out a periodic newsletter as often as monthly via email. If you have not begun receiving this newsletter by the time we meet for our tax appointment please let us know.