

2007 Tax Laws Affecting Individuals

The following are a summary of selected tax laws that have changed in 2007.

Adoption Credit or Assistance

Beginning in 2007, the credit allowed for an adoption of a child with special needs is \$11,390 and the maximum credit allowed for other adoptions is the amount of qualified adoption expenses up to \$11,390. The credit begins to phase out if you have modified adjusted gross income of \$170,820 or more and is completely phased out if you have modified adjusted gross income of \$210,820 or more.

Beginning in 2007, you may be able to exclude up to \$11,390 from your gross income for qualified adoption expenses paid or incurred by your employer under a qualified adoption assistance program in connection with your adoption of an eligible child. This income exclusion starts to phase out if your modified adjusted gross income is \$170,820 or more and is completely phased out if your modified adjusted gross income is \$210,820 or more.

Alternative Minimum Tax

On December 26, 2007, President Bush signed into law the Tax Increase Prevention Act of 2007, legislation that alleviates an immediate AMT hit on millions of middle-class taxpayers. To do this, the Act increases the alternative minimum tax exemption amount for 2007 to: (1) \$66,250 for a married individual filing a joint return, or a surviving spouse; (2) \$44,350 for an unmarried individual who is not a surviving spouse; and (3) \$33,125 to married individuals filing separate returns. Without a patch, the 2007 exemption amounts would have been \$45,000 for joint filers, \$33,750 for single filers, and \$22,500 to separate return filers. Given the lateness of the enactment, the IRS has stated that early return filers will see a delay in getting their refunds.

In conjunction with the AMT relief, above, the Act amends the tax code by extending to taxable years beginning in 2007 the limitation on the nonrefundable personal credits that may be used to offset a taxpayer's alternative minimum tax liability. These credits include the dependent care credit, the Hope and Lifetime Learning credits, and the D.C. first-time homebuyer's credit.

Capital Asset Treatment for Self-Created Musical Works

Musical compositions and copyrights in musical works are generally not capital assets. However, you can elect to treat these types of property as capital assets if you sell or exchange them in tax years beginning after May 17, 2006, and:

Your personal efforts created the property, or

You acquired the property under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

Charitable Contributions

New recordkeeping requirements for cash contributions. You cannot deduct a cash contribution, regardless of the amount, unless you keep as a record of the contribution a bank record (such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount) or a written communication from the charity. The written communication must include the name of the charity, date of the contribution, and amount of the contribution. For more information, see Publication 526, Charitable Contributions.

Contributions to donor advised funds. You cannot deduct a contribution to a donor advised fund after February 13, 2007, if the sponsoring organization is a war veterans' organization, a fraternal society, or a nonprofit cemetery company. There are also other circumstances in which you cannot deduct your contribution to a donor advised fund. Generally, a donor advised fund is a fund or account in which a donor can, because of being a donor, advise the fund how to distribute or invest amounts held in the fund. For details, see Internal Revenue Code section 170(f)(18).

Filing fee for easements on buildings in historic districts. A new \$500 filing fee must be paid for each qualified conservation contribution after February 12, 2007, that is an easement on a building in a registered historic district, if the claimed deduction is more than \$10,000. See Form 8283-V, Payment Voucher for Filing Fee under Section 170(f)(13).

Earned Income Amount for Additional Child Tax Credit

For 2007, the minimum earned income amount used to figure the additional child tax credit has increased to \$11,750.

Earned Income Credit Amounts Increase

The following paragraphs explain the changes to the credit for 2007.

Amount of credit increased. The maximum amount of the credit has increased. The most you can get is:

\$2,853 if you have one qualifying child,
\$4,716 if you have more than one qualifying child, or
\$428 if you do not have a qualifying child.

Earned income amount increased. The maximum amount of income you can earn and still get the credit has increased for 2007. You may be able to take the credit if:

You have more than one qualifying child and you earn less than \$37,783 (\$39,783 if married filing jointly),

You have one qualifying child and you earn less than \$33,241 (\$35,241 if married filing jointly), or

You do not have a qualifying child and you earn less than \$12,590 (\$14,590 if married filing jointly).

The maximum amount of adjusted gross income (AGI) you can have and still get the credit also has increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

Investment income amount increased. The maximum amount of investment income you can have and still get the credit has increased to \$2,900 for 2007.

Advance payment of the credit. If you get advance payments of the credit from your employer with your pay, the total advance payments you get during 2007 can be as much as \$1,712.

Nontaxable combat pay election extended. You can elect to have your nontaxable combat pay included in earned income when you figure your earned income credit for 2007. This election was previously due to expire at the end of 2006 but has been extended through 2007. For more information about the election, see Publication 596.

Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2007, the amount of your interest exclusion is phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified adjusted gross income (MAGI) is between \$98,400 and \$128,400. You cannot take the deduction if your MAGI is \$128,400 or more. For 2006, the exclusion phased out between \$94,700 and \$124,700.

For all other filing statuses, your interest exclusion is phased out if your MAGI is between \$65,600 and \$80,600. You cannot take a deduction if your MAGI is \$80,600 or more. For 2006, the exclusion phased out between \$63,100 and \$78,100. For more information, see chapter 9 in IRS Publication 970, Tax Benefits for Education.

Expired Tax Benefits

The following tax benefits have expired and will not apply for 2007.

- Relief granted for Hurricanes Katrina, Rita, and Wilma.
- Tax-favored treatment of qualified hurricane distributions from eligible retirement plans.
- Increased limits and delayed repayment on loans from qualified employer plans.
- Special rules so a temporary relocation did not affect whether you provided more than half of an individual's support, whether you furnished more than half the cost of keeping up a household, and whether you could treat an individual as a student.
- Increased limits and an expanded definition of qualified education expenses for the Hope and lifetime learning credits.

- Additional exemption for housing individuals displaced by Hurricane Katrina.
- Exclusion from income for discharge of nonbusiness debt by reason of Hurricane Katrina.
- Qualified electric vehicle credit. You cannot claim this credit for any vehicle you placed in service after 2006.

Health Savings Accounts (HSAs)

High deductible health plan. (HDHP) For HSA purposes, the minimum annual deductible of an HDHP increases to \$1,100 (\$2,200 for family coverage) and the maximum annual deductible and other out-of-pocket expenses limit increases to \$5,500 (\$11,000 for family coverage).

Deductible limitation on contributions. The annual deductible limitation for contributions to your HSA based on the amount of your health insurance deductible is repealed. For 2007, the maximum HSA deduction increases to \$2,850 (\$5,650 for family coverage) regardless of the amount of your health insurance deductible. The maximum additional deduction for individuals age 55 or older increases to \$800.

Deductible contributions for part-year coverage. For HSA purposes, you can be treated as an eligible individual for each month in your tax year if you are an eligible individual during the last month of your tax year. This applies to each month for which you would not otherwise qualify as an eligible individual. For these months, you are treated as enrolled in the same HDHP that you were enrolled in for the last month of your tax year. However, if you are not an eligible individual, for any reason other than death or becoming disabled, for the 12 months following the end of your tax year, any contribution attributable to these months is included in your income and is subject to an additional 10% tax. The income and additional 10% tax are reported for the tax year in which you cease to be an eligible individual.

Transfers from a health reimbursement arrangement (HRA) or health flexible spending arrangement (FSA) to an HSA. Your employer can make a one-time direct transfer of the balance in your HRA or health FSA to your HSA without violating the requirements for those arrangements. The maximum allowable transfer is the lesser of the HRA or health FSA balance on September 21, 2006, or on the date of transfer.

The amount transferred is not included in your gross income, is not taken into account in applying the HSA contribution limitation, and is not deductible. However, if you are not an eligible individual, for any reason other than death or becoming disabled, for the 12 months following the month of the transfer, the amount transferred is included in your income and is subject to an additional 10% tax. The income and additional 10% tax are reported for the tax year in which you cease to be an eligible individual.

If the employer makes a transfer available to any employee, all employees who are covered under an HDHP of the employer must be allowed to make a transfer. Otherwise, the employer is subject to an excise tax.

Generally, you are not an eligible individual for an HSA if you have health coverage other than an HDHP. For tax years beginning after 2006, coverage under a health FSA for the period immediately following the health FSA's plan year during which unused benefits or contributions remaining at the end of the year may be paid or reimbursed to you for qualified expenses incurred during that period does not disqualify you from being an eligible individual. The coverage does not disqualify you if the balance in the health FSA at the end of the plan year is zero or the entire remaining balance in the health FSA is transferred to your HSA as described above.

Comparable contributions by an employer. An employer that makes contributions to the HSAs of employees must make comparable contributions to all comparable participating employees' HSAs. For tax years beginning after 2006, for purposes of making contributions to the HSA of an employee who is not highly compensated, a comparable participating employee does not include a highly compensated employee.

Home Sale Gain Exclusion for widow/widower

Effective for sales beginning in 2008, the Mortgage Relief Act extends the time a widow/widower has to sell the principal residence and be eligible for the \$500,000 exclusion available to joint filers, rather than the \$250,000 exclusion generally applicable for unmarried individuals. To qualify, the sale must occur not later than two years after the date of death of the spouse and the both the widow/widower and the deceased spouse must have met the requirements of exclusion provision immediately before the date of death. Prior to this provision, the sale had to occur in the year of death, so that the widow/widower was eligible to file a joint return to be able to claim up to a \$500,000 exclusion.

Income Limits Increased for Hope and Lifetime Learning Credits

For 2007, the amount of your Hope or lifetime learning credit is phased out (gradually reduced) if your modified adjusted gross income (MAGI) is between \$47,000 and \$57,000 (\$94,000 and \$114,000 if you file a joint return). You cannot claim an education credit if your MAGI is \$57,000 or more (\$114,000 or more if you file a joint return). This is an increase from the 2006 limits of \$45,000 and \$55,000 (\$90,000 and \$110,000 if filing a joint return). For more information, see chapters 2 and 3 in IRS Publication 970, Tax Benefits for Education.

Increase in Limit on Long-Term Care and Accelerated Death Benefits Exclusion

The limit on the exclusion for payments made on a per diem or other periodic basis under a long-term care insurance contract increases for 2007 to \$260 per day. The limit applies to the total of these payments and any accelerated death benefits made on a per diem or other periodic basis under a life insurance contract because the insured is chronically ill.

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

The cost of qualified long-term care services during the period.

The dollar amount for the period (\$260 per day for any period in 2007).

Top of Page

Mortgage Insurance Premiums Treated as Home Mortgage Interest

Premiums that you pay or accrue for "qualified mortgage insurance" during 2007 in connection with home acquisition debt on your qualified home are deductible as home mortgage interest. The amount you can deduct is reduced by 10% (.10) for every \$1,000 (\$500 if your filing status is married filing separately) by which your adjusted gross income exceeds \$100,000 (\$50,000 if your filing status is married filing separately).

For the definitions of home acquisition debt and qualified home, see IRS Publication 936, Home Mortgage Interest Deduction.

Qualified mortgage insurance. Qualified mortgage insurance is mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1998 as in effect on December 20, 2006).

Special rules for prepaid mortgage insurance. If you paid premiums for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year, such premiums are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is satisfied before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Administration).

Schedule A (Form 1040). You can deduct mortgage insurance premiums you paid or accrued during 2007 on Line 13 of the 2007 Schedule A (Form 1040).

Mortgage insurance premiums you paid or accrued on any mortgage insurance contract issued before January 1, 2007, are not deductible as home mortgage interest.

The Mortgage Relief extended the deduction for private mortgage insurance, which was set to expire December 31, 2007, to amounts paid or accrued on or before December 31, 2010.

Mortgage Relief

On December 20, 2007, President Bush signed into law the Mortgage Forgiveness Debt Relief Act of 2007. The primary focus of the bill is to relieve taxpayers of the requirement that amounts discharged from indebtedness are included in gross income.

The Act excludes from gross income any discharge of indebtedness income by reason of discharge of qualified principal residence indebtedness. Qualified principal residence indebtedness is similar to the definition used to determine whether you can deduct mortgage interest. However, this provision caps the debt that can be relieved income-free at \$2,000,000 (or \$1,000,000 in the case of married individuals filing separate returns). The provision only applies to a taxpayer's principal residence and not a second or vacation home. Under the provisions of the Act, a taxpayer must reduce their basis in their principal residence (but not below zero) to the extent that amounts are excluded from income as a result of the discharge. This keeps open the possibility of taxation on any future appreciation of the property. However, the general exclusion rule (up to \$500,000 for married couples filing jointly) may alleviate any and all taxes due on the sale.

These rules have retroactive effect as they apply to discharges occurring on or after January 1, 2007. However, the provision is not applicable for discharges on or after January 1, 2010.

Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2007 is \$97,500. There is no limit on the amount of wages subject to the Medicare tax.

Standard Mileage Rates

Business-related mileage. For 2007, the standard mileage rate for the cost of operating your car for business use is 48 ½ cents per mile. For 2008, this increased to 50 ½ cents per mile.

Car expenses and use of the standard mileage rate are explained in chapter 4 of IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses.

Medical- and move-related mileage. For 2007, the standard mileage rate for the cost of operating your car for medical reasons or as part of a deductible move is 20 cents per mile. See Transportation under What Medical Expenses Are Includable in Publication 502 or Travel by car under Deductible Moving Expenses in Publication 521.

Charitable-related mileage. For 2007, the standard mileage rate for the cost of operating your car for charitable purposes remains 14 cents per mile.