2007 year-end tax planning: Plenty to keep busy

With 2008 little less than two months away, tax practitioners finally have their client's attention on the need for year-end tax planning.

As in prior years, year-end 2007 presents unique tax planning challenges, as well as traditional opportunities. Especially this year, sunset provisions, phase-ins and phase-outs, and inflation adjustments, as well as retroactive and prospective legislative changes and deadlines set in final regulations, all contribute to chasing a moving target.

Here are some items to consider in meeting the challenges of this year-end tax-planning season.

Don't forget the old standards. Tried-and-true year-end tax strategies should never be over-looked. Many are particularly well suited to this year's situation. All come under one of two themes: the ability to predict outcomes for the full year because of our close proximity to year's end, and the ability to act to change the outcome for tax purposes.

Applied to year-end 2007, these strategies suggest taking the following steps:

- Review last year's returns for any mistakes in tax planning (through uneven income or deductions, missed deferred savings opportunities, etc.);
- Check for major life changes (births, deaths, marriages, divorce, unemployment, promotions, inheritance, bankruptcy, retirement, business changes, etc.) and take appropriate action;
- Examine income and deductions for 2007 to date, as well as realistically forecast the rest of 2007, and then try to balance income and deductions between years by accelerating or deferring income or deductions as appropriate to remain in the same tax bracket, if possible;

- Determine whether bunching deductions into 2007 or 2008 will enable the use of itemized deductions for at least one of the years;
- Forecast the amount of state and local income and state and local sales tax itemized deductions for 2007 and plan accordingly (also keeping in mind the scheduled sunsetting of the sales tax deduction after 2007);
- Maximize the annual gift tax exclusion of $12,000 per donee for 2007;
- Maximize all annual limits on contributions to retirement plans;
- Evaluate year-end business purchases to take advantage of half-year depreciation conventions;
- Look at portfolio gains and losses to be prepared to trade by year-end as appropriate to net gains and losses most effectively for tax purposes.

Legislation once again impacts year-end tax strategies. This year, it encompasses not only what has been enacted into law recently, but also what may be enacted by the end of the year.

The Small Business and Work Opportunity Tax Act of 2007 raised the applicable age for the "Kiddie Tax" on which unearned income above a minimum amount is taxed at the parent's rate. Before 2007 ends, only those who have not turned 18 by year's end are subject to the Kiddie Tax. After 2007, the age rises to 19, except that fulltime students who remain dependents are subject to the Kiddie Tax until age 23. For those 19-to-23-years-olds not subject to the Kiddie Tax this year but again subject to it in 2008, the strategy of selling appreciated assets now, especially if the capital gains rate goes up after they reach 24, is obvious.

The Small Business Tax Act also raised the annual amount available for Code Section 179 expensing. The 2007 act raised it retroactively to January 1 for 2007 to $125,000 and $500,000 respectively, from the prior 2007 inflation-adjusted amount of $112,000 and $450,000. For

2008, inflation-adjustments will raise those amounts to $128,000 and $510,000, respectively. A small business should plan purchases to maximum this deduction in both 2007 and 2008.

The Small Business Tax Act also extended and enhanced the Work Opportunity Tax Credit through August. 31, 2011. It had been set to expire for employees hired after Dec. 31, 2007. The new law also broadens the scope of the credit. Since it is available on an annual basis, arranging to qualify under the new rules during 2007 should be on many businesses' short list.

The Tax Relief and Health Care Act of 2006 extended some provisions that were due to expire at the end of 2007. The deduction for energy-efficient commercial buildings had been available for property placed in service after December. 31, 2005, and before January. 1, 2008. The law extended this deduction through 2008. Likewise, the business credit for energy-efficient new homes, which was to expire at the end of 2007, was extended through 2008.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 reaches forward to 2008 when the zero percent rate on capital gains for those in no higher than the 15 percent rate bracket takes effect.

Accelerating income into 2007 to qualify for the zero rate in 2008 and/or postponing sales of long-term capital assets until 2008 if within the 15 percent bracket should be considered. For 2008, the projected top of the 15 percent bracket will be up to $65,100 for joint filers and $32,550 for single filers.

The Economic Growth and Tax Relief Reconciliation Act of 2001 also reaches forward by having scheduled the gradual elimination of the phase-out of itemized deductions and personal exemptions for higher-income taxpayers to jump from two thirds to one third starting in 2008. It will be eliminated completely beginning in 2010.

Year-end planning carries with it more than the usual amount of uncertainty for 2007 because of certain provisions set to expire at the end of 2007, unless Congress extends them. Many of these provisions have been extended in the past, but are by no means “slam-dunks” for another extension.

Taxpayers are advised to sit on the fence and be prepared to act quickly to either accelerate or defer specific behavior related to the particular tax break under consideration. At press time, here are the provisions of most concern:

- **AMT exemption amount.** In 2006, the AMT exemption amounts were $42,500 for single individuals and $62,500 for married couples filing jointly. The higher amounts lapsed and are now set for 2007 to revert to just $33,750 for individuals and $45,000 for married couples filing jointly. Congress is expected to enact another round of temporary relief.
- **State and local sales tax itemized deduction.** Although this itemized deduction option has been extended once before, it is set to expire at the end of 2007.
- **Qualified tuition deduction.** This above-the-line deduction for qualified higher education expense expires at the end of 2007. Early this year, Congress had hoped to work on consolidating education tax benefits, but so far little progress has been made.
- **Residential energy credit.** Homeowners can claim a credit of up to $500 for energy improvements ($200 for energy-saving windows), but only if installed before 2008.
- **Conservation contributions.** For 2006 and 2007 only, the usual 30 percent contribution base limitation for contributions of capital gain property does not apply to qualified conservation contributions.
- **IRA distributions to charities.** The $100,000 exclusion from gross income of IRA distributions to charities by tax-payers age 70-1/2 and older is set to expire a the end of 2007.

- **Educator deduction.** Also set to expire at the end of 2007 is a deduction that allows elementary and secondary school teachers and administrators to claim their personal outlays for classroom supplies of up to $250 as an above-the-line deduction.
- **Mortgage insurance premiums.** For 2007 only, qualified residence interest includes the cost of premiums paid for qualified mortgage insurance in connection with a mortgage to acquire a qualified residence.
- **S corporation contributions.** For 2006 and 2007 only, a shareholder's basis reduction in S stock because of a charitable contribution made by the S corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property.
- **Research credit.** The enhanced research credit is available only for amounts paid or incurred before 2008.
- **Contributions of food, books or computer technology.** An enhanced deduction for contributions of food and books is allowed to businesses through 2007 only. Likewise, before 2008, a C corporation may take an enhanced deduction for contributions of computer technology or equipment to schools or libraries.
- **Leasehold and restaurant improvements.** Qualified leasehold and restaurant improvements may be written off over 15 years, rather than 39 years, but only for expenditures made through 2007.

One year-end deadline of major concern to many employers is unique to 2007 compliance with the nonqualified deferred-compensation final regulations. Although the IRS extended the deadline for Code Sec. 409A plans in early September to satisfy the written plan requirements, it by no means extended the deadline for complying with the final Code Sec. 409A regs. The extension did not postpone the December. 31, 2007, deadline for a deferred-compensation plan to satisfy the operational requirements under the final regs. Those requirements are complex and, for many employers, recasting compensation arrangements to comply in time will be extremely difficult.

Other areas to address are how you conduct your in home business. You should make a determination as to whether to incorporate that business beginning January 1, 2008 or not. Also, if you have significant assets exposed to potential lawsuit, you may want to consider organizing a limited liability company for asset protection purposes. All of these actions can begin in 2007 to take effect in 2008 to minimize organization costs, tax preparation costs, and provide for ease of transition from one form of operating a business to another form of operating.

While few clients will need to consider all of the year-end planning opportunities available this season, there appears to be enough of the “old” and the “new” at year-end 2007 to convince most everyone of the value of taking a look-see. Ironically, an unusually active Congress during the past dew years, and a relatively inactive Congress now that we approach the presidential campaigns, may have combines to create a “perfect storm” for year-end tax planning during these waning days of 2007.