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Tax Planning for 2007: Income Tax System Similar to Last Year

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As the year-end approaches, it is time to identify tax benefits that could reduce your 2007 tax bill and assist you to plan ahead for 2008. Except for minor tax benefits which are being phased in over four years, this year's tax system will be very similar to last year.

Basic tax planning requires considering the income tax consequence, both this and next year or longer into the future. This means considering whether to accelerate into 2007 or defer into 2008, income or deductions. This simulation will assist you to evaluate the impact that this actions may have on Adjusted Gross Income (AGI) and your ability to maximize itemized deductions that are tied to AGI, such as IRA deductions, standard deductions, personal exemptions, transfers to ROTH IRA's, etc. If, for example, you expect to be in a lower or at least no higher tax bracket next year, consider pulling some 2008 deductions into this year, e.g., charitable donations, early payment of property taxes, etc.

Tax Brackets

Another important item to identify early is your "tax bracket," i.e., the rate at which your last dollar of income is taxed. (See Table 1)

| Tax Rate | MARRIED COUPLES FILING JOINTLY | | MOST SINGLE FILERS | |
|----------|--------------------------------|----------------------------------|---------------------|----------------------------------|
| | 2007 Taxable Income | 2008 Taxable Income ¹ | 2007 Taxable Income | 2008 Taxable Income ¹ |
| 10% | Not over \$15,650 | Not over \$16,050 | Not over \$7,825 | Not over \$8,025 |
| 15% | \$15,650-\$63,700 | \$16,050-\$65,100 | \$7,825-\$31,850 | \$8,025-\$32,550 |
| 25% | \$63,700-\$128,500 | \$65,100-\$131,450 | \$31,850-\$77,100 | \$32,550-\$78,850 |
| 28% | \$128,500-\$195,850 | \$131,450-\$200,300 | \$77,100-\$160,850 | \$78,850-\$164,550 |
| 33% | \$195,850-\$349,700 | \$200,300-\$357,700 | \$160,850-\$349,700 | \$164,550-\$178,850 |
| 35% | Over \$349,700 | Over \$357,700 | Over \$349,700 | Over \$178,850 |

¹Estimated amounts; these are estimated amounts. The official amounts have not yet been released.

Standard Deduction Planning

Deduction planning is also affected by the standard deduction. (See Table 2). If your itemized deductions are relatively constant and are close to the standard deduction amount, you will obtain little or no benefit from itemizing your deductions each year. But simply taking the standard deduction each year means you lose the benefit of your itemized deductions. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of deductible expenses so that they are higher in one year and lower in the following year, e.g., pay property taxes every other year.

| | 2007 | 2008¹ |
|--|-------------|-------------------------|
| Joint or Qualifying Widow(er) | \$10,700 | \$10,900 |
| Single | \$5,350 | \$5,450 |
| Head of Household | \$7,850 | \$8,000 |
| Married Filing Separately | \$5,350 | \$5,450 |
| Additional for Elderly/Blind—Married | \$1,050 | \$1,050 |
| Additional for Elderly/Blind—Unmarried | \$1,300 | \$1,350 |
| Taxpayer Claimed as Dependent ² | \$850 | \$900 |

¹Estimated amounts. The official amounts have not yet been released.
²If an individual who can be claimed as a dependent on another's return has earned income, the standard deduction is the greater of \$900 or \$300 plus the earned income (but no more than the standard deduction).

The **alternative minimum tax (AMT)** amount was decreased to \$45,000 and \$33,750 for joint and single filers, respectively, in 2007. The AMT may impact more tax payers this year unless Congress changes the AMT before the end of the year. While it is difficult to develop tax saving strategies around the AMT, tax payers should consider its potential implications as early as possible. The AMT will require tax payers to compute their income taxes under two systems, the regular tax system and the so-called alternative minimum tax (AMT) system and pay the higher of the two amounts. The AMT will have a greater impact on tax payers with incomes between \$100,000 and \$500,000 and/or tax payers who deduct a significant amount of state and local taxes (income, property, and/or sales taxes) or miscellaneous itemized deductions (like unreimbursed employee business expenses), or claim multiple dependents exemption. The House tax panel recently passed \$75 billion tax increases designed to find a measure halting the spread of the AMT, but it appears unlikely to become law before the end of the year.

Expensing Option

The Section 179 expensing option for depreciable property used in business, i.e., computers, office furniture, equipment, vehicles, or other tangible business property, was increased to \$125,000 to adjust for inflation. Keep in mind that the expensing option is capped at \$25,000 for SUVs with loaded weights between 6,000 and 14,000 pounds. Non-SUVs, such as heavy pick-ups and nine passengers or larger buses, are exempt from this limit.

Individuals

Tax benefit reminder. The Working Families Tax Relief Act of 2004 expanded the following benefits:

- ☞ Self-employed individuals are allowed to claim 100% of the amount paid for **self-employed health insurance premiums** during the taxable year for insurance that constitutes medical care for themselves, their spouses and dependents as an adjustment (deduction) to gross income, without regard to the 7.5% cap of AGI, required for itemized medical deductions. **Caution:** The IRS has interpreted that this benefit only applies to deductions related to the business, i.e., the program must be sponsored by the business and available to all employees.
- ☞ The \$1,000 **child tax credit** is available through 2010 and reverts to \$500 in 2011.
- ☞ The expanded 10% and 15% **tax brackets** for joint returns, equal to twice the size of the brackets for single filers (see table 1) was expanded through 2010 and reverts to 167 percent in 2011.
- ☞ The increased **standard deduction** (marriage penalty relief) extends through 2010 for married couples filing jointly (equal to twice the a standard deduction for single tax payers) (see table 2) and reverts to 167% in 2011.

Charitable Donations

- ☞ **Charitable contributions in cash** require that the tax payer retain either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax-law requirements. For cash donations of \$250 or more, a bank record is not enough. Tax payers must obtain a charity-provided statement that meets tax-law standards.
- ☞ **Donating cars, boats or planes** requires documentation of what the charity actually received from the sale of the donated property and the taxpayer must itemize. This means that the total itemized amount must exceed the standard deduction in order to save taxes from donated property.
- ☞ **Tax-free IRA Distributions for Charity.** Age 70½ or older tax payers may make up to a \$100,000 tax-free donation of otherwise taxable distributions from traditional IRAs in 2006 and 2007, when the IRA money is paid out directly to a tax-exempt charity. But, the donation cannot be claimed as an income tax deduction since the qualified charitable distribution is federal-income-tax-free. This income exclusion appears financially favorable for seniors who might not otherwise itemize deductions.
- ☞ **Changes for Gifts of Clothing and Household Items.** Tax payers may no longer deduct donations of used clothing and household goods, such as furniture and furnishings, electronics, appliances, linens, and similar items, unless they are in "good used" or better condition. This means proper documentation, such as a photograph or an appraisal, will be required and the taxpayer must itemized, i.e., total itemized deductions must exceed the standard deduction.