



TAX ALERT

JANUARY 14, 2008

AMT RELIEF IN THE NICK OF TIME

As 2007 drew to a close, President Bush signed into law a one-year “patch” for the alternative minimum tax (AMT). The “patch” saves 19 million taxpayers from being subject to the AMT in 2007 and decreases the AMT which will be paid by the 4.2 million taxpayers who will be subject to the AMT in 2007. The “patch” increases the AMT exemption to \$66,250 for married taxpayers and to \$44,350 for unmarried taxpayers. If this relief had not passed, the exemption would have dropped to \$45,000 for married taxpayers and \$33,750 for unmarried taxpayers.

This AMT relief had been in the works for much of 2007. Both political parties agreed that relief was necessary. However, the Democrats wanted to enact a revenue increase to offset the revenue lost as a result of AMT relief. This was in accordance with the pay-go rule that the Democrats re-instated when they assumed control over Congress in 2007. Pay-go requires that new tax cuts and spending programs be offset with new spending cuts or tax increases. The Republicans were opposed to any tax increase to offset the AMT relief because the incremental AMT revenue was not intended to be collected. The Senate Democrats eventually had to back-down because they couldn’t get the votes to pass a bill which would increase taxes to offset the tax lost because of the AMT relief.

The late passage of the AMT relief – which is temporary and effective only for 2007 – may slow tax return processing and refunds for the 2008 filing season. The Internal Revenue Service has warned that it needs up to 10 weeks to re-program its computers for the AMT patch. The Service hopes to be able to begin processing most tax returns in early February.

MORTGAGE RELIEF

Addressing the subprime lending crises, Congress gave tax relief to homeowners whose mortgage debt is forgiven during the three-year period from January 1, 2007 through December 31, 2009. Prior to the enactment of this law, a homeowner could be taxed on the amount of his forgiven mortgage debt. For example, before this change, a homeowner with a \$200,000 mortgage whose lender foreclosed on the home and sold it for \$180,000 would have to pay tax on \$20,000 of income from the forgiven debt. The result would have been the same if the lender restructured the loan and reduce the debt to \$180,000. Under the new law, neither example would result in taxable income. Under the new law a taxpayer does not have to pay tax on up to \$2 million of debt forgiven for a qualifying loan secured by a principal residence.

In addition, the law permitting taxpayers to deduct mortgage insurance premiums was extended through 2010. Originally, it was scheduled to end December 31, 2007.

Finally, married taxpayers are allowed to exclude up to \$500,000 of the gain on the sale of a residence if they satisfy certain requirements. Single taxpayers can exclude up to a maximum of \$250,000 of gain. Before the law was changed, in order to be entitled to a \$500,000 exclusion, the taxpayers had to file a joint return in the year of sale. If the spouse died during a prior year, the surviving spouse would be entitled to a \$250,000 exclusion. The law was changed to permit the surviving spouse to receive the full \$500,000 exclusion if the spouse died up to two years prior to the sale provided:

1. the requirements for receiving an exclusion were met immediately before the spouse’s death, and
2. the surviving spouse had not remarried as of the date of sale.

TAX EXTENDERS

There has been pressure on Congress to extend other provisions of the tax law which were due to expire at the end of 2007 – most notably the provision that permits taxpayers 70-1/2 or older to make a direct contribution from their IRA to charity. Unfortunately, none of these relief provisions were extended. However, Congress is now trying to pass legislation which will reinstitute these relief provisions for 2008.

ESTATE TAX UNCERTAINTY

The 2001 legislation reduced the highest estate tax rate to 45% by 2007, increased the estate tax exemption to \$3.5 million (\$7 million for a husband and wife) by 2009 and repealed the estate tax altogether in 2010. In 2011, the estate tax reverts to where it was under the prior law – an exemption of \$1 million and a top rate of 55%. Congress in 2007 has tried repeatedly to amend the estate tax law to provide for the stability which would enable taxpayers to engage in long-term planning. Attempts to enact a law which would increase the exemption to \$5 million indexed to inflation and reduce the maximum tax rate to 35% have failed. It appears that Republicans and Democrats might agree to make permanent a \$3.5 million estate tax exemption and a 45% maximum estate tax rate.

THE 15% INCOME TAX ON DIVIDENDS

Under current law, the 15% maximum tax rate on qualified dividends will end in 2011 and will be replaced by a maximum tax rate of 39.6%. Rep. Charles Rangel (D – NY), Chairman of the House Ways and Means Committee has vowed to try to permanently repeal the AMT and replace the lost revenue with a 4.6% surcharge on adjusted gross income over \$500,000. If enacted, this would make the top income tax rate on dividends (as well as all ordinary income) 44.2% (39.6% plus 4.6% surtax). Even if the top tax rate on dividends is

limited to 25% - 28%, as some have speculated, it seems likely that the tax on qualified dividends will nearly double at the very least. This would be another blow to the stock market.

ESTABLISH RESIDENCY WHEN LIVING IN TWO OR MORE STATES – DEREK JETER CAUGHT IN A RUNDOWN

Many people who are approaching retirement own or rent residences in two or more states. Often one of the states such as Florida, Nevada or Texas has no individual income tax and the other state such as New York, New Jersey or California has a very high income tax.

Some of the state residency rules are black and white – if you spend more than 183 days in a state, that state deems you to be a resident. Other rules are highly subjective; they turn on your intent in determining your state of residency. Where do you keep most of your near and dear items such as family photos, jewelry and artwork?

New York State is presently claiming that Derek Jeter of the New York Yankees is a resident of New York – Jeter has homes in New York and Florida and claims that he spends less than 183 days in New York and that he is a Florida resident.

State auditors demand to see various types of records such as three years of diaries, credit card statements and phone bills from all of the states in which you reside. A New York residency audit has been likened to a “tax colonoscopy”. If you want to establish that you are a resident of a certain state, in addition to spending more than 183 days in that state, you should:

1. register to vote in that state,
2. get a drivers license and license plates in that state,
3. join a house of worship in that state, and
4. consistently use your address in that state on all correspondence.

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