

2007 Year-End Tax Planning for Individuals

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As the end of 2007 approaches, now is an ideal time for individuals to review tax situations and evaluate strategies that may help minimize their tax bill.

As is typical, some favorable changes to the tax laws over this past year are also accompanied by unfavorable modifications. In addition, a number of tax incentives are scheduled to expire at the end of this year, creating an even bigger need for year-end tax planning as we head toward the end of 2007.

TRADITIONAL TAX STRATEGIES

Year-end tax planning tips typically fall into two general groups:

- (1) the traditional strategies that have proven themselves useful year after year, and
- (2) new opportunities that have arisen from recent changes to the tax laws.

Tried and true tax planning techniques can help virtually every taxpayer save money; some, of course, more than others. Savings will depend on individual circumstances but examination of the following general areas is worth a look in addition to considering the tax impact of any special circumstances.

INCOME SHIFTING

One of the most fundamental year-end tax planning techniques involves accelerating deductible expenses in 2007 and deferring income, if economically feasible, into 2008. By delaying taxable income, taxes are deferred. Delaying taxable income may also prevent losing lucrative tax breaks that can be reduced or eliminated altogether as income levels rise and higher tax brackets are reached.

DEDUCTION MANAGEMENT

Essential end of the year tax planning requires planning for itemized deductions. Consider “bunching” deductible expenses into one or the other year depending upon whether the standard deduction may be taken in one year or whether the adjusted gross income limits for medical (7.5 percent) or miscellaneous itemized deductions (2 percent) may be more easily met.

PORTFOLIO MANAGEMENT

The end of the year is an ideal time to examine investments to take the steps necessary to minimize capital gains income and maximize the benefit of any capital losses. Capital losses can be used to fully offset capital gains. Losses taken in excess of gains can also be used to offset up to \$3,000 in ordinary income (or \$1,500 for a married couple filing separately). Net long term gains are taxed at a maximum rate of 15%.

Starting in 2008 there is a special, nontraditional opportunity — the zero percent net capital gain rate for tax years 2008 through 2010. While this zero rate is only available for individuals in the 10 or 15 percent income tax brackets, it is well worth families, retirees, and others to review, and avail of this opportunity where possible.

RETIREMENT PLANNING

Year-end planning for 2007 also involves maximizing annual contributions to retirement plan accounts, since one year’s limit cannot be added to the next year if not timely contributed.

Maximizing contributions to a retirement plan (or plans) before year end also allows for a reduction to adjusted gross income in direct proportion to those contributions. A reduction of adjusted gross income may also benefit by increasing the deductibility of medical and other deductions subject to adjusted gross income floors.

GIFT GIVING

Take advantage of the 2007 annual and lifetime gift-giving limits to reduce income and estate tax liabilities. For 2007, and then again in 2008, individuals may transfer \$12,000 per person, per year, without incurring a gift tax on the amounts transferred. Married couples can gift \$24,000 per person, per year without tax liability on the amounts transferred. This strategy not only avoids the possibility of paying a hefty estate tax later, but it will eliminate taxable earnings from those gifts from the current taxable income of the donor.

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CHARITABLE GIVING

Consider charitable giving before year end. Cash contributions are generally deductible to the extent of 50% of adjusted gross income.

CHANGES FOR 2007

Tax law changes constantly, and therefore so must individual tax planning. Here are some important changes, and potential changes, directly impacting 2007 year-end tax planning.

KIDDIE TAX

The *Small Business and Work Opportunity Tax Act of 2007* introduced a number of tax incentives for small business, but included a few pitfalls for individuals. For 2007, a child under the age of 18 is subject to the "kiddie tax" (and thus pays tax at his or her parents' highest marginal tax rate on unearned income in excess of \$1,700). In 2008, the applicable age rises and the kiddie tax will apply to a child under the age of 19 and full-time students under age 24. In light of this development, parents should consider selling appreciated stock and other assets belonging to their children now, especially if they will be in the 19 to 24 year-old category next year.

EXPIRING PROVISIONS

Unless extended by Congress, a variety of popular tax deductions and credits are set to sunset at the end of 2007. Provisions set to expire at the end of 2007 include:

State and local sales tax deduction.

Despite being one of the more popular tax breaks, the deduction for state and local sales taxes is not permanent and is set to expire at the end of 2007. *The American Jobs Creations Act of 2004* gave taxpayers who itemize deductions the option of claiming either state and local income taxes *or* state and local general sales taxes. For those individuals who do utilize the sales tax deduction over the income tax deduction, and have been contemplating the purchase of a big-ticket item, such as a car or boat, consider making it sooner rather than later.

Tuition and fees deduction. Taxpayers may deduct qualifying tuition and fees paid in 2007 that are required for the

student's enrollment or attendance at a post-secondary school. The tuition and fees deduction is an above-the-line write-off that, depending on adjusted gross income, can reduce taxable income by as much as \$4,000. The deduction is available for either the taxpayers or their dependents, and is frequently more valuable than taking a Hope or Lifetime Learning Education Credit. As a result, consider the possibility of paying next year's tuition early as year end approaches.

Educator Expenses. Full-time teachers, instructors, counselors and other educators may deduct up to \$250 worth of books, supplies, software, and other qualifying materials that they provide out of pocket. The deduction is set to expire at the end of 2007, unless extended by Congress.

Qualified Conservation Contributions. Also set to expire in 2007 is the enhanced deduction for contributions of real property interests dedicated exclusively for conservation purposes. Easements in facades may also qualify. A 50 percent contribution base limit applies, rather than the 30 percent limit for capital gain property.

ALTERNATIVE MINIMUM TAX

Unfortunately, the alternative minimum tax (AMT) may require both traditional year-end planning techniques and new strategies to avoid or at least minimize its effect, as it reaches a growing number of taxpayers. A planning technique that may benefit under the "regular tax" may be worthless if a taxpayer unexpectedly falls into the AMT.

Start planning around the AMT by projecting income for the rest of 2007 and, to the extent possible, for 2008 and even 2009. The risk of paying AMT in 2007 increases significantly over 2006. In 2006, the AMT exemption amounts were \$42,500 for single individuals and \$62,550 for married couples filing jointly. For 2007, the amounts have been slashed to only \$33,750 for individuals and \$45,000 for married couples filing jointly. While Congress may well raise the exemption amount at the last

minute, planning for the worst is the safest course at this point.


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Planning for the AMT typically focuses on carefully examining normal income tax deductions that become "tax preference" items and no longer deductible under the AMT. These include:

- * Personal exemptions;
- * Deductions for state and local taxes;
- * Home equity loans and other mortgage interest not incurred

in buying, building or improving a principal residence;

- * Incentive stock options (which may generate AMT income even when sold at a loss);
- * Interest from many tax-exempt bonds;
- * Deductions for unreimbursed business expenses; and
- * Other itemized deductions.

The complexity of the tax laws and understanding which tax planning provisions to incorporate make year-end tax planning an overwhelming task. While this article touches on several strategies to follow through before year end, there are many more techniques that can be considered depending upon an individual's circumstances. 

If you have any questions on this article or would like to further discuss your year-end tax planning, please contact Robert M. Pesce, Jr. or a member of our Tax Department. Robert M. Pesce, Jr. is a Partner at Marcum & Kliegman LLP and head of the Agency Services Group. He specializes in providing accounting and consulting services to artists, authors, literary agents and publishers.

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