

SPECIAL INSERT TO OUR 2007 FALL UPDATE

One of the highlights mentioned in the Client Update is a change to the age limit for the "**Kiddie Tax**" that will be effective for most taxpayers during the 2008 tax year. Since this change will affect many of our clients, we would like to provide additional information.

As a reminder, the kiddie tax rules provide that if a child is under a prescribed age **as of the last day of the taxable year**, all the unearned income of the child in excess of an inflation adjusted amount (\$1,700 for 2007) will be taxed in the parent's highest marginal tax bracket if that rate is higher than what the child would otherwise pay.

For 2007, the kiddie tax rules will be applicable to children who are **under the age of 18** on December 31, 2007 (or, the last day of the parent's taxable year for fiscal year taxpayers).

The only exception to this rule is if the child was married and filed a joint income tax return with his or her spouse.

For 2008, the kiddie tax will be applicable to three groups of children:

1. Children who as of the last day of the taxable year have **not** attained age 18.
2. Children who as of the last day of the taxable year have attained the age of 18.
3. Children who as of the last day of the taxable year have attained the age of 19, but are under the age of 24 **and** are full-time students.

The reason for three separate age groups relates to the exceptions from the kiddie tax rule. Groups 2 & 3 are excepted from the kiddie tax rule if the child's **earned income** exceeds one-half of the child's support (i.e., the "earned income exception"). Group 3 will be excepted from the kiddie tax if the child is not a full-time student. Groups 1, 2, & 3 will be excepted from the kiddie tax if the child was married and filed a joint income tax return with his or her spouse.

Earned income includes wages, salaries, professional fees, and other amounts received as compensation for personal services. In determining whether a child's earned income exceeds one-half of the child's support, any scholarships received by the child for study at an educational institution are not counted in determining the amount of the child's support.

Examples of support include amounts spent for food, lodging, clothing, education, medical, dental, travel and recreational expenses, and other necessities.

Final note, the earned income exception does not apply to children under the age of 18 (so, the kiddie tax rule will still apply to children under the age of 18 regardless of the amount of their earned income, unless the child is married and files a joint income tax return with his or her spouse).

2007 Tax Planning Before the 2008 Change in Kiddie Tax Rules

Children who will attain the age of 18 in 2007 (or who are full-time students age 19 but younger than age 24) will not be subject to the kiddie tax in 2007, but will be subject to the kiddie tax in 2008. With respect to these children, consideration should be given to recognizing long-term capital gain income in 2007 because it will be taxed at the child's tax rates, which could include the special 5% long-term capital gain rate.

The special 5% long-term capital gain rate will apply if the child's net capital gain income would otherwise be taxed in the child's two lowest brackets (i.e., the 10% and 15% brackets).

For example, the maximum taxable income a single-filing taxpayer can have in 2007 before exceeding the 15% bracket is \$31,850. If the child's only taxable income in 2007 is net long-term capital gain income of \$31,850, the Federal tax on such income will be \$1,593 (\$31,850 x 5%). In 2008, when the kiddie tax law changes, the tax will be \$4,778 (\$31,850 x 15%), assuming the parent's taxable income exceeds the 15% bracket. Accelerating the gain (in this example) into 2007 that may otherwise be recognized over the next five years saves about \$3,000 in Federal income taxes.

For another example, if the child's taxable income consists of \$10,000 ordinary income and \$50,000 in long-term capital gain income, here's how the Federal tax would look in 2007:

| | | |
|----------------------------|----------|---|
| Taxable income | \$60,000 | (\$50,000 long-term capital gain income, \$10,000 ordinary income) |
| Tax on ordinary income | \$1,109 | (\$10,000 at ordinary rates - first \$7,825 @ 10%, next \$2,175 @ 15% rate) |
| Tax on capital gain income | \$5,316 | (\$50,000 at long-term capital gain rates - \$21,850 @ 5% = \$1,093, plus \$28,150 @ 15% = \$4,223) |
| Total Federal Tax | \$6,425 | (in 2008, the tax could be as high as \$11,000) |
| Effective Tax Rate | 10.71% | |

The key number (or bracket) to pay close attention to in your planning is \$31,850. This number is the bracket that potentially taxes net long-term capital gain income at 5%. But, before the gain is taxed at this special rate, all taxable ordinary income is applied to this bracket first. To the extent that taxable ordinary income does not exceed the \$31,850 bracket amount, the remaining bracket will be used to tax net long-term capital gain income at 5%. Any net long-term capital gain income exceeding the remaining \$31,850 bracket will be taxed at 15%.

Even if the child's taxable income does not benefit from the special 5% capital gain rate, the child still benefits from the lower tax brackets whereas in 2008 the parent's highest marginal rates will apply. Using the above example, the Federal tax in 2008 could be as high as \$11,000.

Please keep in mind that the above examples are very brief and for illustration purposes only. There are other variables that are not illustrated in the example, such as the impact from Alternative Minimum Taxes that could apply if certain conditions exist (i.e., high income, itemized deductions, AMT preference add-backs), and there are also nontax issues that should be analyzed in conjunction with the tax planning. If you need assistance with kiddie tax planning for your children, we urge you to contact us.

JONES and KOLB

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction(s) or tax-related matter(s) addressed herein.

Client UPDATE



Jones and Kolb
Certified Public Accountants
Ten Piedmont Center
Suite 100
Atlanta, Georgia 30305
(404) 262-7920
www.joneskolb.com

FALL 2007

Small Business Tax Act signed

President Bush signed the *Small Business and Work Opportunity Tax Act* on May 25, 2007. This law is part

of a larger bill that provides funds for the troops and increases the federal minimum wage over a two-year period to \$7.25.

To help offset the cost of the increased minimum wage, the law provides a number of tax breaks for businesses.

Some individual taxpayers may find their tax bills are increased by the revenue raising portions of the law.

Here's a brief overview of the tax changes:

■ The limit for the Section 179 election to expense business equipment purchases is immediately increased from \$112,000 to \$125,000, with the phase-out amount increased from \$450,000 to \$500,000.

■ The Work Opportunity Tax Credit for hiring certain disadvantaged workers was set to expire at the end of 2007. The new law extends the credit through August 31, 2011, and broadens the credit to include more veteran groups.

■ The FICA tip credit will continue to be based on the old \$5.15 minimum

wage even though the minimum wage increases to \$7.25 an hour.

■ Married couples who jointly operate an unincorporated business and who file a joint return may elect not to report their income as a partnership. Instead of filing a partnership return, they can each report their income on Schedule C of Form 1040.

■ The age limit for the "kiddie tax," the taxing of a child's unearned income above a certain amount at the parents' higher rate, is increased from age 18 to 19. For full-time students, the kiddie tax will apply until age 24. This change is effective for tax years beginning after May 25, 2007 – which for most taxpayers means the change will become effective in 2008.

Among other provisions in the law are tax incentives to help taxpayers recovering from Hurricane Katrina and some S corporation changes. If you would like to review how these recent changes might affect your business and personal tax planning, give us a call. ♦



Tax-cutting moves

2007

Time is running out on moves you can make to reduce your 2007 tax bill. Some actions to consider right now:

- Be sure to max out your 401(k) plan at work. This year you can sock away \$15,500 (\$20,500 if you're 50 or older).
- Establish a pension plan for your small business. You may qualify for a tax credit of up to \$500 in each of the plan's first three years.
- Make gifts to family or others to utilize your tax-free \$12,000 per donee gifting allowance for 2007.
- Plan year-end business equipment purchases to take full advantage of the increased expensing limit of \$125,000 for 2007.
- The option to deduct either sales taxes or state and local income taxes was reinstated for this year. If you plan to deduct sales tax, consider squeezing planned big-ticket purchases into 2007.
- Review your investments for possible year-end selling to rebalance your portfolio at the lowest tax cost or to offset gains and losses. ♦



An HSA might be the right prescription now

Health Savings Accounts (HSAs) are tax-sheltered accounts that, when combined with a high-deductible health insurance plan, allow a tax deduction for contributions made to the HSA. HSAs have been around for some time, but new legislation passed at the end of 2006 makes them an even more powerful tool with which to pay medical bills.

■ Deductible contributions

Essentially, the contribution to an HSA is deductible annually up to \$2,850 if you're single and \$5,650 if you're married. An additional \$800 can be contributed if you are 55 or older.

These deductions help to reduce your current income taxes. Funds withdrawn from the HSA to pay medical bills are not treated as taxable income to you. It's the best of all possible worlds: you receive a deduction for the contribution to the HSA and don't have to recognize income when qualified medical payments are made by the HSA.

■ Eligibility requirements

In order to qualify, you must participate in a high-deductible health policy (HDHP). This simply means that the deductible on your health policy can't be less than \$1,100 for self-only coverage and \$2,200 for family coverage.

These are minimum deductible limits, and you're free to participate in a health plan with higher limits and still qualify for an HSA. However, the maximum out-of-pocket expenses (including deductibles and co-payments, but not insurance premiums) can't be more than \$5,500 for self-only coverage or \$11,000 for family coverage. All of the limits noted are for 2007; these limits will be

adjusted for inflation in future years.

■ New rules

In addition to raising the HSA deduction limits, the 2006 legislation also changed two other rules.

You can now fund your HSA with IRA money. You can make a transfer of funds from an IRA to an HSA without realizing any income or penalties for such transfer.

Also, if your employer maintains a flexible spending account (FSA) or health reimbursement account (HRA), you can transfer these funds to an HSA. A transfer from an FSA could make a lot of sense when FSA contributions can't be used up and would otherwise be lost.

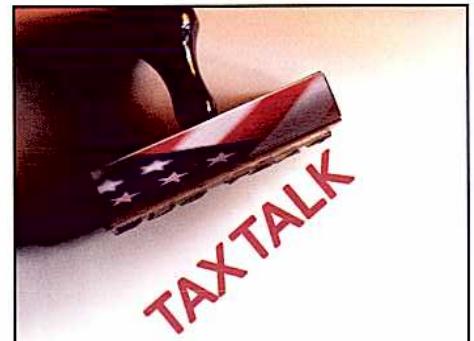
In both cases, the transfer can't exceed the annual contribution limits, and it can only be made once in your lifetime.

Many taxpayers will benefit from the changes in the HSA rules and should consider using an HSA to help control the cost of health care. If you need assistance in analyzing the use of an HSA in your situation, please call us. ♦

Yes, we are accepting new clients...

We are often asked if we have time to serve additional clients. We are a growing firm, and we would appreciate your referrals.

Please mention our name to friends and business associates who might need our services.



2007 depreciation limits

The IRS has issued the depreciation limits for business vehicles first placed in service in 2007. For passenger cars, the limits are \$3,060 for 2007, \$4,900 for 2008, \$2,850 for 2009, and \$1,775 for each year thereafter.

For light trucks and vans first placed in service in 2007, the limits are \$3,260 for 2007, \$5,200 for 2008, \$3,050 for 2009, and \$1,875 for each year thereafter.

No homeschooler deduction

The IRS says homeschooling parents cannot take the deduction educators are allowed for up to \$250 of classroom supplies they purchase with their own money.

The deduction is available only to teachers, instructors, counselors, principals, or aides who work at least 900 hours a school year in a public or private elementary or secondary school.

IRS launches audit program

Beginning this October, the IRS plans to audit about 13,000 individuals for tax year 2006 as part of a research project to update the Service's audit selection process. Audits will focus on those parts of the individual's tax return that cannot be verified through third-party information reports sent to the IRS.

If the program is extended for several years, as the IRS hopes, it will also provide information about the tax gap (the difference between taxes owed and taxes actually collected). ♦

Make the right choice in deducting car expenses

Taxpayers generally may use one of two methods for computing business car expenses: the actual cost method or the standard



rate method. The standard mileage rate may not be used in certain situations; the actual cost method may be used by any taxpayer.

■ Standard mileage

With the standard mileage method, you simply multiply your business miles driven during the year by the IRS's standard rate. The rate, which is set by the IRS each year, is 48.5¢ per mile for 2007. If you use the standard mileage deduction, you can also deduct related tolls, parking fees, and the business portion of interest expense on your car loan. (Interest expense is not deductible by employees.)



■ Actual cost

With the actual cost method, you can deduct the actual expenses of operating the car for business. These expenses include gas, tolls, insurance, parking, repairs, maintenance, registration and license fees, loan interest (except employees), and depreciation.

■ Recordkeeping

Regardless of the method you select, you need records to support the deduction. You'll need to keep track of your mileage under both methods, but the actual cost method requires more record-keeping than the standard mileage method.

Only the business portion of your total mileage is deductible. For example, if your business mileage is 15,000 and your total driving mileage is 20,000 this year, you can deduct 75% of your total automobile expenses if you choose the

actual cost method. If you choose the standard mileage method, you multiply your 15,000 miles of business driving by 48.5¢ a mile and deduct \$7,275.

■ Tax impact

You might be inclined to choose the standard mileage rate to simplify your recordkeeping, but before you opt for this method, consider the potential impact of each method on your tax bill. The price for using the mileage rate's simplicity may be lost deductions. If you drive often or long distances for business, or if your car expenses are high, the alternative actual cost method may be better.

If it's advantageous, you can switch to the actual cost method even if you started with the standard mileage rate. Be aware, however, that once you begin using the actual cost method on a vehicle, you can't switch to the standard mileage deduction for that vehicle. In making your decision, you should consider how long you'll keep the car and the estimated total tax savings under each method.

The rules governing business car deductions are full of exceptions and limitations. To be certain you use the method that's right for you – and that maximizes tax savings – give us a call. We can review your situation and your options with you. ♦

MARK YOUR CALENDAR...

SEPTEMBER

17 – Due date for individuals to pay third quarter installment of 2007 estimated tax.

17 – Due date for filing 2006 tax returns for calendar-year corporations that had an extension of the March 15 filing deadline.

OCTOBER

1 – Deadline for businesses to adopt a SIMPLE retirement plan for 2007.

15 – Filing deadline for 2007 individual tax returns on automatic six-month extension of the April 17 deadline.

15 – If you converted a regular IRA to a Roth IRA in 2006 and now want to switch back to a regular IRA, you have until this date to do so without penalty.

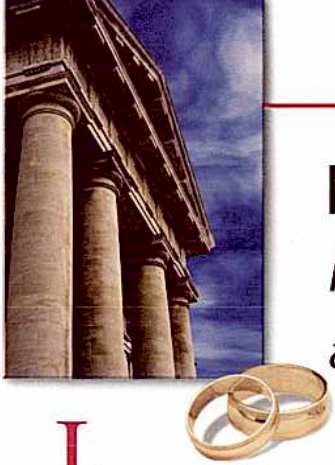
15 – Deadline for filing 2006 partnership and limited liability company returns on extension of the April 17 filing deadline.

NOVEMBER

During November – Estimate your 2007 income tax liability and review your options for minimizing your 2007 taxes. Call us to schedule a tax planning review. ♦

Marriage? Divorce?

Review your finances after a change in marital status



If you are getting married, divorced, or have recently lost your spouse, you certainly have a lot on your mind. While you may feel overwhelmed with all there is to do, it is important not to overlook financial matters when your marital status changes. Some actions you may want to consider include the following:

■ **Will.** Update your will and power of attorney if you have them. If you do not, hire a lawyer to draw them up for you.

■ **Life insurance.** Review your life insurance coverage. Given the recent events in your life, you may want to change your beneficiary and the amount of your coverage.

■ **Beneficiaries.** Review the beneficiaries you have named for your 401(k) and IRA plans. Make any changes that are appropriate given your new circumstances.

If you're getting married, review your combined contributions to 401(k) plans to make sure you're maximizing both employers' matching contributions.

■ **Withholding.** Adjust your Form W-4 (income tax withholding form) for your change in marital status and any change in the number of your dependents.

If you're getting married and both you and your spouse work, check to see if you will be affected by the marriage penalty. If so, you may need to adjust your payroll withholding.

■ **Health insurance.** Analyze your health insurance options. If you are getting married, you may be able to save money by joining your spouse's plan or by having your spouse join your plan.

If you are divorcing or have lost a spouse and have relied on him or her for health insurance, you should investigate the COBRA laws, which may allow you to retain your insurance coverage for up to 18 months.

■ **Disability insurance.** Consider purchasing disability insurance if someone will be dependent on you for financial support.

■ **Auto insurance.** Talk to your automobile insurance agent. If you are getting married, you may save money by combining separate policies. You may also qualify for a marriage discount.

■ **Prenup.** Consider a prenuptial agreement if you're getting married and you have children from a previous marriage or have substantial assets.

■ **Name and address.** Notify the Social Security Administration if you change your name. If you move, notify the IRS of your address change.

Getting your affairs in order after a change in marital status is an important step toward financial well-being. For any assistance you need, contact our office. We can help you sort through your options and find the right choices for your new situation. ♦

IRA charity option

A win-win strategy?

A recent change in the charitable contribution rules provides a potential tax planning opportunity involving your individual retirement account. If you're 70½ or older, you can make contributions of up to \$100,000 directly from your IRA to a qualified charity.

Charitable IRA distributions are withdrawals that are neither included in, nor deducted from, your taxable income. Better yet, such payments qualify as required minimum distributions (RMD) from your retirement account. Thus, if

you do not need the IRA distribution to live on, and you wish to make a donation, a charitable IRA rollover might be a win-win strategy.

Charitable rollovers also make sense when the inclu-

sion of the IRA distribution in your income would result in the phasing out of other deductions, such as personal exemptions or itemized deductions. Non-itemizers also benefit since the donated amount is excluded from their taxable income.

Keep in mind that there are unique restrictions on this type of gift. The IRA rollover cannot be contributed to a donor advised fund or supporting foundation. Also, if any benefit is received in exchange for the gift, such as dinner tickets, the entire distribution becomes taxable. As with any donation, the charity needs to provide you with a tax receipt containing all the proper substantiation for your contribution. Without it, the gift is disqualified. Also be aware that the donation must be made directly from the IRA to the charity and not paid to you first.

This provision is scheduled to expire this year, so now's the time to act. If you're interested in analyzing whether this option is a tax-smart move for you, give us a call. ♦



CLIENT UPDATE

This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details and/or professional assistance.