

What's New Supplement—Late Breaking News!

AMT Exemption Extended for 2007

On December 7, 2007, the United States Senate Committee on Finance released amendments they made to H.R. 3996, the "Tax Increase Prevention Act of 2007." The House of Representatives agreed to these amendments on December 19, 2007, and the President is expected to sign them into law.

AMT exemption amounts. The Senate version of H.R. 3996 increased the AMT exemption amounts as follows:

	2007
• Married filing jointly	\$66,250
• Single and Head of Household	\$44,350
• Married filing separately	\$33,125

Use these amounts to fill in the blank spaces for the 2007 column on page 1-4. If Congress does not pass similar legislation for tax year 2008, the AMT exemption amounts will drop back down to the following 2000 rates:

	2008
• Married filing joint.....	\$45,000
• Single and Head of Household	\$33,750
• Married filing separately	\$22,500

Personal credits and AMT. The Senate version of H.R. 3996 extended the provision that for tax year 2007 all nonrefundable personal credits allowed for regular tax are also allowed for AMT. Except for the adoption expense credit, child tax credit, and the retirement savings credit, which are allowed for AMT on a permanent basis, all other nonrefundable personal credits will no longer be allowed against AMT beginning in the 2008 tax year, unless similar legislation is passed for 2008. This information updates the information presented on page 14-4 under the heading "Personal Credits and AMT."

Provisions That Did *NOT* Make It...Yet

The House Ways and Means Committee released their version of H.R. 3996 on November 1, 2007, with the following provisions that are *not* included in the Senate version:

- An additional \$350 (\$700 MFJ) standard deduction for state and local real property taxes for taxpayers who claim the regular standard deduction.
- Lowering the refundable child tax credit threshold amount from \$11,750 to \$8,500.
- An exclusion from income for the discharge of acquisition indebtedness on a principal residence.
- A repeal of private tax collection contracts.
- A provision to recharacterize income by a partner for the performance of services as ordinary income, even if the income would otherwise be passed through to the partner as capital gain income.
- A provision to require brokers to include the taxpayer's basis and holding period of stock sales that are reported on Form 1099-B.

In addition, the following provisions set to expire after 2007 are *not* included in the Senate version:

- State and local sales tax deduction.
- Tuition and fees deduction.
- Qualified conservation contribution provision.
- Charitable contributions of IRA distributions provision.
- Educator expense deduction.

Latest Tax Law Changes Online

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- Combat pay election to treat as earned income for EIC purposes.
- Research and experimentation tax credit.
- 15-year recovery period for qualified leasehold improvements and qualified restaurant improvements.
- Enhanced charitable deduction by C corporations for contributions of food inventory, book inventory, and computer technology and equipment.
- Hurricane Katrina work opportunity tax credit.
- Mortgage insurance premiums deductible as mortgage interest.
- And other provisions...

See *Expiring Tax Provisions*, page 1-6, for other rules set to expire.

Updates. Some of these provisions may be included in future legislation. Visit our updates page at www.thetaxbook.com/updates.asp for the latest information on new tax law changes.

IRS Warns Return Processing Will Be Delayed

On November 8, 2007, the White House released a fact sheet warning Congress of the consequences if an AMT patch was not passed quickly. The fact sheet said: "From the date an AMT patch is enacted, the IRS estimates it will take 12–13 weeks to reprogram, test, and integrate the changes into the complex computer programs and systems that process tax returns." The fact sheet estimates that 50 million taxpayers will be affected by the delay, and that \$75 billion in refund checks will be held up as a result of the delay. Assuming the IRS can cut the delay to seven weeks, and the President signs the bill on December 19, 2007, the earliest the above referenced 50 million taxpayers could expect their returns to be processed by IRS would be the middle of February.

AMT—What Is It? Why Does It Threaten the Middle Class?

AMT is an alternative set of rules used to determine tax liability. It first came into existence as part of the Tax Reform Act of 1969. It was designed to target the rich. Lawmakers who introduced the concept cited a *Washington Post* article which reported that in 1967, 155 individuals with incomes over \$200,000 did not pay any federal income taxes, and that 20 of these individuals were millionaires. The reason why they paid zero tax was because they used legal tax loopholes to eliminate their tax. AMT was designed to close tax loopholes by imposing an "alternative" set of rules. If this "alternative" way of calculating tax results in a higher tax, then regular tax must be increased by AMT.

Why does AMT threaten the middle class? \$200,000 in 1967 equals \$1,200,550 in 2006, as adjusted for inflation. If AMT rules had stuck to their original purpose, they would only affect people who make in excess of \$1.2 million. Most tax rules are adjusted for inflation on an annual basis. AMT, however, is not automatically adjusted for inflation. Congress must pass new legislation each time they want to adjust AMT to reflect inflation.

Example of how middle class taxpayers are affected. Assume Jack and Jill are married and have six dependent kids, all under age 17. Their only deductions are the standard deduction and 8 personal exemptions (2 for Jack and Jill, and 6 for their kids). Their only source of income is Jack and Jill fetching pails of water for their employer. Their combined total W-2 income is \$90,933 for 2006. Their taxable income is \$54,233 (\$90,933 minus \$10,300 standard deduction minus \$26,400 personal exemptions). Regular income tax on \$54,233 per the tax tables equals \$7,379. Income subject to the AMT rate is \$28,383 (\$90,933 minus an AMT exemption of \$62,550). $\$28,383 \times 26\% = \$7,380$. AMT exceeds regular tax by \$1. Therefore, regular tax is increased by \$1. The standard deduction and personal exemptions are considered tax loopholes under AMT rules and are thus disallowed. The following chart shows the amount of W-2 income per tax year that will subject Jack and Jill to \$1 of AMT.

Tax Year	W-2 income is subject to \$1 of AMT at:	W-2 income adjusted for inflation	AMT exemption for married filing joint
2008	48,822	48,822	45,000
2007	97,814	97,814	66,250
2006	90,933	90,933	62,550
2005	81,922	84,707	58,000
2004	83,564	89,257	58,000
2003	84,518	91,991	58,000
2002	66,929	74,595	49,000
2001	73,825	83,597	49,000
2000	65,787	77,028	45,000
1999	66,564	80,042	45,000
1998	67,229	82,135	45,000

Notes: 2008 amounts apply if Congress does not make another adjustment to the AMT exemption amount. W-2 income adjusted for inflation is based on figures through the end of 2006.

Inflation. The chart above illustrates what happens when the AMT exemption is adjusted for inflation and what happens when it is not. In years where the AMT exemption stays the same (1998 through 2000, and 2003 through 2005), the threshold at which income is subject to AMT drops from one year to the next. That is because as regular tax rates drop due to the regular tax brackets being adjusted for inflation, AMT kicks in sooner. In years where the AMT exemption is increased (2006 to 2007), the threshold at which income is subject to AMT also increases. Comparing 2008 to 2000 illustrates how far down the pay scale AMT could reach in 2008 if Congress does not continue to keep the AMT exemption current with inflation. If 20 million new taxpayers would have been subject to AMT in 2007 if the exemption was allowed to drop to the 2000 rate, then the number affected in 2008 will be even higher if the exemption is allowed to drop back down to the 2000 rate.

AMT—Tax Software and Due Diligence Checklist

See the summary chart on page 14-2 for a list of income and deductions that may increase AMT liability. Tax software will automatically calculate AMT for some of the items included in that chart. Other items must be entered manually. For example, if the taxpayer exercised an incentive stock option, that information must be manually entered into the program's input data worksheet for AMT. In contrast, most professional tax software will transfer personal exemptions used for regular tax purposes to the input data worksheet for AMT. The following due diligence checklist for AMT is based on the function of a leading professional tax software program for the 2006 tax year. A check in the "Yes" box means the tax software will make the calculation automatically, assuming the proper entry was made in the input data worksheet for regular tax purposes. If the check box is blank, the tax professional should check to see if additional data must be manually entered for AMT purposes. Use the checklist for all tax returns where the taxpayer's gross income exceeds the AMT exemption amount.

Will the tax software automatically calculate the following? If not, did the tax preparer inquire about and manually enter any applicable information?	Yes
The standard deduction.	✓
Personal exemptions deduction.	✓
Medical and dental expenses deduction.	✓
Taxes paid deduction.	✓
Mortgage interest deduction.	
Miscellaneous itemized deductions.	✓
Tax refund reported on line 10 of Form 1040.	✓
Investment interest expense.	
Depletion deduction.	
Interest from private activity bonds—yes, if identified as such on the Schedule B input worksheet for regular tax purposes.	✓
Qualified small business stock—yes, if identified as such on the Schedule D input worksheet for regular tax purposes.	✓
Exercise of incentive stock options.	
Disposition of property—yes, if the asset entry worksheet is used properly for regular depreciation and sales purposes.	✓
Depreciation—yes, if the asset entry worksheet is used properly for regular depreciation purposes.	✓
Passive activity loss.	
At risk loss limitations.	
Circulation costs.	
Long-term contracts.	
Mining costs.	
Research and experimental costs.	
Income from installment sales.	
Intangible drilling costs.	
AMT net operating loss adjustments.	