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TAX AND BUSINESS Alert™

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New Tax Legislation Includes "AMT Patch"

Congress recently passed several tax bills, most notably the Tax Increase Prevention Act of 2007 (Tax Increase Prevention Act), which contained the so-called "AMT patch." AMT is the Alternative Minimum Tax, which was originally instituted to ensure the wealthiest citizens pay at least some federal income tax. Originally, only a few wealthy taxpayers (155 households) were required to pay the AMT. But over the years, as incomes have risen, the AMT has captured more and more taxpayers who don't consider themselves wealthy. This is because Congress never indexed the AMT exemption amounts for inflation; you don't pay the AMT unless your federal adjusted taxable income exceeds an exemption amount based on your filing status. In addition, the AMT exemption levels for 2007 were scheduled to be reduced to the lower (when compared with 2006) amounts available in 2000. In 2006, more than four million taxpayers found themselves paying the AMT. The reduction of the exemption levels to the amounts available in 2000 would have subjected more than 20 million additional taxpayers to the AMT in 2007.

Fortunately, Congress has postponed the AMT problem for an additional year by approving the AMT patch, a one-year fix that temporarily increases the AMT exemption amounts for 2007. Congress had to take this action to avoid the political fallout that would have resulted from millions of additional taxpayers being hit by the dreaded AMT. Hopefully, Congress will find a way to permanently fix the AMT problem and alleviate the annual showdown in Washington and the wrangling over how to solve the AMT problem.

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The Tax Increase Prevention Act also extended, for one additional year, the ability to offset your AMT liability with several personal tax credits. Thanks to the new law, the increased exemption and use of the personal tax credits will keep the number of AMT victims at about last year's level.

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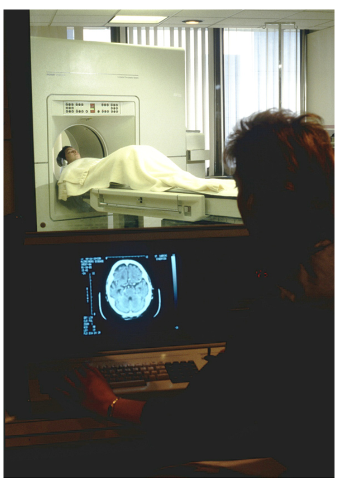
National Taxpayer Advocate Report

The Taxpayer Advocate Service is an independent arm of the IRS that assists taxpayers who are experiencing economic harm, who have tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. Nina Olson is the National Taxpayer Advocate, a tax attorney, and the only IRS employee authorized to make legislative proposals directly to Congress. She reports the top problems taxpayers are having with the IRS and offers suggestions on how these problems can be solved.

In her recent annual report to Congress, Ms. Olson focused attention on the consequences of late-year changes to the Internal Revenue Code (e.g., taxpayer confusion and delayed refunds). She also noted the need for a coordinated IRS approach to combat the cash economy portion of the tax gap. In addition, she urged Congress to enact another Taxpayer Bill of Rights and to authorize symbolic "apology payments" where taxpayers suffer significant harm as a result of IRS errors. Her report discussed problems facing taxpayers, made dozens of recommendations for administrative change, proposed recommendations for legislative change, and discussed the 10 tax issues most frequently litigated in the federal courts during the preceding fiscal year.

IRS Approves New Medical Deductions

Not all services performed by medical professionals are deductible as a medical expense (e.g., cosmetic surgery). Likewise, no deduction is allowed for nonprescription items that are merely beneficial to health. While it is fairly clear that expenses to treat or cure illness are incurred for medical reasons, it is less clear whether procedures or products are obtained for medical or personal reasons when the individual is not sick.



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Fortunately, the IRS recently gave the green light for deducting some fairly common medical expenses incurred by taxpayers who are not experiencing any symptoms of illness. The cost of a physical exam and the related lab fees are deductible, even though the taxpayer is not experiencing any symptoms of illness. The cost of a full-body scan, a relatively high-cost procedure, to possibly identify disease or other abnormalities that is performed by a technician without first obtaining a physician's recommendation or exploring less expensive alternatives is deductible. The cost of a pregnancy test kit is deductible even though its purpose is to test the healthy functioning of the body rather than to detect disease.

Keep in mind that medical expense deductions are subject to a limitation, and contact us if you have questions or concerns about deductible medical expenses.

Exchange Traded Fund (ETF) Information

The American Stock Exchange (AMEX) at *www.amex.com* is a great source for information on Exchange Traded Funds (ETFs) as well as other investment vehicles. Visitors to this website can easily locate ETF descriptions and information on performance, holdings, premiums and discounts, and distributions.

Term or Whole Life Insurance: Which Is Best?

The argument about whether to purchase term insurance or permanent insurance (e.g., whole life) has been around for years. So, we thought it would be a good time to review some of the key aspects of both. Keep in mind that there are other types of life insurance policies available, but these are two of the most commonly owned.

Term insurance provides protection for a specified period of time. Generally, there are two types of term life insurance: annually renewable term (where the premium increases each year) and level premium term (where the premium remains constant for a specified period of years). For example, if the policy is written for 10 years, it provides protection equal to the face amount of the policy for that period. At the end of the period, the coverage terminates, and the policy generally has no value. The principal appeal of term insurance is the low cost.

Term insurance is particularly useful for providing maximum protection for young families at low premium costs. It is also used to provide for the liquidation of a debt, such as a home mortgage, with the insurance amount decreasing as the mortgage gets smaller. Another use of a limited period policy would be to provide a college fund for children in case of the untimely death of the family wage earner. Once the children graduate from college, the policy will have served its purpose and can be canceled.

Some disadvantages of term insurance include higher premiums if the insured needs to renew the policy; the potential inability of the insured to renew the policy at the end of the term because of poor health; the fact that many term insurance policies never pay a death benefit because term policies frequently are allowed to expire; and the policy generally has no cash value.

Whole life is one of the three types of permanent or cash value life insurance (the others are universal and variable life). Whole life is the combination of a savings account (cash value) with insurance. The savings feature arises because, in the early years of a whole life policy, the annual level premium is more than enough to pay the current cost of the insurance protection. The excess premiums in early years and the effect of compound interest make up for the deficiency of premiums in later years when the annual level premium is no longer sufficient to pay for the cost of insurance. The funds accumulated in the early years are held by the insurer for the policyholder and provide the cash value aspect of the policy. Because the earnings being compounded inside the policy are not taxed to the owner of the policy, part of the premium is being paid with pretax dollars.

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Whole life premiums are fixed and usually invested in long-term bonds and mortgages as determined by the insurance company. A common axiom is, "buy term and save the difference." This may be a sound strategy; however, some folks are not good savers, although they do pay their bills. Since, in a whole life policy, the savings occurs through paying a bill, this is a means of forced savings. Also, the life insurance cash value grows on a tax-deferred basis.

Whole life is more expensive than term insurance, but the advantages of a whole life policy include guaranteed premiums, death benefits, and cash values; future uninsurability, old age, or other contingencies cannot terminate the policy; when the policyholder is older and no longer needs a large face amount of insurance protection, the policy can be cashed in; and the policyholder can borrow against the accumulated cash value at the interest rate indicated in the policy.

This information can be used to make a careful decision about life insurance based on your own personal needs and goals.

New Tax Legislation

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A second piece of legislation recently approved by Congress was the Mortgage Forgiveness Debt Relief Act of 2007 (Mortgage Relief Act). The crown jewel of the Mortgage Relief Act is a provision allowing taxpayers a new exclusion (from federal taxable income) for up to $2 million of principal residence mortgage forgiveness debt discharged in 2007 through 2009.

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Prior to the Mortgage Relief Act, this forgiven mortgage debt was classified as debt discharge income (DDI) and was taxable to the borrower unless an exception applied. This DDI could dramatically increase the tax liability for someone who had, for example, just lost their personal residence due to their inability to make their mortgage payments. Generally, this legislation will help victims of the ongoing mortgage crisis. This new exception only applies to debt that was used to acquire, construct, or improve the taxpayer's principal residence. Therefore, it won't help with DDI from home equity loans that were used for other purposes, nor will it help with DDI from vacation home mortgages.

In addition, the Mortgage Relief Act extended for three years the provision allowing qualifying taxpayers to deduct private mortgage insurance premiums, subject to specific limitations. This deduction, which was set to expire after 2007, will now be available through 2010.

The Mortgage Relief Act also liberalized the home sale gain exclusion for surviving spouses. As you may already know, you can exclude a home sale gain of up to $250,000 if you are unmarried, or up to $500,000 if you file jointly with your spouse. However, if you are an unmarried surviving spouse, you are not allowed to file a joint return for years after the year in which your spouse dies. Therefore, the larger $500,000 home sale gain exclusion was not available if you sold your principal residence in a year after the year of your spouse's death. Effective for sales after December 31, 2007, a provision in the Mortgage Relief Act allows an unmarried surviving spouse to take advantage of the larger $500,000 exclusion if the home sale occurs within two years after the spouse's death and all the other requirements for the $500,000 exclusion were met immediately before the spouse's death. Note that the two-year period starts on the deceased spouse's date of death. Therefore, a home sale that occurs in the second calendar year after the year of death, but more than 24 months after the date of death, will not qualify for the larger $500,000 exclusion.

We will continue to follow the AMT saga and keep you updated on any changes within this alternative tax system. As always, please call us if you have questions on this new tax legislation or any other tax compliance or planning issue.

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