

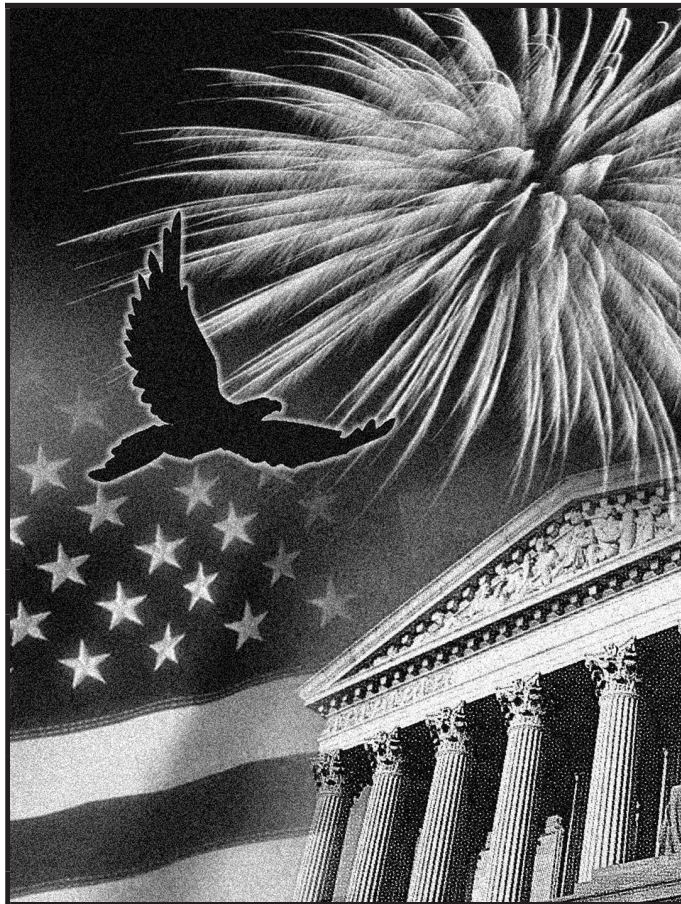


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# Highlights of 2007 Tax Changes



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## Introduction

This publication highlights major tax law changes that take effect in 2007, 2008, and later years. The chapters are divided into sections based on when the changes take effect.



*The tax information for 2008 and later years is accurate as of the time this publication went to print. Subsequent changes to the tax law may occur. For more information, go to [www.irs.gov/formspubs](http://www.irs.gov/formspubs).*

**Adjusting your withholding or estimated tax payments for 2008.** If your tax for 2008 will be more or less than your 2007 tax, you may need to adjust your withholding or estimated tax payments accordingly. If your tax will decrease, you can get the benefit of lower taxes throughout the year. If you will owe more tax, you can avoid a penalty when you file your tax return.

See the following table for forms and publications that will help you adjust your withholding or estimated tax payments. See chapter 7 for information on ordering forms and publications.

To adjust your...	Get Form...	And Publication...
Withholding	<b>W-4</b> , Employee's Withholding Allowance Certificate	<b>919</b> , How Do I Adjust My Tax Withholding?
Estimated tax payments	<b>1040-ES</b> , Estimated Tax for Individuals	<b>505</b> , Tax Withholding and Estimated Tax

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help

bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

**Comments and suggestions.** We welcome your comments about this publication and your suggestions for future editions.

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Although we cannot respond individually to each email, we do appreciate your feedback and will consider your comments as we revise our tax products.

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# 1.

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## Tax Changes for Individuals

**Note.** Some of the changes listed in this section apply to both individuals and businesses.

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### 2007 Changes

#### Economic Stimulus Payment

You may be entitled to an economic stimulus payment of up to \$600 (\$1,200 if married filing jointly). To get your payment, you only need to file a 2007 individual income tax return (Form 1040, 1040A, or 1040EZ). The IRS will determine whether you are eligible, figure the amount, and send you the payment. The IRS will begin sending the one-time payments in May 2008. The economic stimulus payment is in addition to any 2007 income tax refund, which will be made separately from this one-time payment.

Generally, the payment cannot be more than your 2007 net income tax liability (your regular tax liability plus any alternative minimum tax (AMT), minus any nonrefundable credits you claimed other than the child tax credit). However, your payment will be at least \$300 (\$600 if married

filing jointly) if you meet either of the following two conditions:

1. The total of your earned income, social security benefits (including social security disability payments), tier 1 railroad retirement benefits, certain veterans benefits, and nontaxable combat pay you elect to include in earned income is at least \$3,000, **or**
2. Your total income (Form 1040, line 22; Form 1040A, line 15; or Form 1040EZ, line 4) is more than \$8,750 if your filing status is single or married filing separately (\$11,250 if head of household; \$14,100 if qualifying widow(er); \$17,500 if married filing jointly), and your net income tax liability is more than zero.

If you meet either of these conditions, you can also get an additional \$300 for each of your children who is a qualifying child for the child tax credit.

You may be eligible to get a payment of \$300 (\$600 if married filing jointly) even if you are not required to file a return. However, you must file a return to get your payment.

To be eligible, you and your spouse each must have a valid social security number. To get the additional \$300 payment for a child, the child must have a valid social security number. You are not eligible to get a payment if you can be claimed as a dependent of another taxpayer, or if you file Form 1040NR, 1040NR-EZ, 1040-PR, or 1040-SS.

If your 2007 adjusted gross income (AGI) is more than \$75,000 (\$150,000 if married filing jointly), your payment will be reduced by 5% of your AGI in excess of that amount.

If you qualify to receive an economic stimulus payment, you will receive a notice shortly before the payment is made. For more information, visit the IRS website at [www.irs.gov](http://www.irs.gov) and click on “Rebate Questions?” at the top of the page.

#### Alternative Minimum Tax (AMT)

The following changes to the AMT went into effect for 2007. For more information, see Form 6251, Alternative Minimum Tax—Individuals, and its instructions.

**AMT exemption amount increased.** The AMT exemption amount has increased to \$44,350 (\$66,250 if married filing jointly or qualifying widow(er); \$33,125 if married filing separately).

**AMT exemption amount for a child increased.** The AMT exemption amount for a child under age 18 has increased to \$6,300.

**Hurricane Katrina additional exemption expired.** The additional exemption for taxpayers who provide housing for a person displaced by Hurricane Katrina has expired. Therefore, the additional exemption amount (formerly line 6 of Form 8914) is no longer allowable for the AMT.

**Deduction for qualified mortgage insurance premiums allowed for the AMT.** In most cases, no AMT adjustment is required for the deduction of qualified mortgage insurance premiums.

**Foreign Earned Income Tax Worksheet revised.** The *Foreign Earned Income Tax Worksheet* in the Form 6251 instructions has been revised to reflect changes made by the Tax Technical Corrections Act of 2007.

**Certain credits still allowed against AMT.** The special rule that allows the credit for child and dependent care expenses, credit for the elderly or the disabled, education credits, residential energy credits, mortgage interest credit, and the District of Columbia first-time homebuyer credit to be applied against the AMT was scheduled to expire at the end of 2006. However, Congress has extended the special rule through 2007, so those credits can be applied against the AMT for 2007.

## Standard Mileage Rate

**Business-related mileage.** For 2007, the standard mileage rate for the cost of operating your car for business use is 48½ cents per mile.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

**Medical- and move-related mileage.** For 2007, the standard mileage rate for the cost of operating your car for medical reasons or as part of a deductible move is 20 cents per mile. See *Transportation* under *What Medical Expenses Are Includible* in Publication 502, *Medical and Dental Expenses (Including the Health Coverage Tax Credit)* or *Travel by car* under *Deductible Moving Expenses* in Publication 521, *Moving Expenses*.

**Charitable-related mileage.** For 2007, the standard mileage rate for the cost of operating your car for charitable purposes remains 14 cents per mile.

## Earned Income Credit (EIC) Amounts Increased

The following paragraphs explain the changes to the credit for 2007. For details, see Publication 596, *Earned Income Credit (EIC)*.

**Amount of credit increased.** The maximum amount of the credit has increased. The most you can get is:

- \$2,853 if you have one qualifying child,
- \$4,716 if you have more than one qualifying child, or
- \$428 if you do not have a qualifying child.

**Earned income amount increased.** The maximum amount of income you can earn and still get the credit has increased. You may be able to take the credit if:

- You have more than one qualifying child and you earned less than \$37,783 (\$39,783 if married filing jointly),
- You have one qualifying child and you earned less than \$33,241 (\$35,241 if married filing jointly), or
- You do not have a qualifying child and you earned less than \$12,590 (\$14,590 if married filing jointly).

The maximum amount of AGI you can have and still get the credit also has increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

**Investment income amount increased.** The maximum amount of investment income you can have and still get the credit has increased to \$2,900.

**Advance payment of the credit.** If you get advance payments of the credit from your employer with your pay, the total advance payments you get during 2007 can be as much as \$1,712.

## Standard Deduction Amount Increased

The standard deduction for people who do not itemize deductions on Schedule A (Form 1040) is, in most cases, higher for 2007. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2007 Standard Deduction Tables* are shown in Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

## Personal Exemptions

The following changes apply for 2007.

**Exemption amount increased.** The amount you can deduct for each exemption has increased to \$3,400 for 2007.

You lose part of the benefit of your exemptions if your AGI is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2007, the phaseout begins at:

- \$117,300 for married persons filing separately,
- \$156,400 for single individuals,
- \$195,500 for heads of household, and
- \$234,600 for married persons filing jointly or qualifying widow(er)s.

You can lose no more than 2/3 of the dollar amount of your exemptions. In other words, each exemption cannot be reduced to less than \$1,133.

If your AGI is more than the amount shown for your filing status, use the *Deduction for Exemptions Worksheet* in the Form 1040 or Form 1040A instructions to figure the amount you can deduct for exemptions.



**Qualifying relative clarified.** A child is not the qualifying child of any other taxpayer and so may qualify as your qualifying relative if the child's parent (or other person for whom the child is defined as a qualifying child) is not required to file an income tax return and either:

- Does not file an income tax return, or
- Files a return only to get a refund of income tax withheld.

For details and examples, see *Qualifying Relative* in Publication 501.

This clarification of the definition of qualifying relative applies to 2005 and later years. If you did not claim an exemption you could have claimed in 2005 or 2006, you can claim it by filing Form 1040X. Generally, you must file Form 1040X within 3 years after the date you filed your original return or within 2 years after you paid the tax, whichever is later. See Form 1040X and its separate instructions.

## Exclusion From Income for Certain Cancellation of Debt on Principal Residence

You may be able to exclude from gross income a discharge of qualified principal residence indebtedness (defined below). This exclusion applies to discharges made after 2006 and before 2010. Additionally, the basis of your principal residence must be reduced (but not below zero) by the amount excluded from gross income. To claim the exclusion, you must file Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), with your tax return.

**Qualified principal residence indebtedness.** This is a mortgage you took out to buy, build, or substantially improve your principal residence. It also must be secured by your principal residence. If the amount of your original mortgage is more than the cost of your principal residence plus the cost of any substantial improvements, only the debt that is **not** more than the cost of your principal residence plus improvements is qualified principal residence indebtedness. Any debt that is secured by your principal residence you use to refinance qualified principal residence indebtedness is treated as qualified principal residence indebtedness, but only up to the amount of the old mortgage principal just before the refinancing. Any additional debt you used to substantially improve your principal residence is also treated as qualified principal residence indebtedness.

**Principal residence.** Your principal residence is the home where you ordinarily live most of the time. You can have only one principal residence at any one time.

**Amount eligible for the exclusion.** The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately). You cannot exclude from gross income discharge of qualified principal residence indebtedness if the discharge was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

**Ordering rule.** If only a part of a loan is qualified principal residence indebtedness, the exclusion applies only to the extent the amount discharged exceeds the amount of the loan (immediately before the discharge) that is **not** qualified principal residence indebtedness. For example, assume your principal residence is secured by a debt of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If your residence is sold for \$700,000 and \$300,000 of debt is discharged, only \$100,000 of the debt discharged may be excluded (the \$300,000 that was discharged minus the \$200,000 of nonqualified debt).

## Charitable Contributions

The following paragraphs explain the changes to charitable contributions for 2007. For details, see Publication 526, Charitable Contributions.

**New recordkeeping requirements for cash contributions.** You cannot deduct a cash contribution, regardless of the amount, unless you keep as a record of the contribution a bank record (such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount) or a written communication from the charity. The written communication must include the name of the charity, date of the contribution, and amount of the contribution.

**Contributions to donor advised funds.** You cannot deduct a contribution to a donor advised fund after February 13, 2007, if the sponsoring organization is a war veterans' organization, a fraternal society, or a nonprofit cemetery company. There are also other circumstances in which you cannot deduct your contribution to a donor advised fund. Generally, a donor advised fund is a fund or account in which a donor can, because of being a donor, advise the fund how to distribute or invest amounts held in the fund.

**Filing fee for easements on buildings in historic districts.** A new \$500 filing fee must be paid for each qualified conservation contribution after February 12, 2007, that is an easement on a building in a registered historic district, if the claimed deduction is more than \$10,000. See Form 8283-V, Payment Voucher for Filing Fee Under Section 170(f)(13).

## **New Form 8917, Tuition and Fees Deduction**

Beginning in 2007, in order to claim the tuition and fees deduction, you must complete Form 8917 and file it with Form 1040 or Form 1040A. Previously, a worksheet was provided to help taxpayers figure the amount of the deduction. See Form 8917 and chapter 6 of Publication 970, Tax Benefits for Education, for more information about the tuition and fees deduction.

## **Income Limits Increased for Student Loan Interest Deduction**

For 2007, the amount of the student loan interest deduction is phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified AGI is between \$110,000 and \$140,000. You cannot take the deduction if your modified AGI is \$140,000 or more.

For all other filing statuses, your student loan interest deduction is phased out if modified AGI is between \$55,000 and \$70,000. You cannot take a deduction if your modified AGI is \$70,000 or more. For more information, see chapter 4 in Publication 970.

## **Income Limits Increased for Hope and Lifetime Learning Credits**

For 2007, the amount of your Hope or lifetime learning credit is phased out (gradually reduced) if your modified AGI is between \$47,000 and \$57,000 (\$94,000 and \$114,000 if you file a joint return). You cannot claim an education credit if your modified AGI is \$57,000 or more (\$114,000 or more if you file a joint return). For more information, see chapters 2 and 3 in Publication 970.

## **Earned Income for Additional Child Tax Credit**

For 2007, the minimum earned income amount used to figure the additional child tax credit has increased to \$11,750.

## **Mortgage Insurance Premium Deduction**

You may be able to deduct mortgage insurance premiums you paid after 2006 and before 2011. The mortgage insurance must be paid in connection with home acquisition debt and the mortgage insurance contract must have been issued after 2006. You can deduct mortgage insurance premiums on Schedule A (Form 1040), line 13.

**Limit on deduction.** If your AGI is more than \$100,000 (\$50,000 if married filing separately), the amount of your mortgage insurance premiums that are otherwise deductible is reduced. You cannot deduct any mortgage insurance premiums if your AGI exceeds \$109,000 (\$54,500 if married filing separately).

For more information, see the instructions for Schedule A (Form 1040).

## **Limits Increased for Itemized Deductions**

If your AGI is above a certain amount, you may lose part of your itemized deductions. In 2007, this amount is increased to \$156,400 (\$78,200 if married filing separately). See the instructions for Schedule A (Form 1040), line 29, for more information on figuring the amount you can deduct.

## **Health Savings Accounts (HSAs)**

For more information on HSAs, see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

**High deductible health plan (HDHP).** For HSA purposes, the minimum annual deductible of an HDHP increased to \$1,100 (\$2,200 for family coverage) and the maximum annual deductible and other out-of-pocket expenses limit increased to \$5,500 (\$11,000 for family coverage).

**Limit on contributions.** Your contributions to your HSA are no longer limited to your annual health plan deductible. The maximum HSA contribution increased to \$2,850 (\$5,650 for family coverage). The maximum additional contribution for individuals age 55 or older increased to \$800.

**Last-month rule.** If you are an eligible individual on the first day of the last month of your tax year, you are treated as an eligible individual for the entire year for purposes of computing the amount you can contribute to your HSA.

**Transfers from a health reimbursement arrangement (HRA) or health flexible spending arrangement (FSA) to an HSA.** You may be able to request that your employer make a one-time transfer of the balance in your HRA or health FSA to your HSA.

**Transfers from an individual retirement account (IRA) to an HSA.** You may be able to exclude from your income a one-time qualified HSA funding distribution from your IRA.

**Comparable contributions by an employer.** For purposes of making contributions to the HSA of an employee who is not highly compensated, a comparable participating employee does not include a highly compensated employee.

## Child and Dependent Care Credit

The following paragraphs explain the changes to the credit for 2007. For details, see Publication 503, Child and Dependent Care Expenses.

**New definition of earned income.** When you figure your credit, your earned income can no longer include nontaxable employee compensation, such as voluntary salary deferrals or military basic quarters allowances. Generally, only taxable compensation is included. However, you can elect to include any nontaxable combat pay in earned income to figure your credit.



*You can choose to include your nontaxable combat pay in earned income when figuring your credit, even if you choose not to include it in earned income for the earned income credit (EIC) or the exclusion or deduction for dependent care benefits.*

**Temporary absence from work.** You can figure your credit using expenses for care during a short, temporary absence from work, such as for a vacation or minor illness, provided the care-giving arrangement requires you to pay for care during the absence. An absence of 2 weeks or less is a short, temporary absence. An absence of more than 2 weeks may be considered a short, temporary absence, depending on the circumstances.

**Part-time work.** If you work part-time and have to pay for care weekly, monthly, or in another way that includes both days worked and days not worked, you can figure your credit including the expenses paid for days not worked. Any day when you work at least 1 hour is a day of work.

## Adoption Benefits Increased

For 2007, the maximum adoption credit has increased to \$11,390. Also, the maximum exclusion from income for benefits under your employer's adoption assistance program has increased to \$11,390. These amounts are phased out if your modified AGI is between \$170,820 and \$210,820. You cannot claim the credit or exclusion if your

modified AGI is \$210,820 or more. See Form 8839, Qualified Adoption Expenses, and its instructions for more information.

## Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2007, the amount of your interest exclusion is phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified AGI is between \$98,400 and \$128,400. You cannot take the deduction if your modified AGI is \$128,400 or more.

For all other filing statuses, your interest exclusion is phased out if your modified AGI is between \$65,600 and \$80,600. You cannot take a deduction if your modified AGI is \$80,600 or more. For more information, see chapter 9 in Publication 970.

## Increase in Deductible Limit for Long-Term Care Premiums

For 2007, the maximum amount of qualified long-term care premiums you can include as medical expenses has increased. You can include qualified long-term care premiums, up to the amounts shown below, as medical expenses on Schedule A (Form 1040).

- Age 40 or under – \$290.
- Age 41 to 50 – \$550.
- Age 51 to 60 – \$1,110.
- Age 61 to 70 – \$2,950.
- Age 71 or over – \$3,680.

**Note.** The limit is for each person.

## Increase in Limit on Long-Term Care and Accelerated Death Benefits Exclusion

The limit on the exclusion for payments made on a *per diem* or other periodic basis under a long-term care insurance contract increased for 2007 to \$260 per day. The limit applies to the total of these payments and any accelerated death benefits made on a *per diem* or other periodic basis under a life insurance contract because the insured is chronically ill.

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

- The cost of qualified long-term care services during the period.

- The dollar amount for the period (\$260 per day for any period in 2007).

See Section C of Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and its instructions for more information.

## Archer Medical Savings Accounts (MSAs) Limits Increased

For MSA purposes, the minimum annual deductible of a high deductible health plan increased to \$1,900 (\$3,750 for family coverage). The maximum annual deductible of a high deductible health plan increased to \$2,850 (\$5,650 for family coverage). The maximum out-of-pocket expenses limit increased to \$3,750 (\$6,900 for family coverage).

## Credit for Prior Year Minimum Tax

The following changes to the credit for prior year minimum tax went into effect for 2007. For more information, see Form 8801, Credit for Prior Year Minimum Tax—Individuals, Estates, and Trusts, and its instructions.

**Refundable credit for prior year minimum tax.** If you have any unused minimum tax credit carryforward from 2004 or earlier years, you may qualify for a refund of part or all of that credit amount, even if the amount of your current year credit is more than your total tax liability. To figure your current year refundable credit, complete Part IV of Form 8801. Estates and trusts may not claim the refundable credit.

**Foreign Earned Income Tax Worksheet.** If you claimed the foreign earned income exclusion or the housing exclusion for 2006 on Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion, you must use the Foreign Earned Income Tax Worksheet on page 2 of the Instructions for Form 8801 to figure the amount to enter on Form 8801, line 11.

## New Form 8919, Uncollected Social Security and Medicare Tax on Wages

If you were an employee but your employer treated you as an independent contractor, use new Form 8919 to figure and report your share of uncollected social security and Medicare taxes due on your wages. **Do not** use Form 4137, Social Security and Medicare Tax on Unreported Tip Income, for this purpose. By using Form 8919, your social security and Medicare taxes also will be credited to your social security record. For more information, see Form 8919.

## Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2007 is \$97,500. There is no limit on the amount of wages subject to the Medicare tax.

## Federal Telephone Excise Tax Credit

This credit was available only on your 2006 return. If you filed but did not request it on your 2006 return, file Form 1040X, Amended U.S. Individual Income Tax Return, using a simplified procedure explained in its instructions to amend your 2006 return. If you were not required to file a 2006 return, see the 2006 Form 1040EZ-T, Request for Refund of Federal Telephone Excise Tax.

## Changes to the Instructions for Form 1040 and Form 1040NR

As a result of the Tax Technical Corrections Act of 2007, the following instructional changes apply when completing the 2007 Form 1040 (or Form 1040NR). The paper and online versions of Form 1040 (and Form 1040NR) and instructions will not be revised.

- The tax from Form 8889, Health Savings Accounts (HSAs), Part III (relating to health savings accounts) that was to be reported on Form 1040, line 44 (or Form 1040NR, line 41), using checkbox “c” must instead be included in the total on Form 1040, line 63 (or Form 1040NR, line 58), as an additional write-in tax. On the dotted line next to Form 1040, line 63 (or Form 1040NR, line 58), enter “HDHP” and the amount of this tax.
- The additional tax on recapture of a charitable contribution of a fractional interest in tangible personal property that was to be included on Form 1040, line 44 (or Form 1040NR, line 41), must instead be included in the total on Form 1040, line 63 (or Form 1040NR, line 58), as an additional write-in tax. On the dotted line next to Form 1040, line 63 (or Form 1040NR, line 58), enter “FITPP” and the amount of this tax.
- All filers of Forms 2555 or 2555-EZ must figure their tax using the Foreign Earned Income Tax Worksheet at the top of the next page instead of the worksheet on page 34 of the Instructions for Form 1040.



# Foreign Earned Income Tax Worksheet—

## Line 44

Keep for Your Records



**Before you begin:** ✓ If Form 1040, line 43, is zero, do not complete this worksheet.

- |  |    |       |
|--|----|-------|
| 1. Enter the amount from Form 1040, line 43 . . . . .  | 1. | _____ |
| 2. Enter the amount from your (and your spouse's, if filing jointly) Form 2555, line 45, or Form 2555-EZ, line 18 . . . . .  | 2. | _____ |
| 3. Add lines 1 and 2 . . . . .   | 3. | _____ |
| 4. <b>Tax on the amount on line 3.</b> Use the Tax Table, Tax Computation Worksheet, Qualified Dividends and Capital Gain Tax Worksheet*, Schedule D Tax Worksheet*, or Form 8615, whichever applies. See the instructions for Form 1040, line 44, to see which tax computation method applies . . . . . | 4. | _____ |
| 5. <b>Tax on the amount on line 2.</b> Use the Tax Table or Tax Computation Worksheet, whichever applies . . . . .   | 5. | _____ |
| 6. Subtract line 5 from line 4. Enter the result. If zero or less, enter -0-. Also include this amount on Form 1040, line 44 . . . . .   | 6. | _____ |

*\*Enter the amount from line 3 above on line 1 of the Qualified Dividends and Capital Gain Tax Worksheet or Schedule D Tax Worksheet if you use either of those worksheets to figure the tax on line 4 above. Complete the rest of that worksheet through line 6 (line 10 if you use the Schedule D Tax Worksheet). Next, you must determine if you have a capital gain excess. To find out if you have a capital gain excess, subtract Form 1040, line 43, from line 6 of your Qualified Dividends and Capital Gain Tax Worksheet (line 10 of your Schedule D Tax Worksheet). If the result is more than zero, that amount is your capital gain excess.*

*If you do not have a capital gain excess, complete the rest of either of those worksheets according to the worksheet's instructions. Then complete lines 5 and 6 above.*

*If you have a capital gain excess, complete a second Qualified Dividends and Capital Gain Tax Worksheet or Schedule D Tax Worksheet (whichever applies) as instructed above but in its entirety and with the following additional modifications. Then complete lines 5 and 6 above. These modifications are to be made only for purposes of filling out the Foreign Earned Income Tax Worksheet above.*

- 1. Reduce the amount you would otherwise enter on line 3 of your Qualified Dividends and Capital Gain Tax Worksheet or line 9 of your Schedule D Tax Worksheet (but not below zero) by your capital gain excess.*
- 2. Reduce the amount you would otherwise enter on Form 1040, line 9b, (but not below zero) by any of your capital gain excess not used in (1) above.*
- 3. Reduce the amount on your Schedule D (Form 1040), line 18, (but not below zero) by your capital gain excess.*
- 4. Include your capital gain excess as a loss on line 16 of your Unrecaptured Section 1250 Gain Worksheet on page D-9 of the Instructions for Schedule D (Form 1040).*

## Capital Asset Treatment for Self-Created Musical Works

Musical compositions and copyrights in musical works are generally not capital assets. However, you can elect to treat these types of property as capital assets if you sell or exchange them in tax years beginning after May 17, 2006, and:

- Your personal efforts created the property, or
- You acquired the property under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

See chapter 4 in Publication 550, Investment Income and Expenses.

## Whistleblower Fees

If you receive an award from the IRS for information you provided after December 19, 2006, that substantially contributes to the detection of violations of tax laws by the IRS, you may be able to deduct attorney fees and court costs paid by you in connection with the award as an adjustment

to income, up to the amount of the award includible in your gross income.

## Vacant Land Used as Part of Main Home Destroyed by a Hurricane

You may qualify to exclude from income gain from the sale of vacant land you owned and used as part of your main home that was destroyed by Hurricanes Katrina, Rita, or Wilma, if you sell the vacant land within 3 years (instead of 2 years) from the date of destruction. For more information, see Publication 523, Selling Your Home.

## Special Rules for Owners of Cooperative Apartments

If you own a cooperative apartment, you generally receive the same tax treatment as other homeowners. However, some special rules apply to you. In order for you to deduct your share of the corporation's deductible real estate taxes, the cooperative housing corporation in which you own shares must meet certain conditions. Those conditions were expanded for tax years ending after December 20, 2007. For those conditions, see *Special Rules for*



*Cooperatives* in Publication 530, Tax Information for First-Time Homeowners.

## Sale of Main Home by Employees of the Intelligence Community

If you are an employee of the intelligence community, you may be able to exclude from income a gain from selling your main home, even if you did not live in it for the required 2 years during the 5-year period ending on the date of sale. You can choose to have the 5-year test period for ownership and use suspended during any period you or your spouse serve on qualified official extended duty as an employee of the intelligence community at a duty station located outside of the United States. This choice applies to any sale of a main home after December 20, 2006. For more information, see *Members of the uniformed services or Foreign Service or employees of the intelligence community* under *Period of Ownership and Use* in Publication 523.

## Conflict-of-Interest Sales

If you are a judicial officer and you sell property at a gain after December 20, 2006, according to a certificate of divestiture issued by the Judicial Conference of the United States (or its designee) and purchase replacement property (permitted property) within 60 days after the sale, you may elect to defer part or all of the realized gain. This election also applies to sales by certain persons related to the judicial officer and to sales by trustees of certain trusts in which the judicial officer or related person has a beneficial interest.

**Judicial officer.** Judicial officers are the following.

1. Chief Justice of the United States.
2. Associate Justices of the Supreme Court.
3. Judges of the:
  - a. United States courts of appeals,
  - b. United States district courts, including the district courts in Guam, the Northern Mariana Islands, and the Virgin Islands,
  - c. Court of Appeals for the Federal Circuit,
  - d. Court of International Trade,
  - e. Tax Court,
  - f. Court of Federal Claims,
  - g. Court of Appeals for Veterans Claims,
  - h. Court of Appeals for the Armed Forces, and
  - i. Any court created by an Act of Congress, the judges of which are entitled to hold office during good behavior.

**Permitted property.** Permitted property is any obligation of the United States or any diversified investment fund approved by regulations issued by the Office of Government Ethics.

**Reporting of sales.** Report these sales on Part IV of Form 8824, Like-Kind Exchanges. You can also see Form 8824 for additional information.

## Penalty for Filing Erroneous Claim for Refund or Credit

You may have to pay a penalty if, after May 25, 2007, you file an erroneous claim for refund or credit. The penalty is equal to 20% of the disallowed amount of the claim, unless you can show a reasonable basis for the way you treated an item. The penalty will not be figured on any part of the disallowed amount of the claim that relates to the earned income credit or on which the accuracy-related or fraud penalties are charged.

## Dishonored Check Penalty Increased

If your check or money order for payment of tax is not honored by your bank (or other financial institution) and the IRS does not receive the funds, you still owe the tax. In addition, you may be subject to a dishonored check penalty equal to 2 percent of the amount of the check. However, if the check is less than \$1,250, then the penalty is the lesser of \$25 or the amount of the check.

## Penalty for Frivolous Tax Submissions Increased

The IRS has published a list of positions that are identified as frivolous. The penalty for filing a frivolous tax return is \$5,000. A frivolous return is one that does not include enough information to figure the correct tax or that contains information clearly showing that the tax you reported is substantially incorrect. You will have to pay the penalty if you filed this kind of return because of a frivolous position on your part or a desire to delay or interfere with the administration of federal income tax laws. Also, the \$5,000 penalty applies to other specified frivolous submissions. For more information and a list of positions identified as frivolous, see Notice 2008-14, 2008-4 I.R.B. 310, available at [www.irs.gov/irb/2008-04\\_IRB/ar12.html](http://www.irs.gov/irb/2008-04_IRB/ar12.html).

## Expired Tax Benefits

**Relief granted for Hurricanes Katrina, Rita, and Wilma.** The following tax benefits have expired and will not apply for 2007.

- Tax-favored treatment of qualified hurricane distributions from eligible retirement plans.

- Increased limits and delayed repayment on loans from qualified employer plans.
- Special rules so a temporary relocation did not affect whether you provided more than half of an individual's support, whether you furnished more than half the cost of keeping up a household, and whether you could treat an individual as a student.
- Increased limits and an expanded definition of qualified education expenses for the Hope and lifetime learning credits.
- Additional exemption for housing individuals displaced by Hurricane Katrina.
- Exclusion from income for discharge of nonbusiness debt by reason of Hurricane Katrina.

**Qualified electric vehicle credit.** You cannot claim this credit for any vehicle you placed in service after 2006.

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## 2008 Changes

### Recovery Rebate Credit

For 2008, you generally can claim a recovery rebate credit of up to \$600 (\$1,200 if married filing jointly). Generally, the credit cannot be more than your 2008 net income tax liability (your regular tax liability plus any AMT, minus any nonrefundable credits you claimed other than the child tax credit). However, your credit will be at least \$300 (\$600 if married filing jointly) if you meet either of the following two conditions:

1. The total of your earned income, social security benefits (including social security disability payments), tier 1 railroad retirement benefits, certain veterans benefits, and nontaxable combat pay you elect to include in earned income is at least \$3,000, **or**
2. Your total income is more than \$8,950 if your filing status is single or married filing separately (\$11,500 if head of household; \$14,400 if qualifying widow(er); \$17,900 if married filing jointly), and your net income tax liability is more than zero.

If you meet either of these conditions, you can also get an additional \$300 for each of your children who is a qualifying child for the child tax credit.

To be eligible, you and your spouse each must have a valid social security number. To get the additional \$300 credit for a child, the child must have a valid social security number. You are not eligible to get a payment if you can be claimed as a dependent of another taxpayer, or if you file Form 1040NR, 1040NR-EZ, 1040-PR, or 1040-SS.

If your 2008 AGI is more than \$75,000 (\$150,000 if married filing jointly), your credit will be reduced by 5% of your AGI in excess of that amount.

**Credit reduced or eliminated by economic stimulus payment.** Your credit is reduced by any economic stimulus payment you received in 2008. However, if your credit is less than the stimulus payment you received, you do not have to repay the difference.

### Alternative Minimum Tax (AMT)

The following changes to the AMT went into effect for 2008.

**AMT exemption amount decreased.** The AMT exemption amount has decreased to \$33,750 (\$45,000 if married filing jointly or qualifying widow(er); \$22,500 if married filing separately).

**AMT exemption amount for a child increased.** The AMT exemption amount for a child whose unearned income is taxed at the parent's tax rate has increased to \$6,400.

**Certain credits no longer allowed against the AMT.** The credit for child and dependent care expenses, credit for the elderly or the disabled, education credits, residential energy credits, mortgage interest credit, and the District of Columbia first-time homebuyer credit are no longer allowed against the AMT, and a new tax liability limit applies. This limit is your regular tax minus any tentative minimum tax (figured without any AMT foreign tax credit).

### Maximum Tax Rate on Qualified Dividends and Net Capital Gain Reduced

For tax years beginning after 2007, the 5% maximum tax rate on qualified dividends and net capital gain (the excess of net long-term capital gain over net short-term capital loss) is reduced to 0%. This reduction applies for both regular tax and AMT. The 15% maximum tax rate on qualified dividends and net capital gain has not changed.

### Investment Income of Children Under a Certain Age

**Increase in age of children whose investment income is taxed at parent's rate.** The rules regarding the age of a child whose investment income may be taxed at the parent's tax rate will change for 2008. Form 8615 is used to figure the child's tax. These rules will continue to apply to a child under age 18 at the end of the year but, beginning in 2008, will also apply to:

- A child who is age 18 at the end of the year and whose earned income is not more than half of the child's support, and
- A student who is under age 24 at the end of the year and whose earned income is not more than half of the child's support.

These rules also apply to parents who elect on Form 8814 to report their children's income on their own returns.

A student is a child who during any part of 5 calendar months of the year was enrolled as a full-time student at a school, or took a full-time, on-farm training course given by a school or a state, county, or local government agency. A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence school, or school offering courses only through the Internet.

**Increase in investment income amount.** The amount of taxable investment income these children can have without it being subject to tax at the parent's rate has increased to \$1,800 for 2008.

## Standard Mileage Rate

**Business-related mileage.** For 2008, the standard mileage rate for the cost of operating your car for business use is 50½ cents per mile.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463.

**Medical- and move-related mileage.** For 2008, the standard mileage rate for the cost of operating your car for medical reasons or as part of a deductible move is 19 cents per mile. See *Transportation* under *What Medical Expenses Are Includible* in Publication 502 or *Travel by car* under *Deductible Moving Expenses* in Publication 521.

**Charitable-related mileage.** For 2008, the standard mileage rate for the cost of operating your car for charitable purposes remains 14 cents per mile.

## Earned Income Credit

The following paragraphs explain the changes to the credit for 2008.

**Amount of credit increased.** The maximum amount of the credit has increased. The most you can get is:

- \$2,917 if you have one qualifying child,
- \$4,824 if you have more than one qualifying child, or
- \$438 if you do not have a qualifying child.

**Earned income amount increased.** The maximum amount of income you can earn and still get the credit has increased for 2008. You may be able to take the credit if:

- You have more than one qualifying child and you earn less than \$38,646 (\$41,646 if married filing jointly),
- You have one qualifying child and you earn less than \$33,995 (\$36,995 if married filing jointly), or

- You do not have a qualifying child and you earn less than \$12,880 (\$15,880 if married filing jointly).

The maximum amount of AGI you can have and still get the credit also has increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

**Investment income amount increased.** The maximum amount of investment income you can have and still get the credit has increased to \$2,950 for 2008.

**Advance payment of the credit.** If you get advance payments of the credit from your employer with your pay, the total advance payments you get during 2008 can be as much as \$1,750.

**Nontaxable combat pay election.** The election to include your nontaxable combat pay in earned income when you figure your credit has expired and will not apply for 2008.

## Standard Deduction Amount Increased

The standard deduction for people who do not itemize deductions on Schedule A (Form 1040) is, in most cases, higher for 2008 than it was for 2007. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2008 Standard Deduction Tables* are shown in Publication 505, Tax Withholding and Estimated Tax.

## Personal Exemption Amount Increased

The amount you can deduct for each exemption has increased to \$3,500 for 2008.

You lose part of the benefit of your exemptions if your AGI is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2008, the phaseout begins at:

- \$119,975 for married persons filing separately,
- \$159,950 for single individuals,
- \$199,950 for heads of household, and
- \$239,950 for married persons filing jointly or qualifying widow(er)s.

Beginning in 2008, you can lose no more than 1/3 of the dollar amount of your exemptions. In other words, each exemption cannot be reduced to less than \$2,333.

See Publication 505 for more information on figuring the amount you can deduct.



## Income Limits Increased for Student Loan Interest Deduction

For 2008, the amount of the student loan interest deduction is phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified AGI is between \$115,000 and \$145,000. You cannot take the deduction if your modified AGI is \$145,000 or more.

For all other filing statuses, your student loan interest deduction is phased out if modified AGI is between \$55,000 and \$70,000. You cannot take a deduction if your modified AGI is \$70,000 or more. For more information, see chapter 4 in Publication 970.

## Hope and Lifetime Learning Credits

Beginning in 2008, the following changes apply to the Hope and lifetime learning (education) credits. For more information, see chapters 2 and 3 in Publication 970.

**Income limits for credit reduction increased.** For 2008, the amount of your Hope or lifetime learning credit is phased out (gradually reduced) if your modified AGI is between \$48,000 and \$58,000 (\$96,000 and \$116,000 if you file a joint return). You cannot claim an education credit if your modified AGI is \$58,000 or more (\$116,000 or more if you file a joint return).

**Hope credit.** Beginning in 2008, the amount of the Hope credit (per eligible student) is the sum of:

1. 100% of the first \$1,200 of qualified education expenses you paid for the eligible student, and
2. 50% of the next \$1,200 of qualified education expenses you paid for that student.

The maximum amount of Hope credit you can claim in 2008 is \$1,800 per student.

## Earned Income for Additional Child Tax Credit

For 2008, the minimum earned income amount used to figure the additional child tax credit has increased to \$12,050.

## Limits Increased for Itemized Deductions

If your AGI is above a certain amount, you may lose part of your itemized deductions. In 2008, this amount is increased to \$159,950 (\$79,975 if married filing separately). Beginning in 2008, the amount by which these itemized deductions are reduced is only  $\frac{1}{3}$  of the amount of the reduction that otherwise would have applied. See Publication 505 for more information on figuring the amount you can deduct.

## Exclusion on Sale of Main Home by Surviving Spouse

For sales after 2007, the maximum exclusion on the sale of a main home by an unmarried surviving spouse is \$500,000 if the sale occurs no later than 2 years after the date of the other spouse's death. However, this rule applies only if the requirements for joint filers relating to ownership and use were met immediately before the date of such death, and during the 2-year period ending on the date of such death, there was no sale or exchange of a main home by either spouse which qualified for the exclusion.

## Health Savings Accounts (HSAs)

**High deductible health plan (HDHP).** For HSA purposes, the minimum annual deductible of an HDHP remains at \$1,100 (\$2,200 for family coverage) and the maximum annual deductible and other out-of-pocket expenses limit increases to \$5,600 (\$11,200 for family coverage).

**Limit on contributions.** The maximum HSA contribution increases to \$2,900 (\$5,800 for family coverage). The maximum additional contribution for individuals age 55 or older increases to \$900.

## Adoption Benefits Increased

For 2008, the maximum adoption credit has increased to \$11,650. Also, the maximum exclusion from income for benefits under your employer's adoption assistance program has increased to \$11,650. These amounts are phased out if your modified AGI is between \$174,730 and \$214,730. You cannot claim the credit or exclusion if your modified AGI is \$214,730 or more.

## Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2008, the amount of your interest exclusion is phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified AGI is between \$100,650 and \$130,650. You cannot take the deduction if your modified AGI is \$130,650 or more.

For all other filing statuses, your interest exclusion is phased out if your modified AGI is between \$67,100 and \$82,100. You cannot take a deduction if your modified AGI is \$82,100 or more. For more information, see chapter 9 in Publication 970.

## Increase in Deductible Limit for Long-Term Care Premiums

For 2008, the maximum amount of qualified long-term care premiums you can include as medical expenses has increased. You can include qualified long-term care premiums, up to the amounts shown below, as medical expenses on Schedule A (Form 1040).

- Age 40 or under – \$310.
- Age 41 to 50 – \$580.
- Age 51 to 60 – \$1,150.
- Age 61 to 70 – \$3,080.
- Age 71 or over – \$3,850.

**Note.** The limit is for each person.

## Increase in Limit on Long-Term Care and Accelerated Death Benefits Exclusion

The limit on the exclusion for payments made on a *per diem* or other periodic basis under a long-term care insurance contract increases for 2008 to \$270 per day. The limit applies to the total of these payments and any accelerated death benefits made on a *per diem* or other periodic basis under a life insurance contract because the insured is chronically ill.

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

- The cost of qualified long-term care services during the period.
- The dollar amount for the period (\$270 per day for any period in 2008).

## Archer Medical Savings Accounts (MSAs) Limits Increased

For Archer MSA purposes for 2008, the minimum annual deductible of a high deductible health plan increases to \$1,950 (\$3,850 for family coverage). The maximum annual deductible of a high deductible health plan increases to \$2,900 (\$5,800 for family coverage). The maximum out-of-pocket expenses limit increases to \$3,850 (\$7,050 for family coverage).

## Credit for Prior Year Minimum Tax

The following changes to the credit for prior year minimum tax go into effect for 2008.

**Refundable credit for prior year minimum tax.** Beginning in 2008, your current year refundable credit (before the AGI phaseout) cannot be less than your prior year refundable credit (before the AGI phaseout). For 2007, your refundable credit before the AGI phaseout is on line 55 of Form 8801.

**Foreign Earned Income Tax Worksheet revised.** The *Foreign Earned Income Tax Worksheet* in the Form 8801 instructions will be revised to reflect changes made by the Tax Technical Corrections Act of 2007.

## Exclusion of Income for Volunteer Firefighters and Emergency Medical Responders

For tax years beginning after 2007 and before 2011, gross income does not include:

- Rebates or reductions of property or income taxes provided by a state or local government for providing services as a member of a qualified emergency response organization (defined below). Any such rebate or reduction reduces the amount of the income tax deduction for such taxes.
- Qualified payments made by a state or local government for providing services as a member of a qualified emergency response organization. The exclusion is limited to \$30 multiplied by the number of months the member performs such services. A charitable deduction for expenses paid by the member in connection with performing such services must be reduced by any payment excluded from income.

A qualified volunteer emergency response organization is any volunteer organization organized and operated to provide firefighting or emergency medical services for persons in a state or local jurisdiction and required by written agreement with that state or local jurisdiction to furnish such services.

## Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2008 is \$102,000. There is no limit on the amount of wages subject to the Medicare tax.

## Wage Threshold for Household Employees

The social security and Medicare wage threshold for household employees is \$1,600 for 2008. This means that if you pay a household employee cash wages of less than \$1,600 in 2008, you do not have to report and pay social security and Medicare taxes on that employee's 2008 wages. For more information, see *Social security and Medicare wages* in Publication 926, Household Employer's Tax Guide.

## Expired Tax Benefits

In addition to those mentioned earlier, the following tax benefits have expired and will not apply for 2008.

- Deduction for educator expenses in figuring AGI.
- Tuition and fees deduction.
- Deduction for state and local general sales taxes.
- District of Columbia first-time homebuyer credit (for homes purchased after 2007).
- Nonbusiness energy property credit.
- The increased limit on a deduction for a qualified conservation contribution from 30% of AGI to 50% of AGI (100% of AGI for certain farmers and ranchers).



*At the time this publication went to print, Congress was expected to consider legislation that would reinstate many of these benefits. To find out if legislation is enacted, go to [www.irs.gov](http://www.irs.gov), click on More Forms and Publications, and then on What's Hot in forms and publications.*

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# Tax Changes for Businesses

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## 2007 Changes

### Depreciation and Section 179 Deduction

**Increased section 179 limits.** The maximum section 179 deduction you can elect for qualified section 179 property you placed in service in 2007 has increased to \$125,000

(\$160,000 for qualified enterprise zone property and qualified renewal community property). This limit is reduced by the amount by which the cost of section 179 property placed in service in the tax year exceeds \$500,000. For qualified section 179 Gulf Opportunity (GO) Zone property, the maximum deduction is higher than the deduction for most other section 179 property. See chapter 2 of Publication 946, How to Depreciate Property.

**Depreciation limits on business vehicles.** The total depreciation deduction (including the section 179 deduction) you can take for a passenger automobile (that is not a truck or a van) you use in your business and first placed in service in 2007 is \$3,060. The maximum deduction you can take for a truck or a van you use in your business and first placed in service in 2007 is \$3,260. See *Maximum Depreciation Deduction* in chapter 5 of Publication 946.



*These limits are reduced if the business use of the vehicle is less than 100%.*

**Limited applicability of the special depreciation allowance for Liberty Zone property.** The special depreciation allowances for qualified New York Liberty Zone property does not apply to most property placed in service after 2006. However, if you placed qualified nonresidential real property or qualified residential rental property in service during the tax year, you may still be able to claim the special depreciation allowance. See chapter 3 of Publication 946 and the 2007 Instructions for Form 4562.

## Self-Employment Tax

The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2007 is \$97,500. All net earnings of at least \$400 are subject to the Medicare part of the tax.

## Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2007 is \$97,500. There is no limit on the amount of wages subject to the Medicare tax.

## Husband-Wife Business

Generally, if you and your spouse jointly own and operate an unincorporated business and share in the profits and losses, you are partners in a partnership and you must file Form 1065, U.S. Return of Partnership Income.

**Exception—Qualified joint venture.** Beginning in 2007, if you and your spouse each materially participate as the only members of a jointly owned and operated business, and you file a joint return for the tax year, you can make an election to be treated as a qualified joint venture instead of a partnership. By making the election, you will not be required to file Form 1065 for any year the election is in



effect and will instead report the income and deductions directly on your joint return. If you and your spouse filed a Form 1065 for the year prior to the election, the partnership terminates at the end of the tax year immediately preceding the year the election takes effect.

**Note.** Mere joint ownership of property that is not a trade or business does not qualify for the election.

**Making the election.** To make this election, you must divide all items of income, gain, loss, deduction, and credit attributable to the business between you and your spouse in accordance with your respective interests in the venture. Each of you must file a separate Schedule C, C-EZ, or F. On each line of your separate Schedule C, C-EZ, or F, you must enter your share of the applicable income, deduction, or loss. Each of you must also file a separate Schedule SE to pay self-employment tax, as applicable.

If you have employees or otherwise need an employer identification number (EIN) for the business, please see [www.irs.gov](http://www.irs.gov), keyword “qualified joint venture,” for more information.

If you and your spouse make the election for your rental real estate business, you must each report your share of income and deductions on Schedule C or C-EZ instead of Schedule E. Rental real estate income generally is not included in net earnings from self-employment subject to self-employment tax and generally is subject to the passive loss limitation rules. Electing qualified joint venture status and using the Schedule C or C-EZ does not alter the application of the self-employment tax or the passive loss limitation rules. For a rental real estate business not subject to self-employment tax, enter “Exempt–QJV” on Form 1040, line 58, and do not file Schedule SE, unless you had other income subject to self-employment tax. If you had other net earnings from self-employment of \$400 or more, enter “Exempt–QJV” and the amount of your net profit from the rental real estate business from Schedule C or C-EZ on the dotted line to the left of Schedule SE, line 3. Subtract that amount from the total of lines 1 and 2 and enter the result on line 3. Use the amount on line 3 to calculate your self-employment tax that will be reported on Form 1040, line 58. Do not enter “Exempt–QJV” on Form 1040, line 58.

Once made, the election can only be revoked with the permission of the IRS. However, the election technically remains in effect only for as long as the spouses filing as a qualified joint venture continue to meet the requirements for filing the election. If the spouses fail to meet the qualified joint venture requirements for a year, a new election will be necessary for any future year in which the spouses meet the requirements to be treated as a qualified joint venture.

## Self-Employed Health Insurance Deduction

Partners and more-than-2% shareholders in an S corporation may be able to claim this deduction when the insurance policy is in the name of the partner or shareholder. You can either pay the premiums yourself or the partnership or S corporation can pay them. However, if you pay the premiums yourself, you must be reimbursed by the partnership or S corporation to claim the deduction. For more information, see chapter 6 of Publication 535, Business Expenses.

## Domestic Production Activities Deduction Increased

For tax years beginning in 2007, 2008, or 2009, the percentage used to figure the domestic production activities deduction increases to 6%. For more information on this deduction, see Form 8903, Domestic Production Activities Deduction, and its instructions.

## Employer-Owned Life Insurance Contracts

Generally, a policyholder owning one or more employer-owned life insurance contracts issued after August 17, 2006, is required to file a report for each tax year the contract(s) is owned. However, you are not required to file a report for any tax year ending before November 14, 2007. For more information, see Form 8925, Report of Employer-Owned Life Insurance Contracts.

## Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips

For tips received for services performed after 2006, the amount of tips for any month that is used to figure the credit must be reduced by the amount by which the wages that would have been payable during that month at \$5.15 an hour exceed the wages (excluding tips) paid by the employer during that month.

For tax years beginning after 2006, the credit is allowed against both the regular tax and the AMT.

## Work Opportunity Credit

The work opportunity credit has been extended to cover members of targeted groups who begin work for you before September 1, 2011. For tax years beginning after 2006, the credit is allowed against both the regular tax and the AMT. For more information about this credit, see Form 5884, Work Opportunity Credit.

**Members of targeted groups.** For employees who begin work for you after 2006:

- Long-term family assistance recipients are members of a targeted group (if hired before 2007, see Form 8861, Welfare-to-Work Credit).
- Ex-felons are no longer required to be a member of a low-income family.
- Food stamp recipients must be at least age 18 when hired, but not age 40 or older.

For individuals who begin work for you after May 25, 2007:

- The qualified veterans group is expanded to include veterans entitled to compensation for a service-connected disability and who, during the one-year period ending on the hiring date, were (a) discharged or released from active duty in the U.S. Armed Forces or (b) unemployed for a period or periods totaling at least 6 months. The first-year wages taken into account for these disabled veterans is \$12,000.
- The high-risk youth group has been renamed “designated community residents” and the age requirement has been changed to include individuals who are at least age 18 but not yet age 40. In addition, residents of rural renewal counties who meet this age requirement have been added to this group.

For more information, see Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, and its instructions.

## Alternative Fuel Vehicle Refueling Property Credit

For refueling property placed in service after 2005, the \$30,000 and \$1,000 credit limitations apply to each location at which property is placed in service. Also, the definition of alternative fuel is revised. For more information, see Form 8911, Alternative Fuel Vehicle Refueling Property Credit.

## Low Sulfur Diesel Fuel Production Credit

Additional guidance is available on obtaining the required certification of qualified costs. Also, for tax years ending after 2002, the adjustment required when you deduct qualified costs and also claim the low sulfur diesel fuel production credit is clarified. For more information, see Form 8896, Low Sulfur Diesel Fuel Production Credit.

## Fringe Benefit Parking Exclusion and Commuter Transportation Benefit

You can generally exclude a limited amount of the value of qualified parking and commuter highway vehicle transportation and transit passes you provide to an employee from the employee’s wages subject to employment taxes. For 2007, the monthly exclusion for qualified parking increases to \$215 and the monthly exclusion for commuter highway vehicle transportation and transit passes increases to \$110. See *Qualified Transportation Benefits* on page 17 of Publication 15-B, Employer’s Tax Guide to Fringe Benefits (For Benefits Provided in 2007).

## Health Savings Accounts

**Eligibility.** For 2007, a qualifying high deductible health plan (HDHP) must have a deductible of at least \$1,100 for self-only coverage or \$2,200 for family coverage and must limit annual out-of-pocket expenses of the beneficiary to \$5,500 for self-only coverage and \$11,000 for family coverage.

**Employer contributions.** Up to specified dollar limits, you can generally exclude your contributions (must be in cash) to the health savings account (HSA) of a qualified individual (determined monthly) from federal income tax withholding, social security tax, Medicare tax, and FUTA tax. For 2007, you can contribute up to the following amounts to a qualified individual’s HSA.

- \$2,850 for self-only coverage or \$5,650 for family coverage.
- \$3,650 for self-only coverage or \$6,450 for family coverage for qualified individuals who are age 55 or older at any time during the year.

Employers are allowed to make larger HSA contributions for a nonhighly compensated employee than for a highly compensated employee.

For more information, see *Health Savings Accounts* on page 13 of Publication 15-B.

## S Corporations

The following changes affect S corporations.

- The capital gain of an S corporation is not treated as passive investment income. This applies to tax years beginning after May 25, 2007. For details, see Internal Revenue Code section 1362(d)(3).
- Generally, restricted bank director stock is not taken into account as outstanding stock of an S corporation. This applies to tax years beginning after 2006. For details, see Internal Revenue Code section 1361(f).

- A special rule applies to banks required to change from the reserve method of accounting on becoming an S corporation. This applies to tax years beginning after 2006. For details, see Internal Revenue Code section 1361(g).
- If a qualified subchapter S subsidiary no longer qualifies because of a sale of its stock, new rules apply as to how such a sale is treated. This applies to tax years beginning after 2006. For details, see Internal Revenue Code section 1361(b)(3)(C).
- Certain S corporations may be able to eliminate all earnings and profits attributable to tax years beginning before 1983. See Public Law 110-28, section 8235.
- An electing small business trust may be able to deduct interest expense on indebtedness it incurred to acquire stock in an S corporation. This applies to tax years beginning after 2006. For details, see Internal Revenue Code section 641(c)(2).
- For tax years ending on or after December 31, 2007, certain corporations with reasonable cause for not timely filing Form 2553, Election by a Small Business Corporation, can request to have the form treated as timely filed by filing it as an attachment to Form 1120S, U.S. Income Tax Return for an S Corporation. For more information, see Form 2553 and its instructions.

## Penalty for Late Filing of a Partnership Return

For returns required to be filed after December 20, 2007, the late filing penalty is increased to \$85 for each month or part of a month (up to 12 months) the return is late or does not contain the required information, multiplied by the total number of persons who were partners in the partnership during any part of the partnership's tax year for which the return is due. For more information, see the Instructions for Form 1065 or the Instructions for Form 1065-B, U.S. Return of Income for Electing Large Partnerships.

## Penalty for Late Filing of an S Corporation Return

For returns required to be filed after December 20, 2007, a new penalty may be charged if the return is filed after the due date (including extensions) or the return does not show all required information. The penalty is \$85 for each month or part of a month (up to 12 months) the return is late or does not contain the required information, multiplied by the total number of persons who were shareholders in the corporation during any part of the corporation's tax year for which the return is due. For more information, see the Instructions for Form 1120S.

## Certain Transfers of Qualifying Geothermal or Mineral Interests

A 25% exclusion from gross income is allowed for long-term capital gain from certain conservation sales of qualifying mineral and geothermal interests located on eligible federal land. The sale must be to an eligible entity and occur after December 19, 2006. An excise tax may be imposed if an eligible entity fails to take steps consistent with the protection of conservation purposes.

For details, including the geographical location of eligible federal land, see section 403 of Title IV, Division C, of the Tax Relief and Health Care Act of 2006. Also see Form 8924, Excise Tax on Certain Transfers of Qualifying Geothermal or Mineral Interests, when it is released.

## Certain Timber Losses

In determining your net operating loss (NOL), you can no longer treat income and expenses attributable to qualified timber property located in the GO Zone, Rita GO Zone, or Wilma GO Zone as attributable to a farming business for 2007 or later years.

See *When To Use an NOL* in Publication 536, Net Operating Losses (NOL) for Individuals, Estates, and Trusts.

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## 2008 Changes

### Depreciation and Section 179 Deduction

**Increased section 179 limits.** The maximum section 179 deduction you can elect for qualified section 179 property you placed in service in tax years that begin in 2008, has increased to \$250,000 (\$285,000 for qualified enterprise zone property and qualified renewal community property). This limit is reduced by the amount by which the cost of section 179 property placed in service in the tax year exceeds \$800,000. For qualified section 179 Gulf Opportunity (GO) Zone property placed in service in certain counties and parishes of the GO Zone, the maximum deduction is higher than the deduction for most other section 179 property.

**Depreciation limits on business vehicles.** The total depreciation deduction (including the section 179 deduction) you can take for a passenger automobile (that is not a truck or a van) you use in your business and first placed in service in 2008 is \$2,960 (\$10,960 for automobiles for which the special depreciation allowances applies). The maximum deduction you can take for a truck or a van you use in your business and first placed in service in 2008 is \$3,160 (\$11,160 for trucks or vans for which the special depreciation allowance applies).





*These limits are reduced if the business use of the vehicle is less than 100%.*

### **Special depreciation allowance for certain property.**

You may be able to take an additional first year special depreciation allowance for certain qualified property (defined below). The allowance is an additional deduction of 50% of the property's depreciable basis (after any section 179 deduction and before figuring your regular depreciation deduction).

Property that qualifies for this special depreciation allowance includes the following.

- Tangible property depreciated under the modified accelerated cost recovery system (MACRS) with a recovery period of 20 years or less.
- Water utility property.
- Off-the-shelf computer software.
- Qualified leasehold improvement property.

Qualified property must also meet all of the following tests.

- You must have acquired qualified property by purchase after 2007 and before 2009. If a binding contract to acquire the property existed before 2008, the property does not qualify.
- Qualified property must be placed in service after 2007 and before 2009 (before 2010 for certain transportation property and certain property with a long production period).
- The original use of the property must begin with you after 2007.

Property that does not qualify for the special depreciation allowance includes the following.

- Property placed in service and disposed of in the same tax year.
- Property converted from business use to personal use in the same tax year it is acquired. Property converted from personal use to business use in the same or later tax year may be qualified GO Zone property.
- Property required to be depreciated under the alternative depreciation system (ADS).
- Property included in a class of property for which you elected not to claim the special depreciation allowance.

Fiscal year taxpayers with a tax year beginning in 2007 and ending in 2008 should use Form 4562-FY, Depreciation and Amortization, to claim the special depreciation allowance.

## **Meal Expenses When Subject to “Hours of Service” Limits**

In general, you can deduct only 50% of your business-related meal expenses. However, for 2008 and later years, you can deduct 80% of meal expenses while traveling away from your tax home for business purposes if the meals take place during or incident to any period subject to the Department of Transportation's “hours of service” limits. Business meal expenses are covered in chapter 1 of Publication 463. Reimbursements for employee meal expenses are covered in chapter 11 of Publication 535.

## **Self-Employment Tax**

The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2008 is \$102,000. All net earnings of at least \$400 are subject to the Medicare part of the tax.

## **Social Security and Medicare Taxes**

The maximum amount of wages subject to the social security tax for 2008 is \$102,000. There is no limit on the amount of wages subject to the Medicare tax.

## **Federal Unemployment Tax Act (FUTA) Tax Rate**

The 6.2% FUTA tax rate has been extended through calendar year 2008. It was scheduled to decrease to 6.0% after 2007.

## **Maximum Automobile Value for Using the Cents-Per-Mile Valuation Rule**

For 2008, an employer providing a passenger automobile for the first time for the personal use by an employee may determine the value of the personal use by using the vehicle cents-per-mile value rule if the vehicle's fair market value on the date it is first made available to the employee does not exceed \$15,000 for a passenger automobile other than a truck or van, or \$15,900 for a truck or van. For more information, see *Cents-Per-Mile Rule* on page 20 of Publication 15-B, Employer's Tax Guide to Fringe Benefits.

## **Fringe Benefit Parking Exclusion and Commuter Transportation Benefit**

You can generally exclude a limited amount of the value of qualified parking and commuter highway vehicle transportation and transit passes you provide to an employee from the employee's wages. For 2008, the monthly exclusion for qualified parking increases to \$220 and the monthly exclusion for commuter highway vehicle transportation and

transit passes increases to \$115. See *Qualified Transportation Benefits* on page 17 of Publication 15-B.

## Health Savings Accounts

**Eligibility.** For 2008, a qualifying high deductible health plan (HDHP) must have a deductible of at least \$1,100 for self-only coverage or \$2,200 for family coverage and must limit annual out-of-pocket expenses of the beneficiary to \$5,600 for self-only coverage and \$11,200 for family coverage.

**Employer contributions.** Up to specified dollar limits, you can generally exclude your contributions (must be in cash) to the health savings account (HSA) of a qualified individual (determined monthly) from federal income tax withholding, social security tax, Medicare tax, and FUTA tax. For 2008, you can contribute up to the following amounts to a qualified individual's HSA.

- \$2,900 for self-only coverage or \$5,800 for family coverage.
- \$3,800 for self-only coverage or \$6,700 for family coverage for qualified individuals who are age 55 or older at any time during the year.

Employers are allowed to make larger HSA contributions for a nonhighly compensated employee than for a highly compensated employee.

For more information, see *Health Savings Accounts* on page 12 of Publication 15-B.

## Nonqualified Deferred Compensation Plans

Generally, all amounts deferred under a nonqualified deferred compensation plan for the tax year and all preceding tax years are included in your employees' wages in the current year, unless the plan meets certain requirements. These requirements were stated in Notice 2005-1. However, portions of that notice were obsoleted and replaced by final regulations that were effective for tax years beginning after 2007. For more information, see Treasury Decision (T.D.) 9321, 2007-19 I.R.B. 1123, available at [www.irs.gov/irb/2007-19\\_IRB/ar02.html](http://www.irs.gov/irb/2007-19_IRB/ar02.html).

## Penalty for Late Filing of a Partnership Return

For returns required to be filed for tax years beginning in 2008, the penalty is increased to \$86 for each month or part of a month (up to 12 months) the return is late or does not contain the required information, multiplied by the total number of persons who were partners in the partnership during any part of the partnership's tax year for which the return is due.

## Expired Tax Benefits

In addition to certain provisions discussed earlier, the following tax benefits expired as shown below.

- Credit for increasing research activities (research credit) (for amounts paid or incurred after 2007).
- Indian employment credit (for tax years beginning after 2007).
- Railroad track maintenance credit (for tax years beginning after 2007).
- Eligibility of certain biomass and synthetic fuels produced at certain qualified facilities for the nonconventional source fuel credit (for sales after 2007).
- Energy efficient appliance credit (for appliances produced after 2007).
- Shorter recovery periods for qualified Indian reservation property (for property placed in service after 2007).
- Fifteen-year property classification for qualified leasehold improvements and restaurant property (for property placed in service after 2007).
- Seven-year property classification for a qualified motorsports entertainment complex (for property placed in service after 2007).
- Suspension of the 100% taxable income limit on percentage depletion for oil and natural gas from marginal properties (for tax years beginning after 2007).
- Special rules for contributions of food and book inventories (for contributions made after 2007).
- Special rule for corporate contributions of computer technology or equipment for educational purposes (for contributions made in tax years beginning after 2007).
- Environmental cleanup (remediation) costs deduction (for costs paid or incurred after 2007).
- Reforestation expense deduction increase for certain small timber producers (for expenses paid or incurred after 2007).
- Shareholder basis adjustment for stock of S corporations making charitable contributions of property (for tax years beginning after 2007).
- Certain tax incentives based on the designation of the District of Columbia Enterprise Zone (for any period after 2007).
- American Samoa economic development credit (for tax years beginning after 2007).
- Deduction for domestic production activities in Puerto Rico (for tax years beginning after 2007).



At the time this publication went to print, Congress was expected to consider legislation that would reinstate many of these benefits. To find out if legislation is enacted, go to [www.irs.gov](http://www.irs.gov), click on More Forms and Publications, and then on What's Hot in forms and publications.

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## 3.

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# IRAs and Other Retirement Plans

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## 2007 Changes

### Catch-up Contributions in Certain Employer Bankruptcies

If you participated in a 401(k) plan and the employer who maintained the plan went into bankruptcy, you may be able to contribute an additional \$3,000 to your IRA. For this to apply, the following conditions must be met.

- You must have been a participant in a 401(k) plan under which the employer matched at least 50% of your contributions to the plan with stock of the company.
- You must have been a participant in the 401(k) plan 6 months before the employer filed for bankruptcy.
- The employer (or a controlling corporation) must have been a debtor in a bankruptcy case in an earlier year.
- The employer (or any other person) must have been subject to indictment or conviction based on business transactions related to the bankruptcy.

If you choose to make these additional contributions, you cannot use the higher contribution and deduction limits for individuals who are age 50 or older.

### Income Exclusion for Retired Public Safety Officers

For distributions beginning in 2007, you can elect to exclude from income distributions from an eligible retirement plan that is a governmental plan if you are an eligible retired public safety officer. The distribution must be transferred directly to an insurance provider to pay premiums for accident or health insurance or qualified long-term care insurance for you, your spouse, or your dependents.

The maximum annual exclusion is \$3,000. You cannot deduct these premiums as medical expenses or, if you are self-employed, health insurance costs. For more information, see *Insurance Premiums for Public Safety Officers* in Publication 575, *Pension and Annuity Income*.

### Modified AGI Limit for Traditional IRA Contributions Increased

For 2007, if you were covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified AGI is:

- More than \$83,000 but less than \$103,000 for a married couple filing a joint return or a qualifying widow(er),
- More than \$52,000 but less than \$62,000 for a single individual or head of household, or
- Less than \$10,000 for a married individual filing a separate return.

If you either lived with your spouse or file a joint return, and your spouse was covered by a retirement plan at work, but you were not, your deduction is phased out if your AGI is more than \$156,000 but less than \$166,000. If your AGI is \$166,000 or more, you cannot take a deduction for contributions to a traditional IRA.

### Rollover by Nonspouse Beneficiary

Beginning in 2007, you may be able to roll over tax free all or a portion of a distribution you receive from an eligible retirement plan of a deceased employee if you are a designated beneficiary of the employee (other than a surviving spouse). The distribution must be a direct trustee-to-trustee transfer to your IRA that was set up to receive the distribution. The transfer will be treated as an eligible rollover distribution and the receiving plan will be treated as an inherited IRA. For information on rollovers, see Publication 575. For information on inherited IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

### Modified AGI Limit for Retirement Savings Credit Contributions Increased

For 2007, you may be able to claim the retirement savings contributions credit if your modified AGI is not more than:

- \$52,000 if your filing status is married filing jointly,
- \$39,000 if your filing status is head of household, or
- \$26,000 if your filing status is single, married filing separately, or qualifying widow(er).

## Rollover of Nontaxable Amounts

For tax years beginning in 2007, the nontaxable part of an eligible rollover distribution (such as after-tax contributions) from a qualified retirement plan can be rolled over to another qualified retirement plan that is either a qualified employee plan or an annuity contract described in section 403(b). Previously, this part of the distribution could be rolled over only to another qualified retirement plan that was a defined contribution plan.

The rollover must be a direct trustee-to-trustee transfer. The plan to which the rollover is made must separately account for these contributions and the earnings on them. For information on rollovers, see Publication 575.

## Modified AGI Limit for Roth IRA Contributions Increased

For 2007, your Roth IRA contribution limit is reduced (phased out) in the following situations.

- Your filing status is married filing jointly or qualifying widow(er) and your modified AGI is at least \$156,000. You cannot make a Roth IRA contribution if your modified AGI is \$166,000 or more.
- Your filing status is single, head of household, or married filing separately and you did not live with your spouse at any time in 2007 and your modified AGI is at least \$99,000. You cannot make a Roth IRA contribution if your modified AGI is \$114,000 or more.
- Your filing status is married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than -0-. You cannot make a IRA contribution if your modified AGI is \$10,000 or more.

## Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans).

**Limits on contributions and benefits.** For 2007, the maximum annual benefit for a participant under a defined benefit plan has increased to the smaller of:

- \$180,000, or
- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years.

For 2007, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant has increased to the smaller of:

- \$45,000, or

- 100% of the compensation actually paid to the participant.

**Compensation limit.** For 2007, the maximum compensation used for figuring contributions and benefits has increased to \$225,000.

**Elective deferrals (401(k) plans).** For 2007, the limit on elective deferrals (excluding catch-up contributions) for participants in 401(k) plans and SARSEPs (excluding SIMPLE plans) increased to \$15,500.

## Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560.

**Elective deferrals (SARSEPs) limit.** The limits on elective deferrals for participants in SARSEPs are discussed earlier under *Elective deferrals (401(k) plans)*.

**Deduction limit increased.** The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2007, the maximum combined deduction for a participant's elective deferrals and other SEP contributions has increased to \$45,000.

**Contribution limit increased.** For 2007, the annual limit on the amount of employer contributions to a SEP has increased to the smaller of:

- \$45,000, or
- 25% of an eligible employee's compensation.

**Compensation limit.** For 2007, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions has increased to \$225,000.

## SIMPLE Plans

The following change applies to SIMPLE plans. For more information, see Publication 560.

**Salary reduction contributions.** For 2007, the limit on salary reduction contributions (excluding catch-up contributions) to a SIMPLE plan increased to \$10,500.

## 403(b) Plans

The following changes apply to 403(b) plans. For more information, see Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans).

**Increase in the limit on elective deferrals.** For 2007, the limit on elective deferrals (excluding catch-up contributions) has increased to \$15,500.



**Limit on annual additions.** For 2007, the limit on annual additions has increased to \$45,000.

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## 2008 Changes

### Traditional IRA Contribution and Deduction Limit

The contribution limit to your traditional IRA for 2008 will be increased to the smaller of the following amounts:

- \$5,000, or
- Your taxable compensation for the year.

If you were age 50 or older before 2009, the most that can be contributed to your traditional IRA for 2008 will be the smaller of the following amounts:

- \$6,000, or
- Your taxable compensation for the year.

### Modified AGI Limit for Traditional IRA Contributions Increased

For 2008, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified AGI is:

- More than \$85,000 but less than \$105,000 for a married couple filing a joint return or a qualifying widow(er),
- More than \$53,000 but less than \$63,000 for a single individual or head of household, or
- Less than \$10,000 for a married individual filing a separate return.

If you either live with your spouse or file a joint return, and your spouse is covered by a retirement plan at work, but you are not, your deduction is phased out if your AGI is more than \$159,000 but less than \$169,000. If your AGI is \$169,000 or more, you cannot take a deduction for contributions to a traditional IRA.

### Modified AGI Limit for Retirement Savings Contributions Credit Increased

For 2008, you may be able to claim the retirement savings contributions credit if your modified AGI is not more than:

- \$53,000 if your filing status is married filing jointly,
- \$39,750 if your filing status is head of household, or

- \$26,500 if your filing status is single, married filing separately, or qualifying widow(er).

### Roth Contribution Limit

If contributions on your behalf are made only to Roth IRAs, your contribution limit for 2008 will generally be the lesser of:

- \$5,000, or
- Your taxable compensation for the year.

If you were age 50 or older before 2009 and contributions on your behalf were made only to Roth IRAs, your contribution limit for 2008 will generally be the lesser of:

- \$6,000, or
- Your taxable compensation for the year.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced.

### Modified AGI Limit for Roth IRA Contributions Increased

For 2008, your Roth IRA contribution limit is reduced (phased out) in the following situations.

- Your filing status is married filing jointly or qualifying widow(er) and your modified AGI is at least \$159,000. You cannot make a Roth IRA contribution if your modified AGI is \$169,000 or more.
- Your filing status is single, head of household, or married filing separately and you did not live with your spouse at any time in 2008 and your modified AGI is at least \$101,000. You cannot make a Roth IRA contribution if your modified AGI is \$116,000 or more.
- Your filing status is married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than -0-. You cannot make a Roth IRA contribution if your modified AGI is \$10,000 or more.

### Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560.

**Limits on contributions and benefits.** For 2008, the maximum annual benefit for a participant under a defined benefit plan has increased to the smaller of:

- \$185,000, or
- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years.

For 2008, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant has increased to the smaller of:

- \$46,000, or
- 100% of the compensation actually paid to the participant.

**Compensation limit.** For 2008, the maximum compensation used for figuring contributions and benefits has increased to \$230,000.

## Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560.

**Deduction limit increased.** The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2008, the maximum combined deduction for a participant's elective deferrals and other SEP contributions has increased to \$46,000.

**Contribution limit increased.** For 2008, the annual limit on the amount of employer contributions to a SEP has increased to the smaller of:

- \$46,000, or
- 25% of an eligible employee's compensation.

**Compensation limit.** For 2008, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions has increased to \$230,000.

## 403(b) Plans

The following change applies to 403(b) plans. For more information, see Publication 571.

**Limit on annual additions.** For 2008, the limit on annual additions has increased to \$46,000.

## Rollovers From Other Retirement Plans to Roth IRAs

Prior to 2008, you could only rollover (convert) amounts from either a traditional, SEP, or SIMPLE IRA into a Roth IRA. After 2007, you can rollover amounts from the following plans into a Roth IRA.

- A qualified pension, profit-sharing or stock bonus plan (including a 401(k) plan),
- An annuity plan,

- A tax-sheltered annuity plan (section 403(b) plan),
- A deferred compensation plan of a state or local government (section 457 plan), or
- An IRA.

Any amount rolled over is subject to the same rules for converting a traditional IRA into a Roth IRA. See *Converting From Any Traditional IRA Into a Roth IRA* in chapter 1 of Publication 590. Also, the rollover contribution must meet the rollover requirements that apply to the specific type of retirement plan.

## Expired Tax Benefits

The following provisions do not apply for 2008.

- Qualified charitable distributions.
- Qualified reservist distributions.



*At the time this publication went to print, Congress was expected to consider legislation that would reinstate these benefits. To find out if this legislation is enacted, go to [www.irs.gov](http://www.irs.gov) click on More Forms and Publications, and then on What's Hot in forms and publications.*

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# 4.

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## Estate and Gift Taxes

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### 2007 Changes

#### Annual Exclusion for Gifts to Non-U.S. Citizen Spouses Increased

The annual exclusion for gifts made to spouses who are not U.S. citizens has increased to \$125,000.

#### Maximum Estate and Gift Tax Rate Reduced

For estates of decedents dying, and gifts made, after 2006 and before 2010, the maximum rate for the estate tax and the gift tax is 45%.

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## 2008 Changes

### Annual Exclusion for Gifts to Non-U.S. Citizen Spouses Increased

For calendar year 2008, the annual exclusion for gifts made to spouses who are not U.S. citizens will increase to \$128,000.

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## 5.

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## Excise Taxes

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### Changes Effective for the First Quarter of 2007

#### Air Transportation Taxes

For amounts paid during 2007, the tax on use of international air travel facilities will be \$15.10 per person for flights that begin or end in the United States, or \$7.50 per person for domestic segments that begin or end in Alaska or Hawaii (applies only to departures). For amounts paid for each domestic segment of taxable transportation of persons by air, the domestic segment tax is \$3.40 per segment for transportation that begins in 2007.

#### Arrow Shafts

The tax on arrow shafts (IRS No. 106) is \$.42 per arrow shaft.

#### Diesel Fuel Used in Trains

The tax rate on dyed diesel fuel used in trains is \$.001. The claim rate for undyed diesel fuel used in trains is \$.243.

#### Inland Waterways Fuel Use Tax

The inland waterways fuel use tax is \$.201.

#### Taxable Vaccines

Meningococcal and human papillomavirus vaccines are taxable for sales or uses after January 31, 2007.

## Qualified Blood Collector Organizations

Qualified blood collector organizations are exempt from many federal excise taxes (or a credit or payment relating to the tax is available). These taxes include the taxes on fuels, tires, communication services, and heavy vehicles. Each blood collector organization must be registered by the IRS as a condition for applying for exemption (or credit or payments). To apply for registration, see Form 637, Application for Registration (For Certain Excise Tax Activities).

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### Changes Effective for the Tax Period Beginning July 1, 2007

#### Heavy Highway Vehicle Use Tax

After June 30, 2007, qualified blood collector organizations are exempt from the heavy highway vehicle use tax on qualified blood collector vehicles. A qualified blood collector vehicle is a vehicle at least 80% of the use which during the prior tax period was by a qualified blood collector organization in the collection, storage, or transportation of blood.

A vehicle first placed in service in a tax period will be treated as a qualified blood collector vehicle for the tax period if the qualified blood collector organization certifies that the organization reasonable expects at least 80% of the use of the vehicle by the organization during the tax period will be in the collection, storage, or transportation of blood. Qualified blood collector organizations are not required to file Form 2290, Heavy Highway Vehicle Use Tax Return, for qualified blood collector vehicles.

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### Changes Effective for the First Quarter of 2008

#### Air Transportation Taxes

For amounts paid during 2008, the tax on use of international air travel facilities will be \$15.40 per person for flights that begin or end in the United States, or \$7.70 per person for domestic segments that begin or end in Alaska or Hawaii (applies only to departures). For amounts paid for each domestic segment of taxable transportation of persons by air, the domestic segment tax is \$3.50 per segment for transportation that begins in 2008.

## Arrow Shafts

The tax on arrow shafts (IRS No. 106) is \$.43 per arrow shaft.

## Dyed Diesel Fuel Used in Trains

The train operator is no longer liable for the leaking underground storage tank (LUST) tax on dyed diesel fuel used in trains. IRS No. 71 has been removed from Form 720, Quarterly Federal Excise Tax Return. The position holder of the dyed diesel fuel general is liable for the LUST tax under IRS No. 105.

## Inland Waterways Fuel Use Tax

Generally, the inland waterways fuel use tax is \$.20 (IRS No. 64). However, the leaking underground storage tank (LUST) tax (IRS No. 125) must be paid on any liquid fuel used on inland waterways that is not subject to LUST tax under section 4041(d) or 4081. For example, gallons of Bunker C fuel oil must be reported under both IRS Nos. 64 and 125.

## Disregarded Entities and Qualified Subchapter S Subsidiaries (QSubs)

After 2007, qualified subchapter S subsidiaries (QSubs) and eligible single-owner disregarded entities are treated as separate entities for certain excise tax and related reporting purposes. QSubs and eligible single-owner disregarded entities must pay and report excise taxes (other than IRS Nos. 31, 51, and 117), register for excise tax activities, and claim any refunds, credits, and payments under the entity's EIN. These actions cannot take place under the owner's taxpayer identification number (TIN). Some QSubs and disregarded entities may already have an EIN. However, if you are unsure, please call the IRS Business and Specialty Tax Line at 1-800-829-4933. Generally, QSubs and eligible single-owner disregarded entities will continue to be treated as disregarded entities for other federal tax purposes. Thus, taxpayers filing Form 4136, Credit for Federal Tax Paid on Fuels, with Form 1040 can use the owner's TIN. For more information on these new regulations, see T.D. 9356. You can find T.D. 9356, 2007-39 I.R.B. 675, available at [www.irs.gov/irb/2007-39\\_IRB/ar04.html](http://www.irs.gov/irb/2007-39_IRB/ar04.html).

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# 6.

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## Foreign Issues

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### 2007 Changes

#### Foreign Earned Income and Housing Exclusions

**Exclusion amount.** The maximum foreign earned income exclusion has increased to \$85,700.

**Housing expenses—base amount.** The base housing amount has increased to \$37.57 per day, or \$13,712 for an entire calendar year.

#### Foreign Tax Credit

**Income categories eliminated.** The following categories of income have been eliminated for purposes of computing the foreign tax credit limit. Income that previously fell in these categories is either passive category income or general category income.

- High withholding tax interest.
- Financial services income.
- Shipping income.
- Dividends from a domestic international sales corporation (DISC) or former DISC.
- Certain distributions from a foreign sales corporation (FSC) or former FSC.

For more information, see Publication 514, Foreign Tax Credit for Individuals, or the Instructions for Form 1116, Foreign Tax Credit (Individual, Estate, or Trust).

**Carryforward and carryback of unused foreign taxes.** Due to the elimination of the income categories as discussed above, special rules apply to carrybacks of unused foreign taxes to 2006 and carryforwards of unused taxes to 2007 and later years. For more information, see Publication 514 or the Instructions for Form 1116.

**Recharacterization of overall domestic loss.** If you have an overall domestic loss for any tax year beginning after 2006, you must recharacterize a portion of your U.S. source taxable income in succeeding years as foreign source taxable income for purposes of the foreign tax credit.

For more information, see Publication 514 or the Instructions for Form 1116.



**Country-by-country reporting no longer required of mutual fund or other regulated investment company (RIC) shareholders.** If you claim a foreign tax credit in 2007 or later years for your share of foreign taxes paid by a mutual fund or other RIC, you no longer have to report the income or taxes paid on a country-by-country basis. See the Instructions for Form 1116.

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## 2008 Changes

### Foreign Earned Income and Housing Exclusions

**Exclusion amount.** For 2008, the maximum foreign earned income exclusion has increased to \$87,600.

**Housing expenses—base amount.** The base housing amount has increased to \$38.30 per day, or \$14,016 for an entire calendar year.

### Certain Distributions to Nonresident Aliens No Longer Exempt

The exemption from tax on certain interest-related dividends and short-term capital gain dividends paid by a mutual fund or other regulated investment company will not apply to any tax year of the company beginning after 2007.

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## 7.

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## How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Contacting your Taxpayer Advocate.** The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving 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.

You can contact the TAS by calling the TAS toll-free case intake line at 1-877-777-4778 or TTY/TDD 1-800-829-4059 to see if you are eligible for assistance. You can also call or write to your local taxpayer advocate, whose phone number and address are listed in your local

telephone directory and in Publication 1546, Taxpayer Advocate Service - Your Voice at the IRS. You can file Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order), or ask an IRS employee to complete it on your behalf. For more information, go to [www.irs.gov/advocate](http://www.irs.gov/advocate).

**Taxpayer Advocacy Panel (TAP).** The TAP listens to taxpayers, identifies taxpayer issues, and makes suggestions for improving IRS services and customer satisfaction. If you have suggestions for improvements, contact the TAP, toll free at 1-888-912-1227 or go to [www.improveirs.org](http://www.improveirs.org).

**Low Income Taxpayer Clinics (LITCs).** LITCs are independent organizations that provide low income taxpayers with representation in federal tax controversies with the IRS for free or for a nominal charge. The clinics also provide tax education and outreach for taxpayers with limited English proficiency or who speak English as a second language. Publication 4134, Low Income Taxpayer Clinic List, provides information on clinics in your area. It is available at [www.irs.gov](http://www.irs.gov) or at your local IRS office.

**Free tax services.** To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains a list of free tax publications and describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Accessible versions of IRS published products are available on request in a variety of alternative formats for people with disabilities.



**Internet.** You can access the IRS website at [www.irs.gov](http://www.irs.gov) 24 hours a day, 7 days a week to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2007 refund. Click on *Where's My Refund*. Wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2007 tax return available because you will need to know your social security number, your filing status, and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the withholding calculator online at [www.irs.gov/individuals](http://www.irs.gov/individuals).

- Determine if Form 6251 must be filed using our Alternative Minimum Tax (AMT) Assistant.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.



**Phone.** Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications, and prior-year forms and instructions. You should receive your order within 10 working days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* To check the status of your 2007 refund, call 1-800-829-4477 and press 1 for automated refund information or call 1-800-829-1954. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2007 tax return available because you will need to know your social security number, your filing status, and the exact whole dollar amount of your refund.

**Evaluating the quality of our telephone services.** To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



**Walk-in.** Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you're more comfortable talking with someone in person, visit your local Taxpayer Assistance Center where you can spread out your records and talk with an IRS representative face-to-face. No appointment is necessary, but if you prefer, you can call your local Center and leave a message requesting an appointment to resolve a tax account issue. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.



**Mail.** You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 days after your request is received.

National Distribution Center  
P.O. Box 8903  
Bloomington, IL 61702-8903



**CD/DVD for tax products.** You can order Publication 1796, IRS Tax Products CD/DVD, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Bonus: Historical Tax Products DVD - Ships with the final release.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions.
- Tax Topics from the IRS telephone response system.

- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-free and email technical support.
- The CD which is released twice during the year.
  - The first release will ship the beginning of January 2008.
  - The final release will ship the beginning of March 2008.

Purchase the CD/DVD from National Technical Information Service (NTIS) at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) for \$35 (no handling fee) or call 1-877-CDFORMS (1-877-233-6767) toll free to buy the CD/DVD for \$35 (plus a \$5 handling fee). Price is subject to change.



**CD for small businesses.** Publication 3207, The Small Business Resource Guide CD for 2007, is a must for every small business owner or any taxpayer about to start a business. This year's CD includes:

- Helpful information, such as how to prepare a business plan, find financing for your business, and much more.

- All the business tax forms, instructions, and publications needed to successfully manage a business.
- Tax law changes for 2007.
- Tax Map: an electronic research tool and finding aid.
- Web links to various government agencies, business associations, and IRS organizations.
- “Rate the Product” survey—your opportunity to suggest changes for future editions.
- A site map of the CD to help you navigate the pages of the CD with ease.
- An interactive “Teens in Biz” module that gives practical tips for teens about starting their own business, creating a business plan, and filing taxes.

An updated version of this CD is available each year in early April. You can get a free copy by calling 1-800-829-3676 or by visiting [www.irs.gov/smallbiz](http://www.irs.gov/smallbiz).



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