

# TAX BEAT

December 2007

## INSIDE THIS ISSUE:

<i>Planning for the Expanded Kiddie Tax</i>	2—3
<i>New in 2008 - Small Exempt Organizations Filing Requirements</i>	3
<i>Revised I-9 Form Goes</i>	3
<i>IRS Releases 2008 Standard Mileage Rate</i>	3
<i>Planning for 0% Capital Gains Rate</i>	4
<i>Combining Business with Personal Travel</i>	5
<i>Hybrid Tax Credit Update</i>	6

## GIVING A GIFT FROM YOUR IRA

The Pension Protection Act of 2006 brought a limited time opportunity for those age 70½ and older as of 12/31/07 who want to make tax-free gifts from a traditional or Roth IRA. The opportunity is set to expire on December 31<sup>st</sup> of this year, so if you are inclined, you need to act soon.

Individuals age 70½ and older may transfer up to \$100,000 per year directly to a charitable organization. Couples with separate IRAs could each give up to \$100,000, for a total of \$200,000. These direct charitable contribution distributions count towards your minimum required distribution requirements, such that you do not pay tax on the distribution. Since you do not treat the distribution as income, you also will not be able to claim a charitable contribution deduction.

Making charitable contributions from an IRA rather than other assets can be beneficial for those who:

- Do not itemize deductions
- Would not be able to deduct all of their charitable contributions because of deduction limitations
- May lose some of their itemized deductions due to their income level
- Are required to take distributions but do not need them for living expenses

Remember that distributions must be made directly from the IRA to the charitable organization and must be made between now and December 31, 2007.

### Our Mission Statement

*We are dedicated professionals working together to provide comprehensive quality services to satisfy the needs of clients, business advisors, and each other.*



## PLANNING FOR THE EXPANDED KIDDIE TAX

by Bill Wright, CPA

Years ago, Congress came up with the concept known as the Kiddie Tax to discourage high-bracket taxpayers from shifting taxable investment income to their lower-bracket children. It was accomplished by having the child's investment income over a set amount taxed at the parent's higher marginal rate, thus nullifying any potential tax benefit from shifting the income.

Before 2006, the Kiddie Tax only affected children under the age of fourteen, but in 2006 and 2007, children 17 and under with unearned income greater than \$1,700 were also included. Beginning in 2008, children under 19 & full-time students under 24 will also be included. This change could mean that parents who intend to use money accumulating in a child's custodial account to pay for college have it taxed at the parents' higher rate leaving less to pay the education costs. However, given the right circumstances and some advance planning (some may need to take place by the end of 2007), you might be able to minimize or even avoid the Kiddie Tax.

**Kiddie Tax Basics** The Kiddie Tax only affects your child's **unearned** income, which generally is investment income such as dividends, interest, and capital gains. On the other hand, if your child has earned income from a job or self-employment, it is always completely exempt from Kiddie Tax and will always be taxed at your child's rate, which is usually 15% or less.

**Unearned Income Threshold** There is a minimum threshold of \$1,800 of unearned income in 2008 that must be exceeded before the Kiddie Tax kicks in. This threshold is adjusted for inflation. If your child's unearned income does not exceed the threshold, the Kiddie Tax does not apply; all the child's income subject to tax will be taxed at the child's rate. If your child's unearned income exceeds the threshold, only the excess amount is subject to the Kiddie Tax.

**Age Rules** In 2007, the Kiddie Tax only affected your child if he or she were under

the age of 18 as of 12/31/07. So if your child was 18 or older, Kiddie Tax was not an issue. However, this changes in 2008.

Starting next year, the Kiddie Tax can potentially affect your child until the year when he or she turns age 24, and the rules complicate things by creating three categories:

**Under age 18 at year-end:** If your child is age 17 or younger on December 31 of the year in question the Kiddie Tax applies if unearned income exceeds the threshold.

**Age 18 at year-end:** If your child is age 18 at year-end and does not have **earned** income that exceeds half of his or her support, the Kiddie Tax will apply if their unearned income exceeds the threshold.



**Age 19-23 at year-end and a student:** If your child is 19 through 23 at year-end and a student who doesn't have **earned** income that exceeds half of his or her support, the Kiddie Tax will apply if their unearned income exceeds the threshold. A child is considered to be a student if they attend school full-time for 5 months of the year.

Remember, when we say **earned** income we mean wages or self-employment income. In cases 2 and 3 if earned income does not exceed half of the child's support the Kiddie Tax could apply. By support, the IRS means the cost of all items paid out directly (clothing, school, medical, transportation, recreation, etc.) and indirectly (value of lodging and food). Thus, it is easily conceivable that a child could have substantial earned income yet still be subject to the Kiddie Tax. Children can also be subject to Kiddie Tax even if you do not claim them as dependents on your tax return, including situations allowing them to take education credits.

**Kiddie Tax Planning Strategies** As explained earlier, a child who was 18 or older at 12/31/07 will not be affected by the Kiddie Tax in 2007. However, under the stricter new rules starting in 2008, the Kiddie Tax can potentially affect a student age 19-23. Therefore, your child could be exempt from the Kiddie Tax in 2007 yet still be affected by it in 2008 or later years. This situation presents a one-time tax planning opportunity for the rest

of this year.

If it makes investment sense, although you will pay tax, you may want to consider your child triggering some additional capital gains (say from selling stock) and other taxable income (say from cashing in U.S. Savings Bonds) before the end of this year. Since the Kiddie Tax will not apply, those gains and income will be taxed at your child's rates, which are likely to be 5% for long-term capital gains and qualified dividends and only 10% or 15% for ordinary income (including interest, ordinary dividends, and short-term capital gains). To see the potential benefit of this strategy, here are two examples:

A child who is not subject to the Kiddie Tax in 2007, but will be in 2008, has enough unearned income that every additional dollar will be subject to the Kiddie Tax. He/She is in college and will need money to pay tuition in August 2008. The child has a savings bond with \$5,000 of interest income that will be cashed in to pay the tuition. If the bond is cashed in and the interest income is recognized in 2007, the tax on that interest will be  $\$5,000 \times 15\% = \$750$ . If the child waits until 2008 to cash in the savings bond, the interest income will be taxed at the parents' tax rate as high as 35% ( $\$5,000 \times 35\% = \$1,750$ ). By cashing in the bond in 2007, a tax savings of \$1,000 ( $\$1,750$  minus \$750) may be accomplished.

The same child was given shares of stock many years ago to pay for school. The stock now has \$20,000 of appreciation. If the child sells the stock in 2007, the \$20,000 will be taxed at a 5% capital gains rate, which is \$1,000 tax. If the child waits until 2008 to sell the stock, the gain will probably be taxed at the parents' 15% capital gains rate, which is \$3,000 tax. A tax savings of \$2,000 may be accomplished by recognizing the income now.

If selling appreciated investments is not a good option in 2007, you could consider taking out student loans until the child turns 24, and repaying the loans using cash from the sale of the securities at the child's tax rate, knowing interest on most student loans does not begin to accumulate until after graduation. However, the maximum capital gains tax rate is set to revert to 20%

continued on next page

## PLANNING FOR THE EXPANDED KIDDIE TAX, CONT.

after 2010 which means there may not be any tax savings in that strategy unless Congress extends that particular tax break.

Despite stricter rules in 2008, the Kiddie Tax can often be neutralized by selecting the right investments, taking advantage of the unearned income thresholds, and recognizing income when the child is not subject to Kiddie Tax. For instance, tax-free interest from municipal bonds will not cause Kiddie Tax problems. Accumulated

interest from Series EE and Series I bonds won't be hit with the Kiddie Tax if the bonds are not cashed in until the year when your children graduate or have earned income greater than half their support. Capital gains from growth stocks and tax-efficient mutual funds can be managed to stay at or near the annual unearned income threshold with gains being postponed until the child is exempt. Investing in Section 529 accounts or Coverdell education savings accounts are also a more attractive alter-

native with these new rules moving in place.

These are a few ideas that could lessen a potentially unnecessary tax burden in the years to come, and you should consider them while there is time yet in 2007. If you would like more information or wish to discuss your individual situation to see if a particular strategy would make sense for you, please give us a call.

## NEW IN 2008 – SMALL TAX-EXEMPT ORGANIZATIONS REPORTING REQUIREMENTS

In the past, small tax-exempt organizations with gross receipts normally \$25,000 or less were not required to file Form 990 or Form 990-EZ. A new filing requirement applies to tax periods beginning after December 31, 2006 for those organizations that previously were not required to file returns. Small tax-exempt organizations may now be required to file an annual electronic notice, Form 990-N, beginning in 2008. The new form will be filed electronically (no paper form will be available) and once the new procedures

are in place the IRS will post them on their website: [www.irs.gov](http://www.irs.gov)

There are exceptions to this new filing requirement. Those exceptions include organizations that are included in a group return, private foundations required to file Form 990-PF, and section 509(a)(3) supporting organizations required to file Form 990 or Form 990-EZ. In addition, this filing requirement does not apply to churches, their integrated auxiliaries, and

conventions or associations of churches. It is extremely important to note organizations that do not file the notice may lose their tax-exempt status. The new tax law requires the IRS to revoke the tax-exempt status of any organization that fails to meet its annual filing requirement for three consecutive years. Therefore, organizations that do not file the e-Postcard (Form 990-N), or an information return Form 990 or 990-EZ for three consecutive years will have their tax-exempt status revoked as of the filing due date of the third year.



### REVISED I-9 FORM GOES INTO EFFECT DECEMBER 26, 2007

A revised Employment Eligibility Verification Form (known as the I-9 Form) has been released, and must be used by employers as of December 26, 2007.

The revised form eliminates the use of some documents to establish identity and employment eligibility. The revised I-9 form can be found on the United States Citizenship and Immigration Services website at:

[www.uscis.gov/files/form/I-9.pdf](http://www.uscis.gov/files/form/I-9.pdf)

### IRS RELEASES 2008 STANDARD MILEAGE RATE

The optional standard mileage rate increased 2¢ to 50.5¢ per mile in 2008.

The standard mileage for charitable purposes remains at 14¢ per mile, while the rate for medical and moving expenses decreased 1¢ to 19¢ per mile.

# PLANNING FOR 0% CAPITAL GAINS RATE

Stephen A. Bjork, CPA

Beginning in 2008, taxpayers in the 10% and 15% income tax brackets may not be taxed on long term capital gains and qualified dividends (LTCGQD). Currently, those individuals in the 10% and 15% brackets pay 5% on LTCGQD. This reduction is scheduled to last through 2010, when the lower rate on qualified dividends is eliminated and the capital gain rate reverts back to the pre-2003 rates (in 2011, the capital gains rate will be 20%, 10% for those in the 15% bracket and lower). Even though some of the planning opportunities have been eliminated due to the changes in the kiddie tax law (see the article on page 2), some taxpayers will be able to generate income, implement various asset management strategies, or satisfy gift and income shifting objectives at no tax cost.

For 2008, a married couple who files a joint tax return must have taxable income of no more than \$65,100 to fall within the 15% tax bracket; for a single filer, the amount is \$32,550. The tax brackets are based on taxable income. Taxable income is calculated as income less personal exemptions and the greater of the standard deduction or itemized deductions.

Even if you meet the income limit, only a portion of your LTCGQD might qualify for the 0% rate. The 0% rate applies only to the extent that LTCGQD would be taxed at 10% or 15% if it was ordinary income. Therefore if a taxpayer falls into the 15% tax bracket, it is not an unlimited 0% tax bracket.

To illustrate how much of the LTCGQD would not be taxed in 2008, a single taxpayer's taxable income excluding LTCGQD is \$25,550. The taxpayer sold a stock that was held for many years at a gain of \$30,000. The full \$30,000 is not eligible for the 0% tax rate. The amount that is eligible is the difference between their other taxable income and the top of the 15% tax bracket. For 2008, the single 15% tax rate ends at 32,550, and thus only \$7,000 (\$32,550 - \$25,550) of the capital gain will not be taxed; the other \$23,000 will be taxed at the 15% capital gain rate.

If you are going to fall within the 15% tax bracket, you may wish to take advantage of the 0% tax rate and look to rebalance your after tax investment portfolio. You will be able to adjust your asset allocation and equity holdings at no tax or a lower tax cost than before. The 0% tax rate may also allow you to sell an appreciated asset, realize the tax free gain, and repurchase the same asset (make sure the assets you sell have been held for over one year). This strategy allows you to reset your basis in the asset, hedging against expected higher capital gain rates in the future.

Be mindful that even if the LTCGQD are not taxed, they are still added to your adjusted gross income (AGI). By increasing your AGI, you may increase how much of your social security is taxed and decrease how much of your medical expenses and miscellaneous itemized deductions are deducted, negating some of the benefits of the 0% rate. The increase in the amount of social security that is taxed can also complicate planning and rate maximization if not considered, but if you assume that 85% of your Social Security will be taxed, your projections will be safe.

If you want to maximize the amount of LTCGQD that will be taxed at the 0% rate, you may want to take action to decrease your income in 2008 -2010 or increase your deductions during the same years. Some of the ways this can be accomplished include:

- Do not cash in savings bonds during 2008-2010. Either cash them in 2007, or wait until 2011.
- Convert traditional IRAs to Roth IRAs in 2007 and avoid minimum-distribution requirements on the amount converted.
- Wait and pay 2007 medical expenses and charitable contributions until 2008.
- Maximize retirement contributions.
- Convert taxable interest and ordinary dividend (i.e. money market funds) yielding assets into municipal interest and dividend yielding assets.

Taxes alone should never dictate an investment strategy, but if you have any questions or need assistance in projecting your taxable income, please contact us.

# COMBINING BUSINESS WITH PERSONAL TRAVEL

Stephen A. Bjork, CPA

As the temperature drops and the days get shorter and shorter, you might have paged through the convention / seminar catalogs noticing all warm weather locations offered in January and February. You may also have racked your brain to determine if any business needs to be conducted in a warmer location. After you have found your destination, you may want to coincide your trip with a vacation (it is not a coincidence that most large conventions are held in destination cities such as New York, Miami, or Las Vegas). The Internal Revenue Service recognizes that it is reasonable and proper for individuals to combine work along with some pleasure, but beware that if the trip is primarily for vacation, your entire trip may be a nondeductible personal expense.

Convention and business travel expenses are deductible both to employees and the self-employed. In order for them to be deductible, the expenses must specifically relate to your business or profession. Expenses related to attending an investment or financial planning seminar or to attend a stockholder's meeting are not business expenses (unless of course you are in the investment and financial planning business). After determining that your trip has a business purpose, the rules differ on what can be deducted depending on whether your travel is domestic or foreign.

## Domestic Travel

When traveling within the United States and mixing business and personal activities, you can deduct 100% of your travel expenses as long as your trip is primarily related to your business. Lodging, other qualified business expenses, and 50% of your meals are also deductible for the days you spend on business. Even though the IRS does not specify how to determine if the primary reason for the travel is business, most agree that the number of days spent primarily on each activity is a key factor. In calculating business days, travel days are business days. Weekends and holidays that fall between days devoted to business in which it is impractical to return home are business days. "Standby days," when your physical presence is required, also count as business days, even if you are not called upon to work on those days. When staying over on a Saturday night result in lower airfare and net cost savings, that Saturday is a business day. If your personal days exceed your business days, the IRS rules state that none of your travel expenses are deductible.

## Traveling Abroad

When you travel outside the United States primarily for business, the general rule is that you must allocate all your travel expenses, including transportation, in proportion to the number of days you spend on business and personal activities, with two large exceptions that allow you to deduct 100% of your transportation expenses. First, you do not have to follow the allocation rule if you are out of the country for seven days or less, not counting the day you leave, but counting the day your return. You can also deduct 100% of your transportation expenses for trips lasting over a week, as long as you spend less than 25% of your days on non-business activities (in this case, count the day of departure and the day of your return as business days). Other exceptions to this rule are if you have no substantial control over the arrangement of the trip (i.e. flights in and out are only once a week), or if you can show that personal vacation was not a consideration in making the trip. Even if you do not meet any of the exceptions, you can deduct the business percentage of your transportation expenses, as long as the trip is primarily for business.

Let's say that you travel on Thursday to London for customer meetings on Friday and Monday. You vacation the following Tuesday through Friday and return home on Saturday. The two travel days, the two meeting days, and the weekend days in between count as business days. The four vacation days (Tuesday through Friday) amount to 40% of your time, so the 25% test is failed. Therefore you may only deduct 60% of your travel expenses.

More restrictions are imposed on foreign conventions, where the above rules for foreign travel apply, plus you must be able to show that it was reasonable for the convention to be held outside of North America (North America includes Canada, Mexico, US Possessions, parts of Central America, and most of the Caribbean).

Even more restrictions apply to conventions held aboard cruise ships. In order to deduct expenses, the ship must be a US registered vessel, and all of its ports of call must be located in the United States or its possessions. If those restrictions are satisfied, the deduction is limited to \$2,000 per individual per calendar year, and two statements must be attached to your tax return to substantiate the deduction.

## When your family travels with you

If you take your family with you on your travels, your deduction is limited to your expenses. If you fly to your destination, only your individual airfare is deductible. If you drive, you incur the same expenses whether or not you are traveling alone, and thus you can deduct the total cost of driving back and forth. For lodging expenses, you do not need allocate the cost of the room. If you get a double room, you can deduct the cost of what you would have paid for the single rate (ask the hotel to note the single rate on the bill).

## Keeping Records

As with other business expenses, make sure to keep all receipts related to your travels. You should also substantiate your business activities, including dates of departure and return, the number of days you spend on business and the reasons for your travel.





633 West Wisconsin Avenue #900  
Milwaukee, WI 53203

Phone: 414-271-3966  
Fax: 414-271-3502  
Email: kbco@komisarbrady.com

Past Issues of Tax Beat  
can be found at  
[www.komisarbrady.com](http://www.komisarbrady.com)

## HYBRID TAX CREDIT UPDATE



Five companies currently offer Hybrid Vehicles that qualify for a federal tax credit. The credit is only available to the original purchaser of a new, qualifying vehicle. If a qualified vehicle is leased to a consumer, only the leasing company is allowed to take the credit. The 5 companies are Ford (including Ford and Mercury), General Motors (including Chevrolet, GMC, and Saturn), Honda, Mazda, and Nissan. The credit for Toyota vehicles (including Toyota and Lexus) completely phased out as of October 31<sup>st</sup>, 2007. All of the other companies are eligible for 100% of the credit.

When factoring the tax credit into your purchasing decision, be aware that the credit can be limited or lost due to the alternative minimum tax (AMT). If you are subject to AMT, you are unable to take the credit in the current year. Since there is no provision for a carryforward of the credit, it will be lost. If you are not subject to AMT, the credit is limited to the amount that your regular income tax exceeds your AMT.

For a full list of the eligible models and the credit amount, please visit our website [www.komisarbrady.com](http://www.komisarbrady.com).

*Komisar Brady & Co., LLP offers much more than high quality tax, accounting and auditing services. We offer many types of consulting services to businesses, including business succession planning, sale or acquisition of a business, long range forecasts and budgeting, and valuation services. We also offer estate and retirement planning and aid in the choice and implementation of qualified retirement plans for business owners and sole proprietors. If you have any questions in regards to your individual or business financial matters, please give us a call and see what we can do to help, or if we can direct you to someone who can.*

*This document provides information of a general nature. None of the information contained herein is intended or written as a tax opinion relative to specific issues addressed in this document.*