T. DENNIS CONNALLY CONSULTANT, P.C. - NEWSLETTER

Congress Passes AMT Patch And More Year-End Tax Legislation

AMT Patch

Congress has passed an alternative minimum tax (AMT) "patch." The patch is a temporary fix to a big problem. Nearly 40 years ago, Congress created the AMT so that a handful of very wealthy taxpayers would not avoid taxation. The idea worked well at the beginning but over time inflation has eroded the value of the dollar. That handful of very wealthy taxpayers has grown to be many millions. Even more taxpayers, especially taxpayers with household incomes of between $75,000 and $100,000, would have been liable for the AMT this year but for the patch. The Treasury Department predicted that without the patch, up to 25 million taxpayers would face an average tax increase of $2,000 for the 2007 tax year.

The patch prevents the AMT from spreading by giving taxpayers higher exemption amounts and allowing them to use most nonrefundable personal credits to offset AMT liability for the 2007 tax year. The 2007 AMT exemption amounts are $44,350 for single taxpayers and heads of household; $66,250 for married couples filing jointly; and $33,125 for married couples filing separately. These amounts are slightly higher than the 2006 exemption amounts, which is also good news for many taxpayers.

The new law allows taxpayers to use most nonrefundable personal credits to offset AMT liability. These include the HOPE and Lifetime Learning credits and the District of Columbia first-time homebuyers' credit. The adoption, child and saver's credits were already allowed under prior law to the full extent of a taxpayer's regular tax and AMT.

Calculating the AMT is far from simple. In fact, it is one of the most complicated provisions in the U.S. Tax Code. The patch is also very complex. Our office is ready to help you. If you have any questions about the patch and AMT liability, please give us a call today.

2008 filing season

The IRS needs time to reprogram its computer systems for the patch. According to top IRS officials, the agency could need as many as seven to 10 weeks to reprogram its systems for the patch. The start of the 2008 filing season is already less than seven to 10 weeks away. Consequently, return processing and refunds could be delayed. The IRS has promised to get its computer systems reprogrammed as quickly as possible and to ensure that they process returns with 100 percent accuracy.

Some filers may have to wait until February 11, 2008 to file their returns, the IRS has indicated. Everyone else, according to the IRS, should not experience delays. We'll monitor the latest news from the IRS and keep you updated. The IRS has already revised many of the 2007 tax forms that are impacted by the AMT patch.

According to the IRS, taxpayers filing the following forms may experience delays. The forms are Form 8863, Education Credits; Form 5695, Residential Energy Credits; Form 1040A Schedule 2, Child and Dependent Care Expenses for Form 1040A Filers; Form 8396, Mortgage Interest Credit; and Form 8859, District of Columbia First-Time Homebuyer Credit. Additional forms are affected by the AMT patch but the IRS has indicated that it has successfully reprogrammed its computer systems to begin processing those forms.

The IRS Oversight Board has estimated how long potential delays may be and how many taxpayers will be affected. The Oversight Board is a group of individuals that do exactly what their title says...they oversee the agency. According to the Oversight Board, if the filing season starts on January 28, 2008, approximately 6.7 million tax returns will be delayed and $17 billion in refunds will not be issued.

If the filing season starts on February 4, 2008, roughly 15 million tax returns will be delayed and $39 billion in refunds will not be issued. If the filing season starts on February 18, 2008, nearly 38 million tax returns will be delayed and $87 billion in refunds will not be issued.

Foreclosure relief

The housing boom in many areas of the country is in danger of becoming a housing bust. Problems in the lending industry, especially with so-called subprime mortgages, have contributed to the slide in home sales and home values. Congress and the Bush Administration have proposed a variety of measures to help homeowners who are caught in the mortgage meltdown. One measure is in the recently-enacted *Mortgage Forgiveness Debt Relief Act of 2007*.

When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the mortgage debt, the Tax Code treats the cancelled debt as taxable income to the taxpayer. The new law temporarily excludes from taxation discharges involving up to $2 million of indebtedness ($1 million for a married taxpayer filing a separate return) secured by a principal residence and incurred in the acquisition, construction or substantial improvement of the residence.

Let's take a look at an example. Cara's principal residence is subject to a $300,000 mortgage debt. Cara's creditor forecloses in 2008. The residence is sold for $240,000 in satisfaction of the debt later that year. Cara has $60,000 in income from the discharge of indebtedness. Before the new law, the $60,000 would have been includible in Cara's gross income. Now, it is exempt.

The new law also addresses mortgage workouts. Sometimes, a mortgage workout or renegotiation may result in forgiveness of indebtedness income that would be taxable. The new law helps these taxpayers by giving them a full exclusion, too.
The exclusion in the new law is only temporary. Taxpayers have three years, until December 31, 2009, to take advantage of the change. The exclusion is also retroactive to January 1, 2007.

Mortgage insurance deduction

In addition to foreclosure help, Congress also extended the itemized mortgage insurance deduction for three years. If you're unsure if your mortgage insurance qualifies, give our office a call. We'll let you know.

Survivor's home sale exclusion

The new law may also help some recently-widowed individuals. The new law extends the time in which a surviving spouse may use the joint-filers' $500,000 home sale gain exclusion before being treated as a single individual who is entitled to the $250,000 home sale exclusion. As of January 1, 2008, the sale of a residence that had been jointly owned and occupied by the surviving spouse and the deceased spouse is entitled to the $500,000 exclusion if the sale occurs no later than two years after the death of the individual's spouse. Some special rules about use and occupancy also apply.