New Tax Laws--Year End 2007

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The end of 2007 produced a flurry of bills that included a number of tax changes. Many of them were of little interest to the average taxpayer (e.g., a provision extending to 7 years the amortization period for geological and geophysical expenditures of major oil companies), but a number will have an important impact on many taxpayers. The discussion below is a summary of the most important provisions.

Alternative Minimum Tax Relief

The new law increases the AMT exemption amounts to:

- $66,250 for married individuals filing jointly and surviving spouses;
- $44,350 for unmarried individuals (includes heads of household);
- $33,125 for married individuals filing separate returns.

The new law does not increase the exemption amount for trusts or for corporations. Moreover, the new exemption amount is in effect only for 2007. For 2008, unless changed, they return to the old law amounts of $45,000 for married individuals filing jointly, etc.

In addition, the nonrefundable personal tax credits will be allowed to the full extent of a taxpayer's regular and alternative minimum tax liability for 2007.

Mortgage Relief Act

Discharge of mortgage debt on principal residence. Generally, when a debt is discharged for less that the full amount due (remaining principal) the difference is includable in gross income. It's called cancellation of debt or COD income. That's true for both businesses and individuals. There are several exceptions to the rule, the most frequently encountered is in the case of insolvent taxpayers.

Under the new law, a taxpayer may exclude from gross income, income that would result from the discharge of qualified principal residence debt that occurs in 2007, 2008, or 2009. For this purpose, qualified principal residence debt is limited to $2 million ($1 million if married filing separate). Only debt incurred in the purchase, construction or substantial improvement of the residence qualifies. A taxpayer must reduce the basis in his principal residence by the amount of the qualified principal residence debt excluded from income.

If the debt is recourse, any amount realized on the sale could be part discharge of indebtedness that is excluded from income and part gain on the disposition of property. If the debt is nonrecourse, and the debt is forgiven from the amount realized on the sale, foreclosure or other disposition of the property will be treated as realized on the sale of the property and gain on the disposition may result.

Mortgage insurance premiums. Under prior law, mortgage insurance premiums paid during 2007 with respect to mortgage insurance contracts issued on or after January 1, 2007 were deductible (subject to a phase out for taxpayers whose adjusted gross income exceeds $100,000 ($50,000 for married filing separately)). The new law extends this provision so that amounts paid on or after January 1, 2007 and before January 1, 2011 are deductible.

Exclusion of gain on principal residence by surviving spouse. Up to $500,000 of gain from the sale of a principal residence can be excluded by a married couple filing jointly. However, on the death of one of the spouses, the exclusion amount drops to that of a single individual, $250,000. The new law extends the $500,000 exclusion for a sale no later than two years after the death of the spouse. The rule applies only to a single individual; if the spouse remarries, the provision would not apply. In order to qualify, immediately before his or her death, either spouse must have met the two-out-of-five year ownership requirement but both spouses must have met the two-out-of-five year use requirement. In addition, neither spouse can have sold or exchange within the prior two years a residence that qualified for the exclusion.

State and local benefits provided to volunteer emergency response personnel excluded from income. Certain benefits and payments provided to volunteer emergency response personnel are generally excluded from income under the new law. Qualified state and local tax benefits include a reducing or rebate of a state or local real property tax, personal property tax, or income tax. Taxpayers receiving such a reduction or rebate cannot claim a deduction for the reduction. Volunteer emergency response personnel may also exclude payments or reimbursements for performing volunteer services, but the annual amount excluded cannot exceed $30 times the number of months during the year the volunteer provides services (e.g., for 7 months of service the volunteer could exclude $210). Qualified personnel include members of any volunteer organization providing firefighting or emergency medical services.

The provision applies to tax years beginning after December 31, 2007 and before January 1, 2011.

Clarification of student housing eligible for low-income housing credit. Under the new law a unit will not fail to be treated as a low-income unit merely because it is occupied entirely by full-time students if such students are single parents and their children and such parents are not dependents (as defined in Section 152) of another individual and such children are not dependents of another individual other than a parent of such children.

Alternative tests for qualifying as cooperative housing corporation. This law change will make it easier for a housing cooperative to qualify as a cooperative housing corporation. The provision amends the 80% requirement to provide that the requirement is satisfied if, for the taxable year in which the taxes and interest are paid or incurred, the corporation meets one of the following three requirements: (1) 80 percent or more of the corporation's gross income for that taxable year is derived from tenant-stockholders (the present law requirement); (2) at all times during that table year 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use; or (3) 90 percent or more of the expenditures of the corporation paid or incurred during that taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of tenant-stockholders.

Penalties for partnership and S corporation returns. For partnership returns required to be filed after December 20, 2007 the failure to file penalty is increased to $85 (from $50) per partner per month (or fraction thereof) for up to 12 months (previously 5 months). An addition $1 per month per partner applies to returns to be filed under Sec. 6031 for a tax year beginning in 2008. A similar penalty ($85 per shareholder for up to 12 months) will apply to S corporations.

Disclosure limitation. While partners, S corporation shareholders, and trust and estate beneficiaries have the right to inspect the partnership, etc. return, the law provides that information disclosed may not include any supporting schedule, attachment, or list which includes the taxpayer identification number of partners, etc.

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