

# 36 Inflation Adjustments for Tax Rules in 2008

**T**ax rules change annually. Each year, the IRS makes over three dozen cost-of-living adjustments (COLAs) to key tax limits and other items. These changes are based on the Consumer Price Index (CPI) in August. While official IRS figures have not been released (and are not expected until late in the year), the 2008 rules can be projected on the basis of this CPI information. In addition, some statutory changes made in prior years take effect in 2008. Here are some key changes and tax-saving strategies that can be used for the coming year.



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## Families

**Kiddie tax.** This is not a separate tax; it is a rule that taxes a child's investment income over a certain amount at the parent's highest tax rate. The age for the kiddie tax increases in 2008 to include children under age 24 who are full-time students and who do not provide more than half of their own support. In 2007, the kiddie tax was limited to children under age 18.

However, the amount that a child can receive without triggering the kiddie tax increases in 2008 to \$1,800 (up from \$1,700 in 2007). The first \$900 of unearned income is tax free; the balance is taxed to the child at the child's tax rate.

**Personal exemptions.** The personal and dependency exemption increases to \$3,500 in 2008 (up from \$3,400 in 2007). This means a family of four creates a total deduction of \$16,000 ( $\$3,500 \times 4$ ). However, high-income taxpayers are subject to a phase-out of this deduction. The adjusted gross income limits for this phase-out have been raised.

**Important:** Due to prior legislation, only one-third of the total reduction applies (i.e., a taxpayer can claim two-thirds of the deduction after the phase-out amount) (Code Sec. 151(d)(3)(E)).

**Tax brackets.** All of the tax brackets have been adjusted for inflation. This means that a taxpayer can have more taxable income without being pushed into a higher tax bracket. Where appropriate and possible, it can be helpful to defer income to 2008 if such income would fall into a lower tax bracket and there is no risk of loss with respect to the income.

**Child tax credit.** The \$1,000 child tax credit and the modified adjusted gross income (MAGI) limitations on eligibility for the credit remain unchanged in 2008. However, the refundable child tax credit is now the greater of 15% of earned income up to \$12,050 (up from \$11,750 in 2007), or, for those with three or more qualifying children, Social Security taxes over earned income for the year (Code Sec. 24(d)).

**Earned income credit.** Low-income earners can claim a

refundable tax credit; the credit limits and phase-out ranges have been increased for 2008 (Code Sec. 32). The amount of investment income that can be received without disqualifying the recipient for the credit is \$2,950 (up from \$2,900 in 2007).

## Employee benefits

Where employers offer fringe benefits, employees should take advantage of them to the extent possible or desirable. These fringe benefits are tax free and not subject to Social Security and Medicare (FICA) taxes.

**Adoption assistance.** Employers can provide tax-free payments for adoption expenses in 2008 up to \$11,650 (the limit in 2007 was \$11,390) (Code Sec. 137). The exclusion for employer-paid adoption assistance begins to phase out when an employee's modified adjusted gross income (MAGI) exceeds a set amount. For 2007, the MAGI phase-out is \$174,730; the benefit is completely phased out when MAGI reaches \$214,730. **Note:** Individuals who do not have employer-paid adoption assistance can claim a tax credit. The amount of the credit and the MAGI phase-out range is the same as for the exclusion.

**Transportation fringe benefits.** Employers can pay for monthly parking that is tax free up to \$220 in 2008 (up from \$215 in 2007) (Code Sec. 132(f)(2)(B)). The limit on monthly transit passes is \$115 (up from \$110 in 2007) (Code Sec. 132(f)(2)(A)). Alternatively, employers can arrange for employees to pay for their transit passes on a pre-tax basis through cafeteria plans, an option that eligible employees should consider taking advantage of.

## Investments

The top capital gains tax rate remains at 15% (25% for unrecaptured depreciation and 28% for collectibles gains). However, the top rate for taxpayers in the 10% or 15% tax

# Save Taxes By Shifting Appreciated Property to Relatives

bracket in 2008 is zero (down from 5% in 2007). This means such taxpayers can receive qualified dividends and long-term capital gains without paying any tax on such income.

From a planning perspective, a family can save overall taxes by shifting appreciated property to relatives in these low tax brackets. For example, giving appreciated stock held long term to a parent in the 15% tax bracket and having the parent sell the stock means the family has no tax on the sale. However, there will be no substantial tax savings if children are subject to the kiddie tax, as explained above.

These transfers can be made gift-tax free in 2007 and 2008 using the annual gift tax exclusion. The exclusion is \$12,000 per beneficiary per year (there is no change in the exclusion amount in 2008).

## Paying for higher education

The tax law provides some key breaks for paying for college; with COLAs,

there should be increased tax savings eligible for taxpayers. In 2007, these breaks have improved as follows:

**Savings bond exclusion.** Interest on U.S. savings bonds used to pay higher education costs is not taxable. This interest exclusion applies only if a taxpayer's MAGI does not exceed a set limit (Code Sec. 135). In 2008, the MAGI limit for the full interest exclusion is \$67,100 for singles and \$100,650 on a joint return (up from \$65,600 and \$98,400 respectively in 2007).

**Student loan interest deduction.** Interest on a student loan is deductible up to \$2,500 annually if a taxpayer's MAGI does not exceed a set limit (Code Sec. 221). While the dollar limit on this deduction remains unchanged, the MAGI phase-out range has been increased in 2008 to \$115,000 on a joint return; it remains at \$55,000 for singles.

**Education credits.** A Hope credit can be claimed for qualified higher education costs for the first two years of

college (Code Sec. 25A). For 2008, the credit is 100% of costs up to \$1,200, plus 50% of costs up to \$1,200, for a total credit of \$1,800 per eligible student (in 2007, the credit was based on expenses up to \$1,100 so the total credit was limited to \$1,650 per eligible student).

The credit cannot be claimed if MAGI exceeds a set limit. For 2008, the phase-out of the credit begins at \$48,000 for singles and \$96,000 on a joint return (in 2007 it was \$47,000 and \$94,000 respectively). ☺

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*Sidney Kess, CPA, J.D., LL.M., has authored hundreds of books on tax-related topics. He probably is best known for lecturing to nearly every state society and more than 700,000 practitioners on tax and estate planning. In 2003, he received special recognition from AICPA and CCH for his many contributions to the tax profession. He created and moderates the annual AICPA Conference on Tax Strategies for High-Income Individuals.*



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