

## Taxpayers should get a head start on tax planning for 2007

The indexing of many features of the tax code will bring some relief to taxpayers next year, according to CCH, a Wolters Kluwer business, which recently released estimated income ranges for each 2007 tax bracket.

Unlike many changes to the tax laws that are effective for only limited periods of time, indexing has become well established within the tax code.

**Inflation Adjustments.** Since the late 1980s, the Code has required that federal income tax brackets be adjusted for inflation annually, and inflation adjustments have been inserted into the Internal Revenue Code in recent years with increasing frequency. For example, the Code now requires over 50 other inflation-driven computations to determine deduction, exemption and exclusion amounts in addition to the 40 separate computations needed to inflation-adjust the tax bracket tables each year. Tax legislation in 2006 added to the number of required inflation adjustments.

The adjustments are based on Consumer Price Index figures for September through August immediately prior to the adjusted year. CCH's projections are based on the relevant inflation data released Sept. 15, 2006, by the U.S. Department of Labor.

The IRS usually releases official numbers by December each year. CCH tax bracket projections are provided for illustrative purposes only, and should not be used for income tax returns or other federal income tax related purposes until confirmed by the IRS later this year.

**Some items not indexed.** Some items in the Code are not indexed for inflation and stay the same, while others rise by dollar amounts already written into the tax law to ensure Congressional oversight. The exemption amounts for the alternative minimum tax, for instance, are not indexed, which means that each year Congress must either increase the amounts by statute or expose additional households to the alternative tax.

By contrast, the adjusted gross income limits on the ability to make full contributions to Roth IRAs have been established by law at the \$95,000 level for singles and \$150,000 for joint filers since 1998. Now they have been made inflation-sensitive through 2006 legislation. For 2007, the AGI phase-out levels rise to \$99,000 and \$156,000, respectively.

**Standard deduction, personal exemption also rise.** The standard deduction and personal exemption amounts are also subject to indexing and these are projected to increase for 2007. These increases can produce lower taxes by reducing the taxpayer's taxable income.

Single taxpayers and married taxpayers filing separately could see a \$200 increase over 2006 in their standard deduction, to \$5,350, while the standard deduction for joint filers will increase by \$400 to \$10,700. Heads of households will see an increase in their standard deduction of \$300, to \$7,850.

The additional standard deduction for those age 65 or older or who are blind, which did not rise in 2006 from the year before, will take a \$50 jump in 2007 to \$1,050 for married individuals and surviving spouses, and \$1,300 for single filers. The personal exemption amount will go up in 2007 by \$100 to \$3,400.

These inflation adjustments can add up over time. For example, since the 1987 tax year, the standard deduction for joint filers has increased more than two-and-a-half times, from \$3,780 to the anticipated \$10,700 amount for 2007.

Taxpayers can, however, lose a good portion of the value of personal exemptions and itemized deductions when their incomes rise above certain levels. Those "phase-out" levels are also adjusted for inflation. For 2007, married couples filing jointly will begin to lose some of the value of any itemized deductions when their adjusted gross income exceeds \$156,400. Likewise, they will begin to lose some of the value of their personal exemptions when their adjusted gross income exceeds \$234,600.

In 2006 and 2007, the reduction in personal exemptions and itemized deductions is scheduled to be only two-thirds of what it was in 2005. That's because "phase outs," first started under the Revenue Reconciliation Act of 1990, are themselves now scheduled to be phased out by one-third in 2006 and 2007, two-thirds in 2008 and 2009 and completely repealed for 2010.

**"Kiddie" deduction, Gift tax exemption.** In general, inflation adjustments are rounded to the next-lower multiple of \$50, so if the adjustment produces an increase of less than \$50, no increase is made. The "kiddie" standard deduction, used on the returns of children who are claimed as dependents on their parents' returns increased in 2001, from \$700 to \$750, and jumped next to \$800 for 2004. For 2006, it increased to \$850, where it will remain for 2007.

The tax code only allows the gift tax exemption to rise when the inflation adjustment would produce an increase of \$1,000 or more. The last increase occurred at the beginning of 2006, when the exemption increased to its current \$12,000. This year's inflation figures aren't enough to push it over the next threshold, so it will stay at \$12,000 for 2007.