

Clothier & Head Tax Insight

We would like to update you on a couple of recent federal tax law changes which may impact your 2007 tax planning. These changes were contained within the "Small Business and Work Opportunity Tax Act of 2007" signed into law on May 25th by President Bush.

- The Work Opportunity Tax Credit was scheduled to expire for individuals who begin work for an employer after December 31, 2007. The new law extends this expiration date to September 1, 2011, and makes changes to various definitions of a qualified employee.
- The limit on expensing the purchase of furniture, fixtures, and equipment was increased to \$125,000 for 2007 (up from \$112,000). The starting point for phasing-out the ability to claim this expense, was increased to \$500,000 of such purchases (up from \$450,000).
- For Tip Credits arising in 2007 and beyond, there has been an increase in the amount of Tip Credit that can be claimed. The Internal Revenue Service has not had time to comment or provide guidance on how this new provision will be applied. However, based upon the technical explanation prepared by the *Joint Committee on Taxation*, in most (but not all) situations, taxpayers will be able to claim the full Tip Credit arising in 2007 tax year, and for each following year. Unfortunately, any unused Tip Credits accumulated in prior years, do not fall under the new Tip Credit rules. The old rules still apply to those credits.

Summary of Tip Credit changes:

For Individuals and Corporations, the Alternative Minimum Tax (AMT) no longer limits the amount of Tip Credit that can be claimed. AMT still exists for all other purposes; it just does not apply to limit the ability to claim Tip Credits arising in 2007 and beyond. AMT still limits any Tip Credits carrying forward from earlier years.

There is another limitation that still applies to the overall amount of Tip Credit that can be claimed in any given year, though in most situations it is not as limiting as AMT. In effect, this other limitation is as follows: The current year Tip Credit cannot reduce your tax liability below 25% of your regular tax liability in excess of \$25,000.

Here is an example, to help explain these new Tip Credit rules:

Assumptions:

- Assume regular 2007 federal tax liability (before credits) is \$175,000.
- Assume 2007 AMT tax is otherwise calculated to be \$150,000.
- Assume the 2007 Tip Credit is \$70,000.
- Assume there are \$200,000 of prior year Tip Credits carrying forward into 2007.

Application of new rules:

- The regular tax liability in excess of \$25,000, is \$150,000 (\$175,000 regular tax liability - \$25,000).
- 25% of that excess, is \$37,500 (\$150,000 x 25%). Therefore, at a minimum \$37,500 of tax will still have to be paid.
- Since AMT does not limit the amount of allowable Tip Credit arising in 2007, the full 2007 Tip credit of \$70,000 can be claimed.
- By claiming the \$70,000 of current year Tip Credit, the tax liability is reduced to \$105,000 (\$175,000 regular tax liability - \$70,000 of 2007 Tip Credits).
- Since this \$105,000 of tax is less than the otherwise calculated 2007 AMT tax of \$150,000, none of the prior year Tip Credits carrying forward into 2007 can be utilized to further reduce the 2007 tax liability.
- Total tax due for 2007 is \$105,000, and the unused Tip Credits from prior years continue to carry forward into the future.

If you would like to discuss how these new rules affect your specific situation, please contact me at 206.622.1326 or at rfinafrock@c-h.com.

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