

Client *NEWSLETTER*

July 2007

DIVORCED? SEPARATED? HAVE CHILDREN?

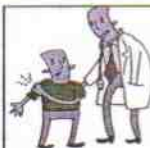


Read this...

Contrary to popular belief, the court does not decide who gets to claim the dependency exemption for children pursuant to a divorce. The court decides who will be the custodial parent, but this parent is not always entitled to claim the child as their dependent. So who *is* entitled?

According to IRS proposed regulations, the custodial parent (regardless of what the court documents say) is the parent with whom the child resides for the greater number of nights during a calendar year. If the child is temporarily away overnight (i.e. a sleepover or away at camp), the night is awarded to the parent with whom the child *would have* resided for the night. In the event of a tie, the parent with the highest adjusted gross income is entitled to the dependency exemption.

The custodial parent may release the dependency exemption to the non-custodial parent by signing a written declaration, which the non-custodial parent attaches to his/her tax return. The declaration may be for one year or many years. If the declaration releases the exemption for future years, the custodial parent now has the right to revoke the declaration for any or all of those future years.



HEALTH SAVINGS ACCOUNTS

Health Savings Accounts (HSAs) are accounts that help individuals and families cover rising health care costs. These accounts allow distributions that are tax free to pay for qualified medical expenses. Contributions may be made by an employer or an employee. After the age of 65, distributions may be taken tax free for any reason, not just for qualified medical expenses. Taxpayers with little to no medical bills may use their HSA as a retirement account, making deductible contributions and taking tax free distributions after the age of 65.

Several changes have been made to the HSA rules starting on January 1, 2007. An HSA owner no longer determines his or her maximum contribution by comparing IRS limits to their deductible. The maximum contribution is now the IRS limit regardless of the deductible amount. For 2007, these limits are \$2,850 for self coverage and \$5,650 for family coverage.

Also, if you have an existing HSA, you may take a "once in a lifetime" tax free distribution from your IRA, and transfer this amount to your HSA account. The amount that you are allowed to transfer into your HSA is determined by your HSA contribution limit. If a self-only HSA owner makes a "once in a lifetime" transfer and subsequently switches to family coverage, a second transfer may be made for the difference in limits between the two plans. Transfers must be trustee-to-trustee, meaning the money may not pass through the account owner's hands at any time.

The Bush Administration's



FY2008 BUDGET PROPOSAL

The goal of the Bush administration's FY2008 budget proposal is to simplify and encourage retirement savings. They plan on doing this by establishing a Retirement Savings Account (RSA) which would consolidate and take the place of traditional and Roth IRAs. Existing Roth IRAs would automatically convert to RSAs. Traditional IRAs would be converted by paying tax on the converted amount. The new RSA characteristics would include:

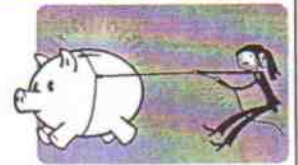
- Contributions limited to the lesser of \$5,000 or earnings included in income,
- No income limits for contributions,
- Contributions are nondeductible, however distributions made after the age of 58 in connection with death or disability would be tax-free,
- No other exceptions for early withdrawals (such as first-time home buying), and
- No minimum distribution requirements.

Another account would be created to take the place of tax-favored accounts such as Health Savings Accounts, Archer Medical Savings Accounts, Coverdale Education Savings Accounts (Education IRAs), and Section 529 Qualified Tuition Programs. This new account would be called a Lifetime Savings Account and its characteristics would include:

- Contributions limited to \$2,000 per year,
- Tax-free distributions regardless of use or account holder's age, and
- Nondeductible contributions.

An Employer Retirement Savings Account would be created to consolidate employer-sponsored retirement plans. No further information has been released on this account.

"KIDDIE TAX"



Prior to the 2006 tax year, only children under the age of 14 were subject to the "kiddie tax" rules. The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) changed the rules to include children under the age of 18. For tax years beginning in 2008, legislation has just been signed to include 18 year olds and full-time students aged 19 to 23 years old who are claimed as dependents on their parents' tax returns.

What is "kiddie tax"? When a child has unearned income (usually investment income such as interest and ordinary dividends) in excess of a certain amount (\$1,700 for 2007), that child's income is taxed at the parents' tax rate. This is known as the "kiddie tax".

How to alleviate the "kiddie tax": Make sure investment accounts consist of growth funds rather than income funds. Income funds pay out dividends and capital gains distributions, which can trigger the "kiddie tax" even if the earnings are reinvested. Growth funds do not pay out income but, instead, grow in value. This results in larger capital gains at time of sale, allowing income to be taxed at favorable rates.

If a child's investment income results from money put aside for college, it is more advantageous to use Section 529 College Tuition Programs rather than Uniform Gift to Minors accounts. Section 529 earnings are not taxable and, therefore, not subject to "kiddie tax".

BEHIND THE SCENES...



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We are updating our client contact information... Please complete and return the enclosed information form and return it to our office by mail, fax, or email. Thank you for your assistance in making sure we have the most up-to-date information possible!