

TAX NEWS



Fall/Winter 2006

The Fall/Winter Tax Client Newsletter brings you up-to-date on a number of important tax law changes for 2006. As a result of 2006 tax legislation, there are a number of significant tax law changes affecting you this year and into 2007.

On May 17, 2006, Congress passed and the President signed into law the Tax Increase Prevention and Reconciliation Act of 2005, TIPRA, and on August 17, 2006, President Bush signed into law the Pension Protection Act of 2006. In addition to these two mammoth pieces of tax legislation, other laws enacted during 2006 impact your taxes and there is still time for Congress to act again before the end of the year.

Call my office to set an appointment should you have any question or concern about your taxes and how your taxes may be affected by this legislation.

Tax Increase Prevention and Reconciliation Act of 2005 - TIPRA

Taxpayer's who invest in stock are the broadest group of beneficiaries of the Act. The 15% favorable tax rate on long-term capital gains and qualifying dividends is extended through 2010.

The Act also raises the amount of income exempted from the Alternative Minimum Tax (AMT).

The amount of income exempted from the AMT is increased to \$62,500 for married couples filing jointly, up from \$58,000 in 2005. The exemption for single filers will be raised to \$42,500 for 2006, up from \$40,250 in 2005.

TIPRA also extended through 2006 the provision allowing taxpayers to use non-refundable personal credits to offset AMT liability including the Dependent Care Credit, Credit for Elderly and Disabled and the Hope and Lifetime Learning Credits. Internal Revenue Code Section 179, Expensing of Business Property, was extended through 2009 by the American Jobs Creation Act of 2004. In 2006, the maximum amount that may be expensed is \$108,000 of qualifying property, reduced by the amount by which the cost of qualifying property exceeds \$430,000. Without the extension in the TIPRA, the amounts would have dropped to \$25,000 on a \$200,000 cap after 2007.

With these provisions to prevent additional taxation, Congress enacted the following provisions into TIPRA in order to facilitate "revenue neutral" legislation.

The Act provides for increasing the age limit of the "kiddie tax" to children under 18 years of age which is up from the previous under age 14.

TAX CLIENT NEWSLETTER

If a child under 18 has investment income, the first \$850 is tax-free and the next \$850 is typically taxed at the child's tax rate. "Unearned" income above \$1,700 is taxable at the parents' top tax rate. This change in the law is retroactive back to January 1, 2006. TIPRA also eliminates the \$100,000 adjusted gross income test for converting a traditional IRA to a ROTH IRA. The change is effective for tax years after 2009.

Hero Act

On May 28, 2006, President Bush signed into law the Hero Act, allowing non-taxable combat pay to be deemed earned income to qualify for an IRA contribution. The Act is deemed effective for years 2004, 2005 and future years allowing those taxpayers who qualify to make IRA contributions for the years of 2004, 2005, 2006 and beyond the normal contribution date. The contribution due date has been extended for qualifying taxpayers until May 28, 2009.

The Pension Protection Act of 2006

This new law includes almost 1,000 pages and includes more than 100 tax provisions. Enacted primarily to create some pension security for workers the provisions of the new law are far more wide-ranging.

529 Plans were made permanent by the Pension Protection Act. This means that the exemption from income tax for distributions used to pay qualified higher education costs will continue indefinitely for 529 Plans.

The Act made the Retirement Saver's Credit permanent. This credit encourages individuals of modest income to make contributions to 401(k) plans as well as IRAs by allowing them to claim a double tax break; the tax credit as well as the tax deferral for the elective deferrals to the 401(k) plan or the deduction for the IRA contribution.

Beginning in 2007, the legislation allows non-spouse beneficiaries to roll over qualified retirement benefits to an IRA. Beneficiaries will be able to take required distributions from the IRA over their life expectancy. The Act provides for automatic enrollment in 401(k) Plans. Automatic enrollment, which ensures nondiscrimination, entitles owners and other highly-compensated employees to take full advantage of contribution opportunities.

The legislation also requires the Internal Revenue Service to create rules to allow withdrawals from 401(k) plans for hardships and unforeseen financial emergencies with respect to any beneficiary.

The Pension Protection Act also made some changes to charitable giving, with some specific changes directed at closing loopholes perceived to exist. Those taxpayers age 70 ½ and older who are taking required minimum distributions from IRAs can opt to do so on a tax-free basis by rolling over the funds to charity. While no charitable contribution deduction

will be allowed for the rollover, by avoiding the taxable impact of the distribution, the taxpayer's adjusted gross income will be reduced, thereby avoiding over twelve potentially negative results to the tax calculation on the tax return.

The ability to claim an itemized deduction for donations of items that are "not in good condition" has been restricted. For donations after August 17, 2006, no deduction can be claimed unless an item is in at least "good" used condition. Currently, cash donations of \$250 or more must be substantiated with a written acknowledgment from the charity. Beginning in 2007, cash donations of any amount will need to be substantiated with either a canceled check, bank statement or a receipt from the charity.

Additionally, in 2007, individuals will be able to combine annuities with long-term care protection. Beginning in 2007, insurance companies will be able to issue annuity policies with a long-term care rider. Earnings from the annuity will be used to provide long-term care insurance for nursing home and in-home care. The effect of this provision will not be implemented until 2010.

2005 Energy Bill

In August 2005, President Bush signed into law the Energy Policy Act of 2005. The 2005 Energy Act provides new credits for energy efficient improvements made to personal residences. To qualify, home improvements must be made to your principal residence and not to a second home. A \$500 lifetime credit is available for certain energy-saving expenditures for your personal residence.

One of the most significant features of the 2005 Energy Act is a new incentive for the purchase of new hybrid vehicles. The Act only rewards the original owners of hybrids. The former deduction of a maximum \$2,000 has now been replaced with a new tax credit which may be as high as \$3,400. This new credit for hybrid cars and trucks is made up of two parts, a fuel economy credit and a conservation credit. The Energy Credit for hybrids is a limited credit and Toyota has already reached its limit of selling 60,000 qualifying hybrid automobiles. The credit will diminish over the next several months after the manufacturer reaches the sales limit of 60,000.

Other 2006 Provisions

For taxpayers making too much in income and losing the deductibility of their itemized deductions and personal exemptions, known as the phase out, 2006 will see the beginning of the phase out of the phase out. Taxpayers in 2006 will lose only 2/3 of the deductions and exemptions they lost in 2005. In 2007 they will only lose 1/3 and in 2008 they will lose nothing. The phase out will no longer exist after 2007.

The filing of your 2006 Federal Income Tax Return will include applying for the Federal Excise Credit. The credit will be representative of Excise Taxes charged on long-distance telephone service for the last three years. The credit will also include interest. The Internal Revenue Service, in conjunction with the U. S. Department of the Treasury has calculated a safe-harbor amount which can be claimed in lieu of

requiring the rigorous exercise of compiling the taxes paid.

Beginning in 2006, refunds on your Federal Income Tax Return can be automatically deposited in up to three different bank accounts, including an account that holds your Individual Retirement Account.

Telephone Tax Refund Issues

The Internal Revenue Service announced a tax refund for taxpayers who paid the long-distance telephone tax. The credit will be on the 2006 federal income tax return. Individual taxpayers claim standard amounts of \$30 for a person filing a return with one exemption, \$40 for two exemptions, \$50 for three exemptions and \$60 for four or more exemptions. Individuals can use the standard amounts or can calculate their refund using the actual amount of tax paid after February 28, 2003 and before August 1, 2006.

Businesses and non-profits must claim their telephone tax refund on the actual amount of tax on long distance paid.

2006 Mileage Rates

- Optional Standard Mileage Rate 44.5 cents
- Medical Mileage Rate 18.0 cents
- Moving Mileage Rate 18.0 cents
- Charity Mileage Rate 14.0 cents

The IRS has announced that it will delay the release of the 2007 mileage rates until the end of the year.

Tax Brackets

Tax brackets for 2006 remain at 10%, 15%, 25%, 28%, 33% and 35%.

Standard Deduction Amounts

- Single \$ 5,150
- Married Filing Jointly \$10,300
- Married Filing Sep \$ 5,150
- Head of Household \$ 7,550

Personal Exemption Amounts

For 2006, the Personal Exemption Amount is \$3,300.

Retirement Plan Contributions for 2006 and 2007

In order to maximize the tax benefits of your retirement contributions the following amounts reflect the maximum contributions for the respective years:

Type of Retirement Plan

	<u>2006</u>	<u>2007</u>
Individual Retirement Account (IRA)	\$4,000	\$4,000
Catch-up amount, age 50 and older	\$1,000	\$1,000
401(k)	\$15,000	\$15,500
Catch-up amount, age 50 and older	\$5,000	\$5,000
SIMPLE Plan	\$10,500	\$10,000
Catch-up amount, age 50 and older	\$2,500	\$2,500
SEP IRA contribution limit	\$45,000	\$44,000

Estate and Gift Tax Rules

For 2006, the value of an estate less than 2 million dollars escapes federal estate tax. The indexing of this value continues over the next several years until in 2010 all decedents will escape the estate tax.

However, on January 1, 2011 the estate tax will again have the threshold of 1 million dollars.

\$12,000 is the annual gift limit escaping, tax-free, from gift tax. The \$12,000 is per beneficiary and can increase to \$24,000 in the case of joint gifts from married couples.

Gifts to college savings 529 Plans permit five years worth of gift giving in a single year. In 2006, provided no other gifts have been made to the beneficiary, a total of \$60,000 in gifts can be made to the 529 Plan. In the case of joint gifts from a married couple the amount would increase to \$120,000.

Social Security

- The COLA increase for 2007 is 3.3%. In 2006 the COLA increase was 4.1%.
- In 2007 Medicare Part B premiums will be indexed according to income.
- In 2007 the maximum taxable payroll earnings for Social Security will increase from the \$94,200 in 2006 to \$97,500.

Conclusion

Although 2006 may go down as a record year for tax law enactments, two particular provisions remain without extension. The \$250 adjustment to income known as the "Educator Deduction" and the deductibility of Sales Tax as an itemized deduction both expired on December 31, 2005 and have yet to be extended. After the mid-term elections it is generally thought that both of these issues will be addressed in other legislation to be passed by years end.

As with any tax planning, you and your particular issues are in the forefront of our thoughts. It is wise to review your tax issues and address them in advance of year end. I look forward to speaking with you regarding any personal concerns or questions you might have.

Best wishes,

