



TAX ALERT

TAX INCREASE PREVENTION AND RECONCILIATION ACT

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In early May, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA). President Bush signed it into law on May 17, 2006. The new legislation includes both favorable and unfavorable provisions. This alert briefly explains the most important changes.

Preferential Tax Rates on Capital Gains and Dividends Extended through 2010

For individual taxpayers, TIPRA extends the preferential federal income tax rate on most long-term gains through 2010. Dividends will remain at the current 15 percent. Even better, the current five percent rate will continue through 2007 for long-term gains and qualified dividends earned by individuals in the lowest two regular tax brackets (the 10 percent and 15 percent brackets) before dropping to zero percent (that's not a typo) for 2008 through 2010. (Prior law called for the rates to rise after 2008.)

One-Year Alternative Minimum Tax Fix

TIPRA includes two quick fixes, for this year only, to the individual alternative minimum tax (AMT) rules. These changes will prevent millions from owing the AMT this year.

Under the first fix, the 2006 AMT exemption amounts are increased as follows:

- ◆ To \$62,550 for married individuals who file jointly (up from the 2005 figure of \$58,000). Without the fix, the 2006 exemption would have been \$45,000.
- ◆ To \$42,500 if you are a single individual or head of household (up from the 2005 figure of \$40,250). Without the fix, the 2006 exemption would have been \$33,750.
- ◆ To \$31,275 if you use married filing separate status (up from the 2005 figure of \$29,000).

Without the fix, the 2006 exemption would have been \$22,500.

Under the second fix, nonrefundable personal tax credits (such as the dependent care credit and the Hope Scholarship and Lifetime Learning higher education credits) can be used to reduce both your 2006 regular tax and AMT bills (same as for 2005). You will also be able to use the new residential and non-business energy property credits to reduce both of these taxes for 2006. So, if you are considering making energy efficient improvements to your home, you might want to do it in 2006 rather than waiting until next year.

Favorable "Section 179 Deduction" Rules Extended through 2009

The so-called Section 179 rules allow many small businesses to deduct the full cost of most equipment and software additions (whether new or used) in the first year they are put to use. For tax years beginning in 2006, the maximum Section 179 write-off is a generous \$108,000. However, the maximum Section 179 deduction was scheduled to decrease to only \$25,000 for tax years beginning in 2008 and beyond. TIPRA extends the current taxpayer-friendly Section 179 rules by two years, through tax years beginning in 2009.

Kiddie Tax Rules now Apply to Older Kids, Starting Right Now!

The so-called Kiddie Tax rules can cause a dependent child's unearned income (typically from investments) to be taxed at the parent's higher marginal federal income tax rate. Until now, the Kiddie Tax only applied through the year before a child turned age 14. In other words, the Kiddie Tax ceased to exist the year the child turned 14 and all subsequent years. Starting in 2006, TIPRA extends the Kiddie Tax



rules through the year before a child turns 18. Specifically, beginning this year the Kiddie Tax issue will be lurking until the year a dependent child turns 18. Children who are still age 17 on December 31, 2006 are potential Kiddie Tax victims this year. The only saving grace is that for 2006, the Kiddie Tax only affects under-age-18 dependent children with unearned income in excess of \$1,700. Parents may have a dependent child who is exposed to the Kiddie Tax this year, even though it didn't apply last year.

Income Restriction for Roth IRA Conversions is Eliminated (for 2010 and Beyond)

The Roth IRA conversion privilege is currently restricted to individuals with modified adjusted gross income (MAGI) of no more than \$100,000. TIPRA eliminates the MAGI restriction. However, this change won't become effective until 2010. For Roth conversions that occur in that year only, half the taxable income triggered by the conversion can be reported on your 2011 return and the other half can be reported on your 2012 return. For conversions in 2011 and beyond, all the income must be reported on the return for the conversion year (same as under the current rules).

Domestic Producers Deduction

For tax years beginning after May 17, 2006, TIPRA limits wages for the 50 percent limit for the new domestic producers deduction to include only those allocable to domestic production gross receipts. TIPRA also repeals a complicated W-2 wages limitation provision for wages allocated to partners and S corporation shareholders for tax years beginning after May 17, 2006.

There May be Another New Tax Law this Year

You now understand the key tax changes included in the TIPRA legislation, but there are other provisions that we've had to ignore in order to keep this alert from turning into a book.

Also, don't be surprised if you see at least one more new tax law passed before year-end. Why? Because additional legislation might be enacted to extend various popular federal income tax breaks including (but not limited to) the following:

- ◆ The itemized deduction for general state and local sales taxes in lieu of writing off state and local income taxes.

- ◆ The write-off for up to \$4,000 of higher education tuition costs and related fees.
- ◆ The deduction for up to \$250 of classroom costs paid by elementary and secondary school educators out of their own pockets.
- ◆ The tax credit for expanding research and development activities.

All these breaks (plus some others not listed here) expired at the end of 2005 and will probably be retroactively resurrected for at least this year by future legislation.

Although not a Part of TIPRA, Good News Worth Mentioning – Government to Stop Collecting Long Distance Telephone Tax; Refunds Being Issued

The IRS has announced that it will stop collecting the federal excise tax of 3 percent on long distance telephone service. (Excise taxes imposed on local telephone service and taxes imposed by various states and localities are not affected.)

Taxpayers will be eligible to receive a refund for the excise taxes they paid for long distance services from March 1, 2003 through July 31, 2006. Interest will be paid on these refunds. It is estimated that \$13 billion dollars in refunds will be issued. Refunds can be claimed by individuals as well as businesses on their 2006 tax returns. The IRS will soon announce a simplified method that individuals can use so "they don't have to spend time digging through old telephone bills". Businesses, trusts and other entities can only request refunds of the actual amount of tax paid as the simplified method will only available for individuals.

Look for future tax alerts from W&G as more news about this becomes available. In the interim, businesses can begin to accumulate the information that will be necessary as the 2006 tax year-end approaches.

For clarification or more information on these and other tax matters, contact your W&G tax advisor at 732-846-3000.

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