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## The Tax Increase Prevention and Reconciliation Act of 2005



On May 17, 2006, President Bush signed into law the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). TIPRA extends provisions relating to capital gains and dividends, the alternative minimum tax, and

small business expensing. This law also contains several other provisions, including changes to both the "kiddie tax" rules and the requirements that apply to Roth IRA conversions.

### Capital gains and dividends

Currently, the maximum federal income tax rate for most long-term capital gains and qualifying dividend income is 15%. Taxpayers in the 10% and 15% tax brackets receive the benefit of an even lower 5% maximum tax rate. And, in 2008, the maximum rate will drop all the way to zero for taxpayers in the lower tax brackets--these individuals will actually owe no tax at all on most long-term capital gains and qualifying dividend income. All of these rates were, however, scheduled to expire after 2008.

TIPRA extends the rates that apply in 2008 for two additional years (through 2010).

	Long-Term Capital Gain	Qualifying Dividends
<b>2006 - 2007</b>	<ul style="list-style-type: none"> <li>15% for individuals in a tax bracket greater than 15%</li> <li>5% for individuals in a 10% or 15% tax bracket</li> </ul>	
<b>2008 - 2010</b>	<ul style="list-style-type: none"> <li>15% for individuals in a tax bracket greater than 15%</li> <li>No tax for those in a 10% or 15% tax bracket</li> </ul>	
<b>Beginning in 2011</b>	<ul style="list-style-type: none"> <li>20% for individuals in a tax bracket greater than 15%</li> <li>10% for individuals in a 10% or 15% tax bracket</li> <li>Special rules for qualifying 5-year property</li> </ul>	<ul style="list-style-type: none"> <li>Dividends taxed as ordinary income</li> </ul>

### Alternative minimum tax (AMT)

Temporary legislative solutions relating to the AMT expired at the end of 2005, setting the stage for a dramatic rise in the number of individuals impacted by this parallel system of taxation. TIPRA postpones this problem for one additional year.

The legislation increases AMT exemption amounts for 2006 only. New AMT exemption amounts for 2006 are:

- \$62,550 for married individuals filing jointly
- \$42,500 for single filers
- \$31,275 for married individuals filing separately

TIPRA also resurrects, for 2006, the rules that allow non-refundable personal tax credits (e.g., the dependent care credit, the credit for the elderly and disabled, the Hope credit, and the Lifetime Learning credit) to offset the AMT.

AMT Exemption Amounts			
Filing Status	2003 - 2005	2006	Beginning in 2007
<b>MFJ</b>	\$58,000	\$62,550	\$45,000
<b>Single / HOH</b>	\$40,250	\$42,500	\$33,750
<b>MFS</b>	\$29,000	\$31,275	\$22,500

### Section 179 expensing

Currently, a small businesses can elect to deduct up to \$100,000 of investment in qualifying depreciable assets in the year they are purchased. The deduction begins to phase out when a business's annual investment in Section 179 property exceeds \$400,000. Both the \$100,000 and \$400,000 amounts are adjusted for inflation (for 2006, the amounts as adjusted are \$108,000 and \$430,000). Beginning in 2008, the Section 179 limits would have returned to their 2002 levels of \$25,000 and \$200,000.

TIPRA extends the increased Section 179 limits through 2009. In addition, TIPRA extends for two years other Section 179 rules that were scheduled to expire after 2007, including:

- The inclusion of off-the-shelf computer software as qualifying property
- Permission for taxpayers to revoke expensing elections on amended returns without the consent of the Commissioner

Section 179 Expense Limits	
2003 - 2009	\$100,000* reduced by amount by which cost of qualifying property placed in service during the year exceeds \$400,000*
Beginning in 2010	\$25,000 reduced by amount by which cost of qualifying property placed in service during the year exceeds \$200,000

\*Indexed for inflation

**Roth IRA conversions**

Unlike a traditional IRA, contributions to a Roth IRA are never tax deductible for federal income tax purposes, which means that only after-tax dollars can be contributed. But amounts contributed to a Roth IRA grow tax deferred and, if certain conditions are met, distributions (including both contributions and investment earnings) are tax free at the federal level. Individuals are generally able to convert all or a portion of their traditional IRA funds to a Roth IRA. When funds are converted from a traditional IRA to a Roth IRA, the funds are subject to federal income tax (to the extent that those funds represent investment earnings and tax-deductible contributions) in the year they're converted.

Unfortunately, not everyone who wants to convert a traditional IRA to a Roth IRA is able to do so. Individuals (and married couples filing a joint tax return) with an adjusted gross income (AGI) exceeding \$100,000 are prohibited from converting funds to a Roth IRA. Married individuals who file separate federal income tax returns are also prohibited from converting funds to a Roth IRA.

*Beginning in 2010, any individual will be able to convert funds from a traditional IRA to a Roth IRA.*

TIPRA eliminates the \$100,000 income limit for Roth IRA conversions, and allows married individuals who file separate returns to convert funds to a Roth IRA, but these changes aren't effective until 2010.

**Disclosure Information -- Important -- Please Review**

This information is not intended to be tax or legal advice. It is provided for your education only by Pennytree Advisers, LLC. Individual circumstances may vary.

In addition, for Roth conversions in 2010 only, the amount includible in income as a result of the conversion will be averaged over the following two years unless an individual elects otherwise. That is, no resulting income will be reported on an individual's federal income tax return for 2010. Half the resulting income will be reported on the individual's federal income tax return for 2011, and the remaining half will be reported on the individual's federal income tax return for 2012.

**Kiddie tax rules**

To prevent parents from avoiding tax by shifting investment income to young children in a lower tax bracket, the tax law contains provisions that are known as the "kiddie tax." Under the kiddie tax rules, unearned income (for example, interest or dividend income) of a young child is--under some circumstances--taxed at the top marginal income tax rate of the child's parents. In 2006, the kiddie tax rules apply when children have unearned income in excess of \$1,700. Prior to TIPRA, the kiddie tax rules were applicable to children under the age of 14.

TIPRA increases the age limit for the kiddie tax from 14 to 18. That is, effective January 1, 2006, children under the age of 18 are subject to the kiddie tax rules. Exceptions apply for minor children who are married and file a joint tax return, and distributions from certain qualified disability trusts.

Since this provision is effective for 2006, individuals who may be affected should immediately re-evaluate their tax situation.



To learn more about the provisions described here, as well as other provisions included in the Tax Increase Prevention and Reconciliation Act of 2005, talk to your financial professional.