

Tax Increase Prevention and Reconciliation Act ***A Brief Analysis***

by

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The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) was passed and signed into law on May 17, 2006. This Bulletin is our summary of the provisions that are most likely to affect you or your business.

Two year reduced rate extension on dividends and capital gains.

The 15 percent tax rate that applies to most dividend income and capital gains was scheduled to revert back to higher rates (substantially so for dividends) after 2008. TIPRA extends the 15 percent rate for dividends and capital gains through the end of 2010. The reduced rate is similarly extended for alternative minimum tax (AMT) purposes.

AMT exemption amount increase extended one year for 2006.

This provision, while providing no benefit to higher income taxpayers, will benefit many others at least partially. Without the changes in TIPRA, the 2006 AMT exemption amounts were scheduled to fall back to \$45,000 for married taxpayers and \$33,750 for singles. TIPRA increases the AMT exemption available for 2006 to \$62,550 for married individuals and surviving spouses, and \$42,500 for other single taxpayers. Additional legislation will be required to maintain

or increase the exemption levels for 2007 or later years. Higher income individuals receive limited or no benefit from the exemption since it begins to phase out at AMT income levels of \$112,500 for single taxpayers and \$150,000 for married couples or surviving spouses.

In addition, the ability to reduce the AMT liability by certain nonrefundable personal credits was extended for 2006. The credits available include the dependent care, elderly and disabled, HOPE and lifetime learning, adoption, residential energy, and child tax credits.

“Kiddie Tax” age raised from under 14 to under 18.

Effective for 2006 and later years, the provisions that require that children’s investment income be taxed at the parents’ marginal rates now apply to any child who has not reached age 18 by December 31 (prior law was based on attaining age 14). For 2006, any child under 18 who earns more than \$1,700 of investment income will be subject to the “kiddie tax” rules.

Roth IRA income limitation for conversions eliminated in 2010.

Effective in 2010 and later tax years, the limitation that prevented taxpayers with adjusted gross income of \$100,000 or

more from converting a traditional IRA to a Roth IRA is eliminated. The requirement that tax be paid at conversion for any amounts previously deducted when contributed to the traditional IRA still applies. However, all future earnings on the Roth IRA, once converted, would be tax free. Taxpayers who may want to consider the conversion, despite the tax payment required, would be those who have large traditional IRAs funded by nondeductible contributions, taxpayers who anticipate being in a substantially lower tax bracket in withdrawal years, and those who anticipate exceptional appreciation in their IRA accounts.

2010 conversions receive the additional benefit that half the taxable amount will be included in the 2011 return and half in the 2012 return. Post 2010 conversions receive no similar deferral.

Higher section 179 business expensing election limits extended.

Pre-TIPRA law scheduled the section 179 expensing election amount for certain business property acquired to drop to \$25,000 after 2007. The 2006 amount for section 179 is \$108,000, and is not affected by TIPRA. TIPRA extends the \$100,000 expensing election (as adjusted upward annually for inflation) for two years including all tax

years beginning before 2010. The same extension is made for the related phaseout ceiling for qualified property of \$400,000 and the eligibility of off-the-shelf computer software.

Wage limitation for section 199 domestic production deduction modified.

The cap on the section 199 deduction (which was 50% of all wages paid by the taxpayer) is reduced to 50% of the wages that are properly allocable to domestic production activities for tax years beginning after May 17, 2006.

Material discussed in this Bulletin is meant to provide general information and should not be acted on without obtaining professional advice appropriately tailored to your individual needs.

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