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## President Bush Signs the Tax Increase Prevention and Reconciliation Act

President Bush signed the Tax Increase Prevention and Reconciliation Act on May 17, 2006. Originally introduced in 2005, the bill contains \$70 billion in net tax cuts and approximately \$20 billion in revenue generators.

Highlights of the Act include:

- Alternative minimum tax exemption for individuals increased and extended
- Dividend and capital gains tax rate cuts extended for two more years
- Small business expensing thresholds extended
- Changes to Roth IRA conversions
- Kiddie tax cutoff age raised from age 14 to 18

### Alternative Minimum Tax Exemption Amount Increased

*The Act provides limited alternative minimum tax (AMT) relief by both limiting the number of individuals subject to the AMT and potentially decreasing the tax impact of those subject to the AMT.*

The Act allows taxpayers to take advantage of higher AMT exemption amounts through December 31, 2006. Under this Act, the new exemption amount for married couples filing jointly is \$62,550 (was \$58,000). For single taxpayers, the new exemption amount is \$42,500 (was \$40,250).

The Act also extends the ability to utilize nonrefundable personal credits to reduce a taxpayer's AMT liability. The following credits are potentially available:

- Dependent care
- Elderly and disabled
- Interest on certain home mortgages
- Hope scholarship and Lifetime Learning credits

The number of taxpayers impacted by the AMT continues to grow significantly. Although it has been widely discussed, Congress has not been successful in either repealing or reforming the AMT provisions.



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## **Dividend and Capital Gains Rate Cuts Extended**

Since 2003, the maximum dividend and capital gains tax rates have been 15 percent for taxpayers over the 15 percent tax brackets and 5 percent for those in the 10 and 15 percent tax brackets. In 2008, the tax rates for those in the 10 and 15 percent tax brackets drops to zero.

These tax rate cuts were set to expire at the end of 2008. However, the Tax Reconciliation Act extends these tax rate cuts through December 31, 2010.

## **Small Business Expensing Thresholds Extended**

As an incentive for small businesses to invest in equipment, the Act extends the expensing threshold for small businesses. For 2006, the inflation-indexed expense limit is \$108,000. This limit will be adjusted annually through December 31, 2009 for inflation.

## **Roth IRA Changes**

*High-income taxpayers are now eligible to convert a traditional IRA account into a Roth IRA. As opposed to traditional IRAs, contributions to a Roth IRA are not deductible, and the earnings are permanently tax free.*

For tax years after 2009, the Tax Reconciliation Act allows taxpayers with adjusted gross income in excess of \$100,000 to convert their traditional IRAs to Roth IRAs. Previously, only taxpayers with AGI under \$100,000 could convert from a traditional to a Roth IRA. The conversion is treated as a taxable distribution but is not subject to the 10 percent early withdrawal penalty. If taxpayers convert in 2010, they can choose to recognize the conversion income in 2010 or average it over the next two years.

## **Kiddie Tax Cutoff Age Raised from age 14 to 18**

*Changes to the kiddie tax rules will increase the number of dependents impacted by this tax.*

Under the kiddie tax rules, a child's investment income, such as interest, dividends and capital gains, is taxed at the parents' tax rate, which is typically higher than the child's tax rate. Previously, the kiddie tax applied to children under age 14, claimed as dependents on their parents' returns, and had net unearned income over \$1,700.

The Tax Reconciliation Act raises the age limit to under age 18 and was put into effect immediately after the President signed the bill. This new age limit will alter the very common practice of giving gifts to children in order to reduce a family's tax bills.

## **Additional Changes to Come**

In order to reach an agreement and keep within a budget, Congress removed some of the bill's important provisions. However, the following provisions will likely appear in future legislation:

- Extending the state and local sales tax deduction
- Teachers' classroom expense deduction
- R&D provisions
- Employment tax credits

This newsletter serves to highlight the key components of the Tax Increase Prevention and Reconciliation Act. For more detailed information, contact your C&P Advisor, Brian Marita or Donna Sakony at 216.831.7171.



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