September 2006

MMCO Year-End Tax Update

Miller, Morton & Company, LLC
Certified Public Accountants
and Advisors

Inside this issue:

Tax Increase Prevention and Reconciliation Act of 2006

On May 17, 2006 the President signed the Tax Increase Prevention and Reconciliation Act of 2006 into law. The act extends a number of popular individual tax breaks that were due to expire, such as favorable capital gains and dividends rates. It also contains investor tax breaks, alternative minimum tax (AMT) relief, and several other provisions with immediate and long-term impact on individuals. The legislation also contains an assortment of business and corporate tax breaks.

AMT Relief

The Alternative Minimum Tax, or AMT, is a parallel tax system which does not permit several of the deductions permissible under the regular tax system, such as state, local and property taxes. Originally enacted to make sure that wealthy Americans did not escape paying taxes, AMT has started to affect more middle-income taxpayers. This is in part due to the fact that the AMT parameters are not indexed for inflation. Congress has provided a measure of relief from the AMT by raising the AMT "exemption amounts" for 2006.

Extension of Increased Expensing for Small Business

Your businesses may elect to deduct as an expense (Section 179), rather than depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year. The maximum dollar amount that may be deducted for 2006 is $108,000. This amount was scheduled to drop to $25,000 for property placed in service in tax years beginning after 2007.

The maximum annual expensing amount is reduced dollar-for-dollar by the amount of qualified eligible property that your business places in service during the tax year in excess of a phase-out amount. This amount is $430,000 for 2006. This amount was scheduled to drop to $200,000 for property placed in service in tax years beginning after 2007.

The new law extends the $108,000 expense election limit and the $430,000 ceiling (as inflation adjusted), and adds the right to amend or revoke an expense election without IRS's consent for two years, to tax years beginning before 2010.

Investor Tax Breaks Extended

In 2003, Congress lowered the tax rate on most dividends to 15 percent from as high as 38.6 percent, and lowered the rate on most long term capital gains from 20 percent to 15 percent. The rates were due to expire at the end of 2008, but the new law extends the favorable tax rates through 2010.

Kiddie Tax Age Limit Raised From 14 to 18

At one time, parents could significantly lower their family's tax bill by transferring investment assets to minor children. This tax technique, called income shifting, worked by taking income out of the parents' higher tax bracket and placing it in the lower tax brackets of their children.

To curtail the use of this tax technique, Congress enacted the “kiddie tax” rules. Children under 14 who had more than a small amount of unearned (investment) income had to pay tax at their parents' marginal tax rate. Under the new law, the "kiddie tax" age limit is raised from 14 to 18 beginning January 1, 2006. For 2006, the "kiddie tax" begins to apply when the child has more than $1,700 in unearned income. However, the tax does not apply to a child who is married and files a joint return for the tax year.

Income Limitations on Roth IRA Conversions

If you make deductible contributions to a regular individual retirement account (IRA) you receive a tax break now for the dollars you put in and earnings on those dollars are tax deferred, but every dollar you take out is taxed as ordinary income. In a Roth IRA, you do not receive a tax deduction for contributions, but your money still grows tax free and there's no tax on qualifying withdrawals. A commonly asked question is whether or not it makes sense to convert a traditional IRA to a Roth IRA, paying the tax now on the amount converted to take advantage of tax free withdrawals in the future.

Generally speaking, Roth conversions are appealing if you anticipate an increase in your tax rate during retirement, or you believe that the value of your account will rise significantly, and thus are willing to make that upfront tax payment when you convert in order to realize potential tax savings in later years.

Under prior law though, only taxpayers with $100,000 or less in modified adjusted gross income were able to convert a regular IRA into a Roth IRA. Under the new law the conversion limitations remain in effect until the beginning of 2010, when taxpayers with more than $100,000 of modified adjusted gross income also will be able to convert a regular IRA into a Roth IRA. To make such conversions more attractive in 2010, the new law permits you to spread the income and resulting tax payments on the converted funds over two years - 2011 and 2012.

Please contact our office if you would like assistance in determining if a Roth conversion is right for you.

Year End Tax Planning

It is not too early to start thinking about tax planning for 2006. Consider increasing your contributions to your retirement plan. Invest in energy efficient home improvements. If you are going to replace a car, consider purchasing a hybrid car. Order your business equipment so that you place it in service before December 31 to take advantage of the expensing election. These are only some of the ways you can reduce your 2006 tax burden.

Energy Credits

Remember that you may claim energy credits during 2006 or 2007 for:

- The cost of making energy saving improvements to your home. This is a new 10% credit for energy efficient improvements to an existing home. The lifetime maximum per taxpayer is $500.
- The use of solar power to generate electricity or solar hot water in your home. The credit is 30% of the purchase of qualifying residential solar water heating, photovoltaic equipment and fuel cell property. You may claim a maximum credit of $2,000. However, equipment cannot be used to heat a swimming pool or hot tub.
- The purchase of a hybrid automobile. The original use of the vehicle must begin with you and you must not acquire the car for resale. The credit is calculated on the fuel economy of your automobile relative to the 2002 fuel economy.

Long Distance Telephone Tax Refunds

On your 2006 income tax return you may be able to claim a refund of the federal excise tax on long-distance telephone service paid since February 28, 2003. There will be an option of using a table or calculating the actual taxes paid. The tax, which was originally used to finance the Spanish-American War, will end on July 31, 2006.

Want to receive Important Information by E-Mail?

We would like to communicate with you electronically when matters come to our attention that we think would be of interest to you. In order to make sure we have your correct email address, please visit our website at http://www.millermoriarty.com and click on the Contact Us section, fill in the requested information, type “current email address” in the Comment/Question box and click on the submit button to forward the information to us.

State Taxes

Donate your Computers

Your business can claim a maximum credit against the state corporation tax of 50% of the fair market value of a new or a used computer which is no more than two years old, if you donate it to a public or nonpublic school after January 1, 2006.

Hybrid Car Exemption

Your passenger car that uses two on-board sources of stored energy and is certified to meet the low emission vehicle requirements is exempt from sales tax at the time of purchase.

Sales Tax Holiday

From June 1, 2006 through June 30, 2007 Connecticut has declared a sales tax holiday on home weatherization products. The exemption applies to items for residential use only, and includes programmable thermostats, window film, caulking, weather stripping, insulation, water heaters and their blankets. It also includes boilers, gas furnaces, propane furnaces, windows, doors and heat pumps that meet certain Energy Star standards or efficiency ratings.

Plan Your Education Credits Carefully

Who is eligible to claim one of the education credits for tuition and related expenses of a student? It may be you, another person or the student. In other words, it depends. If the student is a claimed dependent of parent or another person, that parent or other person is eligible to claim the education credit even if the tuition and related expenses are paid by the student. Conversely, if a parent or other person is eligible to, but does not claim the student as a dependent, only the student may claim the education credit for those educational expenses paid by or on behalf of the student. However, the student cannot claim a dependency exemption deduction for himself.

The ability for taxpayers to shift the education credit to the student as described above is particularly beneficial to higher income taxpayers who are not able to utilize the credit due to income limitations. However, parents should review their health insurance policies to make sure that there is not a clause in the policy disallowing coverage to students not claimed as a dependent.

Please keep in mind that we have described only some of the highlights of the most important changes in the new law.
Please call our office for more details on how you may be affected by this important tax legislation.

All of the Team Members at
Miller, Moriarty & Company, LLC
are here to help answer
any of your tax questions.

Call us at 860.225.7854

Fax us at 860.225.4893

Email us at main@millermoriarty.com

Miller, Moriarty & Company, LLC

35 Court Street

New Britain, CT 06051

ADDRESS CORRECTION REQUESTED