Summary of the Tax Increase Prevention and Reconciliation Act of 2005

Provided by:

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Life Insurance, Annuities and Long-Term Care

The 2005 Tax Act (Tax Increase Prevention and Reconciliation Act of 2005 - TIPRA) was signed into law by President Bush on May 17, 2006.

The 2005 Tax Act offers tax relief to individuals and small businesses by extending certain tax relief measures scheduled to expire. The bill also contains several "revenue raisers." While some of these provisions may not apply to you, other provisions will and you may want to revise your planning to take full benefit of those provisions.

As you review the attached summary, pay particular attention to any provisions you feel may impact on your situation. If you would like additional information on the 2005 Tax Act or to discuss the impact of specific provisions on your planning, please call my office.

Tax Increase Prevention and Reconciliation Act of 2005

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) was passed by Congress on May 11, 2006 and signed into law by President Bush on May 17, 2006. This tax package, which contains an estimated $90 billion in tax cuts, also contains "revenue enhancers" worth an estimated $20 billion, resulting in a $70 billion net tax cut.

The tax relief provisions of TIPRA are designed primarily to extend several tax breaks in order to provide taxpayers with more certainty in planning their finances over the next several years.

Individual Tax Relief:

Tax relief for individuals comes primarily in the form of extending previously-passed tax reductions.

Reduction in Tax Rates on Long-Term Capital Gains

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) reduced the maximum long-term capital gains tax rate from 20% to 15% for long-term capital gains realized on or after May 6, 2003 and through December 31, 2008. Beginning in 2009, the maximum capital gains rate was scheduled to revert to 20%. **TIPRA, however, extends the 15% long-term capital gains tax rate through 2010.**

Maximum Long-Term Capital Gains Tax Rate			
2002	**January 1, 2003 to May 6, 2003**	**May 6, 2003 through 2010**	**2011 and later**
20%	20%	15%	20%

For taxpayers in the 10% and 15% tax brackets, JGTRRA reduced the capital gains rate from 10% to 5% for capital gains realized on or after May 6, 2003 and through December 31, 2007, and to zero percent in 2008. On January 1, 2009, the 10% capital gains rate was scheduled to return. **TIPRA, however, extends the 0% long-term capital gains tax rate from 2008 through 2010.**

Long-Term Capital Gains Tax Rate (10% and 15% Tax Brackets)				
2002	**January 1, 2003 to May 6, 2003**	**May 6, 2003 through 2007**	**2008 through 2010**	**2011 and later**
10%	10%	5%	0%	10%

Dividend Tax Relief

Under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), beginning with dividends paid in 2003, dividends paid by domestic and qualified foreign corporations to individual shareholders are taxed at the new, lower capital gains tax rates (15% or 5%) retroactive to the beginning of 2003. Effective January 1, 2009, dividends were scheduled to again be taxed at ordinary income tax rates. **TIPRA, however, extends the capital gains tax treatment of qualified dividends through 2010.**

Qualified Dividend Tax Rate				
Tax Bracket:	**2002**	**2003 through 2007**	**2008 through 2010**	**2011 and later**
Above 15%	Taxed as ordinary income	15%	15%	Taxed as ordinary income
10% and 15%	Taxed as ordinary income	5%	0%	Taxed as ordinary income

Alternative Minimum Tax Relief

The Economic Growth and Tax Relief Reconciliation Act of 2003 (JGTRRA) **increased the AMT exemption amount** by $9,000 for married couples (from $49,000 to $58,000) and by $4,500 for single taxpayers (from $35,750 to $40,250), but only for the 2003 and 2004 tax years. The Working Families Tax Relief Act of 2004 (WFTRA) then **extended the increased AMT exemption, but only through the 2005 tax year.** With the passage of TIPRA, the higher **AMT exemption is not only extended, but is also increased for the 2006 tax year.**

Beginning in 2007, without Congressional action, AMT exemption amounts will return to their pre-2001 levels of $45,000 for married couples and $33,750 for single taxpayers.

Alternative Minimum Tax Exemption Amounts			
Filing Status:	**2003 - 2005**	**2006**	**2007 and later**
Joint Filers	$58,000	$62,550	$45,000
Single Filers	$40,250	$42,500	$33,750

According to projections, unless a future Congress takes action to reform the AMT, millions more taxpayers will become subject to the alternative minimum tax in its current form.

Small Business Tax Relief:

Small Business Expensing

The Jobs and Growth Tax Relief Reconciliation Act of 2003 provided that, in lieu of depreciation, **business taxpayers could immediately deduct under Section 179 up to $100,000 of qualified property placed in service for the year** (up from $25,000). In addition, the phase-out threshold for this special treatment was increased from $200,000 to $400,000. These changes were effective for the 2003, 2004 and 2005 tax years only, with both amounts indexed for inflation in 2004 and 2005. Beginning in 2006, the Section 179 deduction was scheduled to return to its pre-2003 maximum of $25,000. **TIPRA, however, extends the higher inflation-adjusted Section 179 deduction through 2006.**

Section 179 Expensing

	2005*	2006*	2007 and later
Maximum Section 179 Deduction	$105,000	$108,000	$25,000
Phase-Out Threshold	$420,000	$430,000	$200,000

* Indexed for inflation

Revenue Enhancers:

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) also contains several measures intended to increase tax revenues. These include:

Roth IRAs

Currently, a taxpayer can convert a traditional IRA to a Roth IRA, but only if the taxpayer's adjust gross income does not exceed $100,000 in the year of the conversion. **TIPRA eliminates the $100,000 adjusted gross income ceiling for tax years after 2009.**

This means that, **beginning in 2010, any taxpayer can convert a traditional IRA to a Roth IRA.** The conversion is treated as a taxable distribution, but is not subject to the 10% early withdrawal penalty. In addition, taxpayers who convert to a Roth IRA in 2010 can elect to either recognize the taxable distribution as income in 2010 or average it over the next two years, with half due in 2011 and the remaining half payable in 2012.

While contributions to a Roth IRA are not tax deductible, the earnings are permanently income tax free. This means that no federal income tax is due on permissible distributions from a Roth IRA. In addition, the age 70-1/2 required minimum distribution rule does not apply to Roth IRAs.

Planning Note #1: Unless you believe future income tax rates will decline significantly, converting a traditional IRA to a Roth IRA has the potential to pay off handsomely in retirement. Keep in mind, however, that you must pay income tax on the taxable portion of your traditional IRA. In order to avoid the 10% early withdrawal penalty tax, the entire amount in the traditional IRA must be converted to a Roth IRA. This means that to maximize the tax benefits of the conversion, you must be able to pay the income tax due from funds other than the proceeds of the traditional IRA. Any portion of the traditional IRA proceeds used to pay the tax bill on the conversion will be subject to the 10% early withdrawal penalty tax.

Planning Note #2: Married couples with adjusted gross incomes over $160,000 and single taxpayers with adjusted gross incomes over $110,000 cannot contribute to a Roth IRA. These higher-income taxpayers, however, can make non-deductible contributions to a traditional IRA between now and 2010, and then convert the traditional IRA to a Roth IRA in 2010, paying tax only on any investment earnings.

Kiddie Tax

The so-called kiddie tax requires that if a child's unearned income, such as capital gains and dividends, exceeds a stated amount ($1,700 in 2006), the excess must be taxed at the parents' marginal tax rate, which is usually higher than the child's rate.

Prior to TIPRA, the kiddie tax applied to children under age 14. With the passage of TIPRA, beginning in 2006 the kiddie tax applies to children under age 18. This means that **in 2006, the unearned income in excess of $1,700 of any child under age 18 will be taxed at the parents' usually higher marginal tax rate.**

Planning Note #1: With the capital gains tax rate declining to 0% in 2008 for taxpayers in the 10% and 15% brackets, some parents were planning to sell a child's college stock portfolio in 2008, assuming the child would be over age 13 in 2008. That planning technique will no longer be effective, unless the child has reached age 18.

Planning Note #2: With the kiddie tax now applying through age 17, parents may wish to evaluate whether a Section 529 college savings plan is a better option than using custodial accounts to save for college costs. The kiddie tax does not apply to Section 529 plans.