

# AHLBECK & COMPANY

## CERTIFIED PUBLIC ACCOUNTANTS

### UPDATE ON TAX CHANGES AND ISSUES

#### PERSONAL INCOME TAXES

- Individual income tax rates for 2005 consist of six brackets (from 10% to 35%).
- Single individuals may be eligible for "head of household" status.
- Taxpayers subject to AMT (alternative minimum tax) should try to reduce or move to a different (non-AMT) year items that are added back to income for AMT purposes (i.e. real estate and state taxes). Large capital gains and non-recurring high income need proper AMT planning.
- Through 2008, the maximum tax rate for qualifying dividends and long-term capital gains is 15% (lower tax brackets subject to a 5% rate).

#### ESTIMATED TAXES

- Taxpayers are subject to penalty unless total 2006 quarterly estimated tax payments or withholding are the lesser of:
  - 90% of the expected 2006 tax liability or
  - 100% of the actual 2005 tax liability (110% if adjusted gross income is greater than \$150,000 for married filing joint)

#### EDUCATION

- Coverdell Education Savings Account contributions remain at \$2,000.
- Qualified distributions from Section 529 plans are generally tax-free. Plan contributions are subject to gift tax, but may be spread over five years.
- The maximum Lifetime Learning Credit is \$2,000 and the Hope Scholarship Credit is \$1,500. Alternatively, you may deduct up to \$4,000 for qualified post-secondary expenses. You are not required to itemize and income limitations apply.
- All student loan interest is deductible up to \$2,500 based on income limitations.

#### CHILD AND DEPENDENT CARE

- "Qualifying" child and dependent care expenses of up to \$3,000 for one qualifying individual and \$6,000 for two or more are eligible for a credit.

#### DEDUCTIONS AND CREDITS

- For 2005, individuals who itemize deductions may elect to claim the higher of state and local income taxes or sales and use taxes. The sales and use tax deduction will not be available in 2006.
- For 2006, the standard mileage rate for medical and moving expenses is 18 cents. The charity mileage deduction is 14 cents, other than activities related to Hurricane Katrina relief. The Katrina-related charitable rate will be 32 cents in 2006.

- If you placed a qualified clean-fuel vehicle in service during 2005, you can deduct \$2,000. For 2006, this deduction is replaced with a more generous credit.

- The Katrina Emergency Tax Relief Act of 2005 provides additional opportunities to deduct charitable contributions. Taxpayers in the disaster area have many added relief provisions.

- You may be able take a residential energy credit for expenses paid in 2006 to have qualified energy saving items installed in your principal residence.

#### RETIREMENT PLANNING

- The maximum IRA contribution is \$4,000 in 2006. If age 50 or older, the 2006 contribution is \$5,000. A credit up to \$1,000 is available to low-income individuals through 2006.
- Make sure the Required Minimum Distribution is being withdrawn from your IRA to avoid penalty. Amounts not subject to penalty *are still subject to income tax*.

# Income Taxes

■ A portion of the penalty assessed for early withdrawal to those under age 59 1/2 can be avoided under certain exceptions. Penalties can be avoided by taking yearly payments for the longer of 5 years or until you reach age 59 1/2.

■ Consider Roth IRA conversion if you have high net worth and low income. Qualifying income is now computed without IRA distributions.

■ For 2006, participants can defer up to \$15,000 to 401(k), 403(b), SEP or 457 plans and \$10,000 to a SIMPLE plan. Individuals age 50 or older are eligible for "catch-up contributions." The additional amount allowed in 2006 is \$2,500 for SIMPLE IRAs or SIMPLE 401(k) plans and \$5,000 for other qualified plans.

■ Annual employer contributions to profit sharing and stock bonus plans, as well as SEPs, are 25% of compensation (20% for self-employed individuals). Overall, contributions are limited to \$44,000 for 2006.

■ Starting in 2006, the Roth 401(k) is available and offers many of the same benefits of a Roth IRA. However, the Roth 401(k) contributions are not subject to income limitations and the annual contribution limits are much higher than standard IRAs. Roth 401(k) contributions must be segregated from other 401(k) contributions. Also, employer contributions do not qualify for Roth 401(k) plans.

## **BUSINESS**

■ For 2005 and 2006, you may be able to deduct up to 3% of your qualified domestic production activities income from certain business activities, such as manufacturers, contractors, engineers and architects.

■ Extended through 2007, Internal Revenue Code Section 179 depreciation expense is limited to \$108,000 for 2006 (subject to phase-out when asset purchases exceed \$430,000). Vehicles are excluded (except those over 6,000 pounds, which are then limited to \$25,000).

■ Subject to limitations, a deduction is allowed for business organization and start-up expenses when incurred, with the remainder deducted ratably over 15 years.

■ The standard mileage rate for business changes to 44.5 cents for 2006.

■ Self-employed health insurance and qualified long-term care insurance for you or your family are fully deductible.

■ Review high deductible health plans.

■ In 2006, wages up to \$94,200 are subject to FICA.

## **ESTATES AND TRUSTS**

■ The estate tax exclusion is \$2,000,000 and the exclusion for gifts of present interests increases to \$12,000 for 2006.

■ The IRS allows an additional 65 days after year-end for distributions of trust income (if an election is made).

## **ABOUT AHLBECK & COMPANY**

We pride ourselves on serving our clients and excel at going "beyond the taxes" to assist with issues related to tax planning. To review any of these items or any other tax issues, please contact us.

Ahlbeck & Company offers a diverse menu of services. We are more than an accounting firm. We are your business partner, willing to assist in all aspects of your individual and business needs.

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