

2006 TAX SEASON NEWSLETTER

I) ELECTRONIC FILING PAYMENT OPTIONS

New York State

New Electronic Filing requirements were enacted starting with the 2005 tax year. Starting January 1, 2005 any tax practitioners who prepared more than 200 NYS original tax returns for the 2004 tax year in 2005 and uses tax preparation software **MUST** e-file their clients 2005 tax returns.

Also the Form IT-201E has been replaced with Form TR-579, NYS E-file Signature Authorization for Tax Year 2005. Taxpayers can elect out of electronic filing by submitting Form IT-800 with their paper return.

Taxpayers may elect to pay their balance due by authorizing a direct debit from their savings or checking account in 2005. Taxpayers must specify, at the time their return is electronically filed, the type of account (savings or checking), account number, routing number of the bank account and the date they wish the debit to occur. The direct debit option must be chosen before the state income tax is transmitted to New York State.

Taxpayers can pay their 2005 tax liability with their credit cards (American Express, Discover, MasterCard or VISA), by contacting one of the two credit card service providers listed below. Taxpayers must contact these providers directly.

Official Payments Corp
Call - 1-800-2PAYTAX
www.officialpayments.com

Link 2 Gov Corp
Call – 1-866-TAXESNY
www.nytaxpayment.com

You can also connect to either of these sites by visiting the NYS Tax Department's website www.tax.state.ny.us

Internal Revenue Service

Taxpayers can pay their federal taxes using a direct debit or credit cards (American Express, Discover, MasterCard or VISA) in 2005. Direct debit payments can be made by calling 1-888-353-4537 or by setting up the payment schedule with your tax preparer at the time of your tax appointment.

You can pay income taxes using either of the two credit card service providers listed below. Taxpayers must contact these providers directly.

Official Payments Corp
Call - 1-800-2PAYTAX
www.officialpayments.com

Link to Gov Corp
Call - 1-888-PAY1040
www.PAY1040.com

II) 2005 TAX FIGURES

Standard Deductions for 2005

Married Filing Jointly	10,000.00
Single	5,000.00
Head of Household	7,300.00
Married Filing Separately	5,000.00

Personal Exemptions for 2005

\$3,200.00 per person

2005 Phase-Out Amounts / Adjusted Gross Income Ranges

<u>Filing Status</u>	<u>Lifetime Learning & Hope Scholarship</u>	<u>Coverdell ESA</u>	<u>Student Loan Int</u>
Married Filing Joint	\$87,000-107,000	\$190,000-220,000	\$105,000-135,000
Single	42,000 - 52,000	95,000 - 110,000	50,000-65,000
Head of Household	42,000 - 52,000	95,000 - 110,000	50,000-65,000
Married Separately	Do Not Qualify	95,000 - 110,000	Do Not Qualify

<u>Filing Status</u>	<u>Regular IRA Active Participant</u>	<u>Roth IRA</u>	<u>Child Tax Credit</u>
Married Filing Joint	\$70,000-80,000	\$150,000-160,000	(under)\$ 110,000
Single	50,000-60,000	95,000-110,000	(under) 75,000
Head of Household	50,000-60,000	95,000-110,000	(under) 75,000
Married Separately	0-10,000	0- 10,000	(under) 55,000

<u>Filing Status</u>	<u>Tuition & Fees Deduction</u>	
	<u>First Phaseout</u>	<u>Second Phaseout</u>
Married Filing Joint	\$0-130,000	& \$130,000 – 160,000
Single	0-\$65,000	& \$ 65,000 – 80,000
Head of Household	0-\$65,000	& \$ 65,000 – 80,000
Married Separately	Do Not Qualify	

III) 2005 TAX UPDATES

Uniform Definition of Child

Starting in 2005, IRS has established a uniform definition of a qualifying child for purposes of claiming the following five commonly used provisions:

- 1) The dependency exemption
- 2) The child tax credit
- 3) The earned income credit
- 4) The dependent care credit
- 5) Head of Household filing status

Under the new uniformed definition, a child generally is a qualifying child of a taxpayer if the child satisfies the following three tests:

- 1) Residency Test – A child must have the same principal place of abode as the taxpayer for more than half the year.
- 2) Relationship Test - A child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any such individual.
- 3) Age Test – A child must generally be under the age of 19 (or under 24 in the case of a full-time student) to be a qualifying child. The new uniformed guidelines retain the same age limitations for the dependent care credit (under age 13) and the child tax credit (under age 17).

Please Note: The main change, with respect to the Uniform Definitions, is that adult children, living with a parent, must be claimed as a dependent, by that parent, in order for the parent to claim Head of Household status.

All the special provisions related to the Earned Income and Dependent Care Credits remain the same in 2005. For details on these please call our office or go to www.irs.gov.

Charitable Donations of Automobiles

Starting in 2005, tougher rules will apply to the charitable deduction for vehicles donated to charities if the vehicle has a claimed value of more than \$500. If the charitable organization immediately sells the vehicle, your charitable deduction generally cannot exceed the charity's gross proceeds from the sale. Previously, the charitable deduction was based only on the fair market value of the vehicle regardless of how used by the organization. If the charitable organization keeps the vehicle for their use, your claimed deduction will be based on the fair market value of the vehicle at the time of the donation.

When making a donation the charitable organization must substantiate the contribution with a written acknowledgment containing the donor's name, identification number of the donor, and the vehicle identification number. More importantly if the charitable organization sells the donated vehicle they must include the gross sale amount and provide this information to the donor within 30 days.

This law will establish more due diligence for the taxpayer and charitable organization when donating vehicles.

Itemized Deduction for State and Local General Sales Tax

For 2005, taxpayers can elect to deduct their state and local general sales and use taxes as an itemized deduction, instead of deducting their state and local income taxes.

Taxpayers who make this election may choose from two options in calculating their sales tax deduction:

- 1) Deduct their actual sales taxes paid during 2005 or
- 2) Use IRS published tables plus sales tax paid for any motored vehicles, boats and other larger priced items specified by IRS.

Please note: IRS has not issued the published tables at this time. They are hopeful to have the tables available by the start of the upcoming filing season. Itemized Deduction for State and Local Sales Taxes

Tuition and Fees Deduction

The Tuition and Fees Deduction is \$4,000 in 2005. The deduction allows for up to \$4,000 of tuition and fees paid for the enrollment at an eligible educational institution. In 2005 if taxpayer's Adjusted Gross Income is above the first phase out amounts of \$130,000 for Married Filing Jointly and \$65,000 for Single or Head of Household they can qualify for a reduced deduction. The reduced deduction of \$2,000 is available only if the taxpayer's Adjusted Gross Income does not exceed \$160,000 for Married Filing Jointly and \$80,000 for Single or Head of Household taxpayers.

Educator's Expenses

Similar to 2004, an above the line deduction is available for kindergarten through grade 12 teachers, that purchase books, supplies, equipment used in the classroom. The

deduction is limited to \$250 per taxpayer, as long as the taxpayer spends at least 900 hours during the year as an educator. This deduction was set to expire in 2003; however, new legislation has allowed the deduction for tax years 2004 and 2005.

Student Loan Interest Deduction

Taxpayers can deduct up to \$2,500 of interest on qualified educational loans for college or vocational school expenses as an adjustment to income.

Qualified Electric Vehicle Credit and Clean-Fuel Vehicle Deduction

The phase out percentage of the Qualified Electric Vehicle (QEV) Credit and Clean-Fuel Vehicle deduction in 2004, 2005 and 2006 has been eliminated. The amount of the QEV is 10% of the vehicle's cost up to a maximum credit of \$4,000. The Clean-Fuel Vehicle deduction is an adjustment to gross income not to exceed \$2,000.

Non-Taxable Combat Pay Income

Non-taxable combat pay can be treated as earned income for purposes of the refundable child credit.

2005 taxpayers can elect to treat combat pay that is otherwise excluded from gross income, as earned income for purposes of the earned income tax credit.

New Section 179 Expensing of Sports Utility Vehicles (SUV's)

For property placed in service after 10/22/04, the act limits taxpayer's ability to fully deduct heavy SUV's, those with Gross Vehicle Weights over 6,000 pounds and higher. Effective 10/22/04 only \$25,000 of the cost of a heavy SUV may be expensed. Previously a heavy SUV used 100% for business could be fully deducted up to \$102,000.

Example: Joan purchased an SUV for her consulting business on 11/20/04 for \$50,000. She uses the vehicle 100% for business and fully qualifies for section 179 expensing. Joan can expense \$25,000 in 2004, in addition to a regular depreciation deduction of \$5,000 ($\$25,000 \times 20\%$), for a total depreciation deduction of \$30,000. Prior to 10/23/04 Joan could have fully depreciated the SUV of \$50,000 in the year of acquisition.

NEW 15-YEAR RECOVERY (DEPRECIATION) PERIOD FOR QUALIFIED LEASEHOLD IMPROVEMENTS & RESTAURANT PROPERTY

Qualified Leasehold Improvements

For property placed in service from 10/22/04 to 12/31/05, the Act provides a statutory straight-line 15-year depreciation period for Qualified Leasehold Improvement property placed in service before 2006. Previously leasehold improvements were depreciated as a 39-year property.

In general terms, qualifying leasehold improvements are interior improvements made under a lease to commercial property and placed in service more than three years after the building was first placed in service. Certain structural improvements or expansions do not qualify.

Qualifying Restaurant Property

Similar rules apply for Restaurant Property placed in service from 10/22/04 to 12/31/05. The act provides a 15-year straight-line depreciation for qualified restaurant property.

Qualified restaurant property is any improvement to a building if the improvement is placed in service more than three years after the building was originally placed in service and more than 50% of the building's square footage is devoted to the preparation of or seating for on-premises consumption of prepared meals.

Child Tax Credit

The 2005 child tax credit will remain at \$1,000 per qualifying child through 2010.

Standard Mileage Rate for 2005

The standard mileage rate for 2005 is 40.5 cents per mile from 1/1/05 to 8/31/05 and 48.5 cents per mile from 9/1/05 to 12/31/05.

New Federal Personal & Fiduciary Tax Rates

Below is a table detailing the tax rates for all Federal Taxpayers.

Married Filing Jointly or Qualifying Widower Taxable Income:

\$ 0 to 14,600 X 10% minus \$ 0.00 = Tax
14,601 to 59,400 X 15% minus 730.00 = Tax
59,401 to 119,950 X 25% minus 6,670.00 = Tax
119,951 to 182,800 X 28% minus 10,268.50 = Tax
182,801 to 326,450 X 33% minus 19,408.50 = Tax
326,451 and over X 35% minus 25,937.50 = Tax

Single Taxable Income:

\$ 0 to 7,300 X 10% minus \$ 0.00 = Tax
7,301 to 29,700 X 15% minus 365.00 = Tax
29,701 to 71,950 X 25% minus 3,335.00 = Tax
71,951 to 150,150 X 28% minus 5,493.50 = Tax
150,151 to 326,450 X 33% minus 13,001.00 = Tax
326,451 and over X 35% minus 19,530.00 = Tax

Head of Household Taxable Income:

\$ 0 to 10,450 X 10% minus \$ 0.00 = Tax
10,451 to 39,800 X 15% minus 522.50 = Tax
39,801 to 102,800 X 25% minus 4,502.50 = Tax
102,801 to 166,450 X 28% minus 7,586.50 = Tax
166,451 to 326,450 X 33% minus 15,909.00 = Tax
326,451 and over X 35% minus 22,438.00 = Tax

Married Filing Separately Taxable Income:

\$ 0 to 7,300 X 10% minus \$ 0.00 = Tax
7,301 to 29,700 X 15% minus 365.00 = Tax
29,701 to 59,975 X 25% minus 3,335.00 = Tax
59,976 to 91,400 X 28% minus 5,134.25 = Tax
91,401 to 163,225 X 33% minus 9,704.25 = Tax
163,226 and over X 35% minus 12,968.75 = Tax

Fiduciary (Estates and Trusts) Taxable Income:

\$ 0 to 2,000 X 15% minus \$ 0.00 = Tax
2,001 to 4,700 X 25% minus 200.00 = Tax
4,701 to 7,150 X 28% minus 341.00 = Tax

7,151 to 9,750 X 33% minus 698.50 = Tax
9,751 and over X 35% minus 893.50 = Tax

Updated New York State Tax Brackets

Below is a chart detailing the tax rate schedule for NYS taxpayers.

Married Filing Jointly or Qualifying Widower Taxable Income:

\$ 0 to 16,000 X 4.00% minus \$ 0.00 = Tax
16,001 to 22,000 X 4.50% minus 80.00 = Tax
22,001 to 26,000 X 5.25% minus 245.00 = Tax
26,001 to 40,000 X 5.90% minus 414.00 = Tax
40,001 to 150,000 X 6.85% minus 794.00 = Tax
150,001 to 500,000 X 7.25% minus 1,394.00 = Tax
500,001 and over X 7.70% minus 3,644 = Tax

Single Taxable Income and Married Filing Separately:

\$ 0 to 8,000 X 4.00% minus \$ 0.00 = Tax
8,001 to 11,000 X 4.50% minus 40.00 = Tax
11,001 to 13,000 X 5.25% minus 122.50 = Tax
13,001 to 20,000 X 5.90% minus 207.00 = Tax
20,001 to 100,000 X 6.85% minus 397.00 = Tax
100,001 to 500,000 X 7.25% minus 797.00 = Tax
500,001 and over X 7.70% minus 3,047.00 = Tax

Head of Household Taxable Income:

\$ 0 to 11,000 X 4.00% minus \$ 0.00 = Tax
11,001 to 15,000 X 4.50% minus 55.00 = Tax
15,001 to 17,000 X 5.25% minus 167.50 = Tax
17,001 to 30,000 X 5.90% minus 278.00 = Tax
30,001 to 125,000 X 6.85% minus 563.00 = Tax
125,001 to 500,000 X 7.25% minus 1,063.00 = Tax
500,001 and over X 7.70% minus 3,313.00 = Tax

IV) WHAT'S AHEAD IN 2006

Energy Tax Incentives Act of 2005

Alternative Motor Vehicle Credit

Starting January 1, 2006 the new law allows a tax credit for the following four types of new vehicles:

- 1) Qualified Hybrid
- 2) Advanced lean burn technology
- 3) Qualified Fuel Cell
- 4) Qualified alternative Fuel

The credits are allowed for both personal and business vehicles and the credit is calculated based on a complicated set of rules. For example, the credit for qualified hybrid motor vehicles is based on fuel economy efficiency improvements and conservation of anticipated lifetime fuel savings. The credits will vary based on the vehicle purchased.

Personal Energy Property Credit

Beginning in 2006, taxpayers can claim a personal tax credit equal to the sum of:

- 1) 10 % of expenditures for qualified energy efficiency improvements installed during the year, plus
- 2) 100% of residential energy property expenditures paid during the year.

To be eligible, the improvements must be done to the taxpayer's principal residence. The lifetime credit is \$500 for any taxpayer, including married filing jointly returns. The credit is only available for property placed in service in 2006 and 2007.

Please note there are many specific guidelines and components that make up this new credit. The credit varies on the specific improvements placed in service. Items included in this credit are the following:

- 1) Insulation materials or systems designed to reduce heat loss or gain.
- 2) Exterior windows, including skylights.
- 3) Exterior doors.
- 4) Metal roofs coated with heat-reduction pigments.
- 5) Energy-efficient building property-qualified electric heat pumps, electric heat pump water heaters, geothermal heat pumps and central air conditioners.
- 6) Qualified natural gas, propane and oil furnaces and qualified hot water boilers.
- 7) Advanced main air circulating fans, a fan used in a natural gas, propane or oil furnace.

Dependency Exemption

In 2006 the dependency exemption will increase to \$3,300.

Estate Tax Exemption

The Estate tax unified credit will increase to \$2,000,000 for 2006 through 2008.

Standard Mileage Rate

IRS has announced that the standard mileage rate for business use has adjusted to 44.5 cents for 2006.

Social Security Tax

Social Security tax will be assessed on the first \$94,200 of wages in 2006, up from \$90,000 in 2005.

PLEASE NOTE:

REMEMBER, THE TOPICS COVERED IN THIS NEWSLETTER ARE AN ABRIDGED VERSION TO THE ACTUAL TAX LAWS AND CODES COVERED BY THE IRS AND NEW YORK STATE. THEREFORE SOME INFORMATION MAY BE SUBJECT TO CHANGE ON A CASE-BY-CASE BASIS. IF YOU HAVE ANY QUESTIONS REGARDING THE ABOVE INFORMATION PLEASE EMAIL US AT KENNETH.SPEANBURG@PRATTASSOCIATES.COM.