Tax Increase Prevention and Reconciliation Act of 2005

This article gives you a broad overview of a new tax law, the "Tax Increase Prevention and Reconciliation Act of 2005," which the President signed into law on May 17, 2006. The following information outlines the major provisions affecting individual taxpayers and small business owners.

Qualified Dividends and Capital Gains

Two provisions include the reduction of capital gains rates and taxing qualified dividends at the capital gains rate. Thus, for taxpayers above the 15% tax bracket, capital gains will be taxed at a maximum rate of 15% through 2010. For taxpayers in the 10% or 15% tax bracket, capital gains will be taxed at 5% through 2007, but then be dropped to 0% for 2008 through 2010.

Kiddie Tax

The Act increases the age to which a child's unearned income (i.e., income from investments) is taxed at the parent's tax rate, from under 14 to under 18 years of age (the "kiddie tax"). The Act provides an exception to the kiddie tax for distributions from certain qualified disability trusts. The Act also provides that the kiddie tax does not apply to a child who is married and files a joint return for the taxable year. This provision is effective for taxable years beginning after December 31, 2005.

Roth-IRA Conversions - 2010

Beginning in 2010, the Act eliminates the income limits on conversions of traditional IRAs to Roth IRAs. Thus, taxpayers could make such conversions without regard to their adjusted gross income. Furthermore, in contrast to current law, the Act allows married taxpayers filing separate returns to convert amounts in a traditional IRA into a Roth IRA.

Under the Act, for conversions occurring in 2010, unless the taxpayer elects otherwise, none of the amount is includible in gross income as a result of the conversion in 2010; half of the income resulting from the conversion is includible in gross income in 2011, and half is includible in 2012. However, the Act provides that income inclusion is accelerated if converted amounts are distributed before 2012.

IRC Section 179 Deduction

This provision extends the temporary $100,000 (adjusted for inflation) amount for small business to expense, rather than capitalize and depreciate, equipment purchased for use in business. This dollar amount was set to expire in 2008, but the new law extends the provision to tax years beginning before 2010.

Taxpayers Working Abroad

For taxpayers having foreign earned income and using employer-provided housing, the Act accelerates the indexing of the $80,000 annual exclusion amount (so that the indexing begins in 2006, rather than in 2008; for 2006, the amount is $82,400).

Offers-in-Compromise

For taxpayers trying to settle controversies with the IRS, the Act provides that a taxpayer making an offer-in-compromise must: (1) in the case of a lump sum offer, pay 20% of the offer when the offer is submitted; and (2) in the case of an offer of periodic payments, pay the amount of the first proposed installment when the offer is submitted. Under the Act, a lump sum offer is any offer of payments made in five or fewer installments. The Act provides that, during the time an offer of periodic payments is being evaluated by the IRS, if the taxpayer fails to make a payment under the submitted offer, it must be treated as a withdrawal of the offer. The Act also provides that if the IRS fails to reject the offer-in-compromise within 24 months of its submission (not taking into account any period during which the subject tax liability is in dispute in a judicial proceeding), it is deemed accepted. This provision is effective for offers-in-compromise submitted on or after July 16, 2006.

Tuition--Above the Line Tax Deduction

Expired and not extended past 2005.

Sales Tax Itemized Deduction

Expired and not extended past 2005.

Credit for Retirement Plan Contributions – IRAs and Elective Deferrals

Not extended past 2006.

Credit for Electric Vehicles

Not extended past 2006.