Pay Attention: New Tax Laws

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(Published in GAA UpDate magazine, July 2006)

Hot off the Press in May 2006, a $70 billion tax cut package that President Bush signed into law. What does this mean to you?

The Tax Increase Prevention and Reconciliation Act impacts a broad cross-section of taxpayers. Most notably, the new law extends the controversial dividend and capital gains tax rate cuts for two more years beyond 2008. As a result, taxpayers with qualified dividends and capital gain transactions continue to benefit from a 15% tax rate (5% for lower income taxpayers) versus higher ordinary income tax rates that approach 35% in 2006.

Uncle Sam continues to encourage business investment by enhancing the small business expensing thresholds and extending the provisional dates to December 31, 2009. Since the year 2003, small businesses were allowed to deduct up to $100,000 of qualified tangible personal property without using the regular tax depreciation methods. Subject to phase-put rules, this deduction was indexed from inflation and $108,000 for the year 2006.

Bad news for large corporations (greater than $1 billion in assets) is that there was an increase in the amount required for estimated tax payments. However, the good news is that the due dates of these estimated tax payments were delayed to soften the blow.

There is a tougher wage limitation for the domestic production deduction. This deduction, which debuted in 2005, allows for a business write-off equal to 3% of "qualified production activities income" (QPAI). The deduction will increase to 6% for tax years beginning in 2007 through 2009, and will increase further to 9% of qualified production activities income for tax years beginning after 2009. The deduction cannot exceed 50% of W-2 wages paid for the year and that are used in arriving at QPAI. Shareholders, partners, and beneficiaries will be allocated a ratable share of the business wages

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For purposes of computing their 50% of wages paid limitation on the deduction. The deduction will also be allowable for alternative minimum tax (AMT) purposes.

The Tax Act eliminates the $100,000 adjusted gross income ceiling for converting a traditional IRA to a Roth IRA. The conversion is a taxable transaction but there is no 10% early withdrawal penalty. Remember that contributions to a Roth IRA are not deductible but the future earnings are tax-free and there is no required minimum distribution at age 70 ½ years old.

The Kiddie Tax now applies to children that are under age 18. The rules require a child's unearned income, such as dividends and interest, to be taxed at the parents' tax rate, which is usually higher. This tax applies if the child is under age 18 and has unearned income greater than $1,700 and the parent can claim the child as a dependent.

Finally, there is some relief from the dreaded Alternative Minimum Tax (AMT). For the year 2006 only, the AMT exemption for individuals was increased to $62,550 for married taxpayers and $42,500 for single taxpayers. In addition, taxpayers are now allowed to use certain nonrefundable personal credits to offset the AMT. Without these limited concessions for the AMT, an additional fifteen million taxpayers (many middle class) would be subject to the AMT. Even though there was no mention of AMT relief for corporations, owners of businesses that are S-corporations, partnerships, and limited liability companies will be able to take advantage of the higher exemption amounts.

Even after these tax law changes, there will be more to come in the near future. So look for a trailer bill that will address items such as the state and local sales tax deduction, teacher's classroom expense deduction, R&D provisions, employment tax credits and other popular but temporary incentives.

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