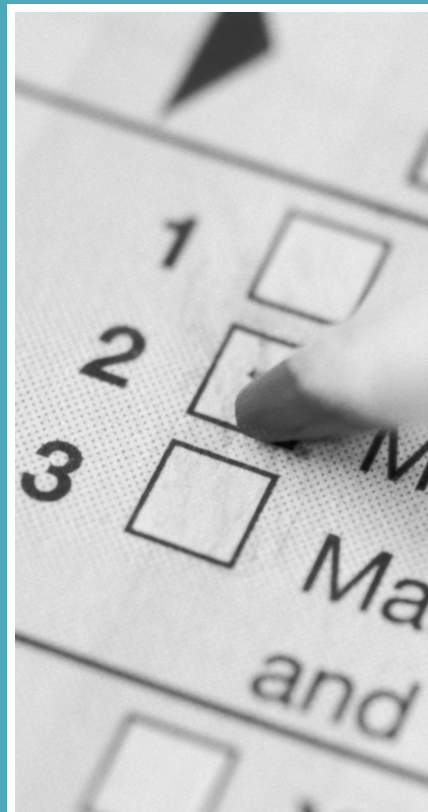


# Tax Saving Tips for 2006



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Advice from CPAs

## Tax Planning for 2006

Knowledge is a powerful weapon when it comes to tax planning. But constant changes to tax laws can make it difficult to keep up. In 2006, Congress passed numerous revisions to the tax code in areas such as retirement savings, charitable giving and the “kiddie tax.”

At the same time, Congress extended certain tax breaks through 2007, including the higher education tuition deduction and the option to deduct sales tax instead of state and local taxes. (Since these deductions were extended late in 2006, IRS forms and instructions will not reflect the changes. For more information, visit <http://www.irs.gov/newsroom/article/0,,id=165631,00.html>.)

Throughout this guide you’ll find an overview of changes that may affect your return, as well as tips to help minimize your tax bill.

### Filing Basics

#### Filing Status

Taxpayers can file as single, head of household, married filing separately, or married filing jointly/qualifying widow(er). If you are married and filing jointly, you can take advantage of tax credits and benefits not available to couples filing separately. Unmarried taxpayers may file as single or, if they qualify, as head of household.

#### Exemptions

You may claim a personal exemption for yourself, your spouse and each of your dependents. Each exemption reduces your taxable income by \$3,300 in 2006. You begin to lose part of the exemption benefit if your adjusted gross income (AGI) is above the following:

### 2006 Exemption Phase-Out Limits

- Single — \$150,500
- Married filing jointly/Qualifying widow(er) — \$225,750
- Married filing separately — \$112,875
- Head of household — \$188,150

The good news is that the personal exemption reduction is being phased out, so the reduction is lower in 2006 than it was in 2005. It will be fully repealed by 2010.

#### Deductions

Even if you don’t itemize, the following deductions may be available to you: traditional IRA, SEP and qualified plan contributions; one half of self-employment tax; alimony; job-related moving expenses; and self-employed health insurance premiums.

In addition to above-the-line deductions, you can claim the standard deduction or itemize. The basic standard deduction for 2006 is \$5,150 if single or married filing separately, \$10,300 for married filing jointly or surviving spouse, and \$7,550 for head of household. In general, if your total allowable itemized deductions are larger than the standard deduction, you should itemize.

Keep in mind that the value of some of your deductions will be reduced if your AGI is above \$150,500 (\$75,250 if married, filing separately). Like the exemption reduction, this deduction is being phased out and the reduction for 2006 will be lower than it was in 2005. The itemized deduction also will be eliminated by 2010.

### Tax Breaks for Homeowners

#### Interest and Property Taxes

Home mortgage interest on up to \$1 million of home acquisition loans secured by your principal residence and/or second home is fully deductible. You may also deduct mortgage interest on a home equity loan or line of credit (up to \$100,000). Points paid to secure a loan for the purchase or improvement of a principal residence are usually fully deductible in the year you pay them. Points paid to refinance an existing mortgage must be deducted over the life of the loan. Real estate taxes and state and local property taxes on all your real estate are deductible.

#### Exclude Capital Gains

When you sell your principal residence, you can exclude from income up to \$250,000 in gains (\$500,000 if married and filing jointly). To qualify, you must have owned and used your home as a principal residence for at least two years during the five-year period ending on the date of sale. The full tax break is available once every two years.

## Retirement Savings Tax Breaks

Tax-advantaged retirement plans can help you lower your current tax bill and achieve a secure retirement. What's more, new legislation makes higher IRA and 401(k) contribution limits permanent. They were due to revert to their 2001 levels in 2010.

### Individual Retirement Accounts (IRAs)

You may contribute up to \$4,000 to fund a traditional or Roth IRA for 2006 and 2007. Those age 50 or older can make an additional catch-up contribution of \$1,000 for both years. The catch-up contribution will rise to \$5,000 in 2008.

Traditional IRA contributions may be deductible depending on your AGI and whether you or your spouse (if filing jointly) are covered by an employer's pension plan. Roth IRA contributions are not deductible, but the earnings accumulate tax-deferred and may be withdrawn tax-free if you meet the qualified distribution requirements. Eligibility to contribute to a Roth IRA is phased out as AGI rises from \$95,000 to \$110,000 for single filers, and \$150,000 to \$160,000 for joint filers. Married taxpayers who file separately cannot contribute to a Roth IRA if their income is above \$10,000.

### Employer-Sponsored 401(k)s

Pre-tax contributions to employer-sponsored retirement plans reduce your taxable wages. Matching contributions and income earned within your plan are also tax-deferred. The employee contribution limit for 2006 is \$15,000. Employees age 50 or older by the end of 2006 may make an additional catch-up contribution of \$5,000 for 2006.

## Child and Education-Related Tax Breaks

### Child Tax Credit

The Child Tax Credit allows you to reduce your federal income tax by \$1,000 for each qualifying child under the age of 17. This credit begins to phase out if your modified AGI is above \$110,000 for joint filers, or \$75,000 for single or head of household filers.

### Dependent Care Credit

Parents who must pay for the care of a dependent under age 13 in order to work may be eligible for a tax credit of between 20 and 35 percent of qualifying expenses. For 2006, the maximum amount of expenses on which the credit can be claimed is \$3,000 for the care of one dependent, or \$6,000 for two or more.

### Education Tax Credits

Two popular credits can help defray higher education costs. The Hope Credit, up to \$1,650 for every qualifying student, is available for each of the first two years of college. A Lifetime Learning Credit of up to \$2,000 per year is available for undergraduate, graduate and professional degree courses. Both credits are phased out as modified AGI increases from \$90,000 to \$110,000 for joint filers, and from \$45,000 to \$55,000 for single filers. You cannot claim both credits for the same student in the same tax year.

### 529 Plans

Congress eliminated the uncertainty regarding 529 plans, which were to expire in 2010. These plans give parents and other relatives a tax-advantaged way to save money for higher education expenses. While no deduction is available for contributions, funds in the account grow tax-free and withdrawals are also tax-free if they are used to pay qualified educational expenses.

## Tax Considerations for Investors

### Long-Term Capital Gains and Dividends

Congress extended lower capital gains and dividend rates through 2010 (they were to expire at the end of 2008). Thus the maximum tax rate on net long-term capital gains remains at 15 percent. For taxpayers in the 10 or 15 percent tax brackets, net long-term capital gains are taxed at 5 percent through 2007 and will be tax-free from 2008 to 2010. To qualify as a long-term capital gain, an asset must be held for more than one year before selling. Capital gains on investments held for one year or less are taxed at regular income tax rates – as high as 35 percent. For collectibles held for more than one year, the maximum capital gains tax rate is 28 percent. Qualified dividend income from a domestic or qualified foreign company is taxed at a top rate of 15 percent (5 percent for taxpayers in the 10 and 15 percent tax brackets).

### Offset Capital Gains with Losses

Net capital losses are fully deductible against capital gains. If your capital losses exceed your capital gains, you can deduct up to \$3,000 in net capital losses against ordinary income (\$1,500 if married filing separately). Any remaining capital losses may be carried over to the next year.

### New "Kiddie Tax" Rules

Investors with children need to be aware that Congress has increased the number of children who are subject to the "kiddie tax." Under the "kiddie tax" rules, a child's investment income over a certain threshold is taxed at the parent's tax rate. Before the rule change, the "kiddie tax" ended at the age of 14. At that age, the child's income was taxed at his or her own rate. Starting in 2006, the "kiddie tax" will apply until the year the child reaches age 18. For 2006, the threshold amount is \$1,700. For a child under age 18, any net unearned income above that amount will be taxed at parental rates.

## Other New Provisions For 2006

### Energy Tax Breaks

Making energy-efficient improvements to your home like new windows, water heaters or furnaces, may garner a tax credit of up to \$500 in 2006. Additionally, a credit may be available for the purchase of a hybrid or alternative fuel vehicle. The credit could be worth up to \$3,400 in 2006, depending on the type of vehicle.

### New Rules for Charitable Contributions

Starting in 2007, a donor must be able to show proof of a donation to take a deduction for any monetary charitable gift. A cancelled check, credit card statement or receipt from the charity will satisfy the documentation requirement.

For clothes or household items donated after August 17, 2006, a deduction is allowed only if they are in "good" or better condition. However, the law did not define the term "good." An exception to this rule exists for a single donated item worth more than \$500, as long as a qualified appraisal is included with the donor's tax return.

### Alternative Minimum Tax (AMT) Exemptions

Finally, Congress passed a one-year increase in AMT exemption amounts to \$62,550 for joint filers and qualifying widow(ers), \$42,500 for single and head of household filers, and \$31,275 for married persons filing separately. Without further Congressional action, exemption amounts will return to their 2000 levels in 2007.

## Common Deductions

- *Student loan interest*
- *Higher education tuition*
- *Penalty for early withdrawal of savings*
- *Alimony*
- *Charitable contributions — cash, property, and donated clothing or household items*
- *State and local income taxes and personal property taxes*
- *Points paid for mortgage or refinancing*
- *Mileage and other expenses associated with volunteer work*
- *One-half of self-employment tax*
- *Unreimbursed casualty and theft losses*
- *Income tax preparation software and fees\**
- *Job search expenses\**
- *Investment expenses\**
- *Unreimbursed employee business expenses\**
- *Prescription eyeglasses, contacts, and hearing aids\*\**
- *Crutches, canes, and orthopedic shoes\*\**
- *Medical transportation\*\**
- *Cost of alcohol or drug abuse treatment\*\**

\* Deductible as miscellaneous itemized deductions to the extent the total exceeds 2% of AGI.

\*\* Deductible to the extent the total of all medical and dental expenses exceeds 7.5% of AGI.

## Get Professional Advice

A CPA tax professional understands the business of taxes and finances and can review your overall financial picture to help you find winning tax strategies.

Information is current as of January 12, 2007.