The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA")

June 30, 2006

TIPRA, enacted on May 17, 2006, extends many tax provisions and makes several significant changes to the law that will affect individuals and businesses. Some of TIPRA's highlights are listed below:

Increased expensing for small business

The enhanced small business expensing thresholds in the American Jobs Creation Act of 2004 have been extended through December 31, 2009. A taxpayer may expense a maximum amount of $100,000 of the cost of "qualifying property," reduced by the amount by which the cost of the qualifying property exceeds $400,000.

Capital gains and dividends rates

The 15% tax rate for capital gains and qualified dividends (5% for lower income taxpayers) is extended for two years, through the 2010 tax year.

Capital gains treatment for certain self-created musical works

TIPRA provides that, at the election of the taxpayer, the sale or exchange of musical compositions or copyrights in musical works created by the taxpayer's personal efforts is treated as a capital asset. This is effective for sales or exchanges made in tax years beginning after May 17, 2006, and before January, 2011.

Amortization of expenses incurred in creating music or music copyrights

TIPRA provides an elective five-year amortization period for musical works and copyrights. Where an election is in effect, any expense that is paid or incurred by the taxpayer in creating or acquiring any applicable musical property placed in service during the tax year is ratably amortized over five years. An eligible taxpayer that does not make the five-year amortization election may recover costs under any allowable method.

Increase in alternative minimum tax exemption amount for 2006

AMT exemption amounts for 2006 have been increased to $42,500 for unmarried individuals, $62,550 for joint filers, and $31,275 for married filing separately. The AMT relief provided by this provision is for one year only.

Allowance of nonrefundable personal credits against regular and alternative minimum tax liability

Nonrefundable personal credits are credits such as the dependent care credit, the credit for elderly and permanently and totally disabled, the child tax credit, and the adoption credit. TIPRA extends current law allowing most of these nonrefundable credits to be claimed against both the regular tax and the AMT. Absent another extension, for tax years after 2006, nonrefundable personal credits other than the adoption credit and child tax credit will be the only credits that may be used to reduce AMT liability. These post-2006 rules have specific ordering rules which may reduce the amount allowable for these credits.

Time for payment of corporate estimated taxes

For corporations with total assets of at least one billion dollars, timing of estimated payments of income tax liability (as well as the percentage of estimated tax due) is adjusted. For all corporations, a portion of the estimated amounts due in September of 2010 and 2011 are not due until October 1 of those respective years.

Continued

Reporting of interest on tax-exempt bonds
After December 31, 2005, payors of interest on tax-exempt bonds (and those who receive such interest as a nominee) are required to report payments of interest in the same manner that interest must be reported on taxable obligations. This requires filing an annual information return reporting these interest payments.

Increase in age of minor children whose unearned income is taxed as if parent's income
After TIPRA, the so-called "kiddie tax" rules apply to children under age 18, increased from age 14. The kiddie tax applies to unearned income of a minor child that exceeds $1,700. This unearned income is taxed at the parent's highest marginal rate. However, distributions for certain qualified disability trusts are treated as earned income of the child for the tax year. This provision of TIPRA applies to tax years beginning after December 31, 2005.

Imposition of withholding on certain payments made by government entities
Beginning in 2011, the federal government and every division of state government, including multi-state agencies, making certain payments to a person providing property or services must deduct and withhold tax in an amount equal to 3% of the payment. This also applies to payments made in connection with government vouchers. These payments will also be subject to applicable information reporting requirements.

Conversion to Roth IRAs
For tax years beginning after 2009, income limitations for converting a traditional IRA to a Roth IRA are eliminated. The amount includable in gross income from a 2010 conversion can be included in income over a two-year tax period beginning in the year after the conversion. This option is available for 2010 conversions only. However, income inclusion is accelerated where there is a premature nonqualified distribution.

Modification of exclusion for citizens living abroad
The $80,000 foreign earned income exclusion is indexed for inflation beginning in 2006. This indexing was originally scheduled to begin in 2008.

In addition, the base housing amount used in calculating the foreign housing cost exclusion was modified, and the housing cost exclusion is limited to 30% of the taxpayer's foreign earned income exclusion.

Finally, income excluded as foreign earned income or as a housing allowance must be added back into income for the purpose of determining the marginal tax rate applicable to the non-excluded income.

If you have further questions about this alert you may contact our Federal Tax and Employee Benefits Group; Vernon Bennett, III at (269) 383-5820 (Kalamazoo) or (616) 454-8656 (Grand Rapids), email: bennett@millercanfield.com; or Lisa M. Berden at (313) 496-7581 (Detroit), email: berden@millercanfield.com. This message is for general information only and should not be used as a basis for specific action without obtaining further legal advice.