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TAX PLANNING FOR THE REST OF 2006

The period from now until the end of 2006 holds unique opportunities for you to save on your taxes. It is the ideal time of year for tax planning for at least three reasons:

1. You finally have a good fix on what your taxable income and expenses are shaping up to be for 2006 and for several months into 2007, allowing you to effectively use acceleration or deferral techniques to maximize your overall tax savings between 2006 and 2007.
2. Time still remains to take advantage of new-for-2006 tax laws before the door shuts.
3. Last, but not least, you can use this time to fully prepare for new tax breaks that will begin immediately on January 1, 2007.

2006 opportunities and pitfalls

The tax law changes constantly. New tax breaks – and pitfalls – come and go all the time. 2006 is no exception. Literally scores of changes have been made to the tax law that impact 2006 tax year returns. Among those most notable for impacting the largest groups of taxpayers are:

- Start of the extended “kiddie tax” under which a child’s income is taxed at a parent’s tax rate, under age 18 (up from age 14 and applied retroactively from January 1, 2006);
- Start of the hybrid vehicle credit available to purchasers, along with its reduction once a manufacturer sells more than 60,000 units (which is already the case for Toyota hybrids starting October 1, 2006);
- Start of the residential energy credits of \$500 for residential energy improvements, \$2,000 for solar equipment and \$500 for fuel cells per half kilowatt capacity, restricted to 2006 and 2007 only;
- Start of strict limitations on the quality of clothing and household items that are entitled to a charitable deduction, beginning August 17, 2006;
- Start of the new (and generally unfavorable) limitations on the housing allowance for those working abroad, retroactive to January 1, 2006; and
- Start of allowing direct, tax-free charitable contributions from IRAs for those 70½ and older, for 2006 and 2007 only.

2007 opportunities and pitfalls

Despite the number of new provisions that began this year, 2006 does not have a lock on recent changes. 2007 is set to inaugurate several changes of its own, even before tax legislation in 2007 will likely produce still more changes. Here’s a list of some of the major ones:

- Starting in 2007, cash donations of any size must be backed up by paperwork that includes either a cancelled check or a written note from the charity indicating amount, date and the name of the charity;

- Starting in 2007, businesses will face a more generous, but stricter, domestic production activities deduction that includes a rise in the deduction cap from three percent to six percent and a restriction of the W-2 wage limitation to manufacturing activities only;
- Starting in 2007, heretofore fixed contribution limitations on individual retirement accounts will be inflation adjusted, including Roth IRAs income limits of \$156,000 (formerly \$150,000) for marrieds filing jointly and \$99,000 (formerly \$95,000) for most others;
- Starting in 2007, inflation adjustment of the Saver's Credit for lower income taxpayers means higher income levels will qualify (for example, joint filers will get a 50 percent credit with income up to \$31,000, 20 percent up to \$34,000 and 10 percent up to \$52,000).

Also noteworthy, starting in 2010 there will be no maximum income level to restrict conversion of regular IRAs into Roth IRAs. Maximizing that opportunity, however, can begin immediately for those taxpayers presently over that limit. This strategy calls for making annual contributions to a nondeductible IRA that can then be converted into a Roth IRA in 2010 when the income cap is lifted.