



BDO Seidman, LLP
Accountants and Consultants

May 17, 2006

Washington Tax Report

The Tax Increase Prevention and Reconciliation Act of 2005 was passed by Congress on May 11, 2006 and signed into law by the President today. For individuals, the Act extends the maximum 15 percent rate on capital gains and qualifying dividends, currently set to expire on December 31, 2008, for two years until December 31, 2010. To prevent more individuals from being subject to the Alternative Minimum Tax (AMT) in 2006, the Act extends a larger AMT exemption (\$62,550 on a joint return and \$42,500 on a single return) only to 2006. For small businesses, the Act extends for two years until December 31, 2009, the current \$100,000 maximum cost of tangible personal property that businesses may elect to expense in the year the property is placed in service and the \$400,000 maximum tangible personal property cost after which the expense allowance begins to phase out. Other less significant taxpayer-favorable amendments are included in the Act, for example, relating to controlled foreign corporations, tax-free corporate spin-offs, and self-created musical works.

To help offset the revenue loss from the taxpayer-favorable provisions of the Act, the Act contains a number of revenue-raising provisions, including the following:

Modification of Wage Limit for Purposes of Domestic Production Activities Deduction

Current law provides a taxpayer a deduction equal to the lesser of a percentage of the taxpayer's qualified production activities income or 50 percent of all wages paid by the taxpayer during the calendar year ending in such tax year. (See our January 2006 *Washington Tax*

Report at www.bdo.com.) Effective for tax years beginning after the date of enactment, May 17, 2006, the Act lowers the wage limitation to 50 percent of those wages which are attributable to qualified production activities income.

Corporate Estimated Tax Provisions

Effective May 17, 2006, the Act provides that in the case of corporations with assets in excess of \$1 billion, estimated tax payments due in July, August, and September of 2006 shall be increased to 105 percent of the amount otherwise due and the next required payment shall be

reduced accordingly. Similar provisions apply for such payments in 2012 and 2013. With respect to corporate estimated tax payments due on September 15, 2010, 20.5 percent of that payment shall not be due until October 1, 2010. A similar provision applies for such payment in 2011.

Repeal of Foreign Sales Corporation and Extraterritorial Income Binding Contract Relief Measures

In response to findings by the World Trade Organization (WTO), Congress repealed the Foreign Sales Corporation (FSC) regime in 2000 and the Extraterritorial Income (ETI) regime in 2004. Both repeals provided binding contract relief measures. In early 2006, the WTO found that these relief measures constitute prohibited export subsidies. The Act repeals these measures for tax years beginning after May 17, 2006.

Increase in Age of Minor Children Whose Unearned Income is Taxed as if Parent's Income

Currently, if a child who is under the age of 14 at the end of the year has unearned income for the year exceeding \$1,700 and is required to file a return for the year, the child's net unearned income is taxed at his or her parent's highest marginal rate. Effective for years beginning after

Washington Tax Report

December 31, 2005, the Act provides that if the other requirements are met and the child is under the age of 18 at the end of the year, the child's net unearned income is taxed at his or her parent's highest marginal rate.

Modification of Exclusions for Citizens Living Abroad

A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and certain foreign housing costs. Effective for tax years beginning after December 31, 2005, the Act accelerates by two years the indexing for inflation of the foreign earned income exclusion; modifies the base housing amount used in calculating the foreign

housing cost exclusion and imposes a cap so as to lower the amount of housing costs eligible for the housing exclusion; and includes a new provision requiring that the exclusion amount be added back to income in order to determine the graduated tax rates applicable to all non-excluded income. (See our May 2006 *Expatriate Tax Alert* at www.bdo.com.)

Elimination of Income Limitations on Conversions to Roth Individual Retirement Accounts

While distributions from a traditional Individual Retirement Account (IRA) are generally includible in gross income, distributions from a Roth IRA are excludable from gross income. Currently, a taxpayer

with adjusted gross income of \$100,000 or less may, subject to tax, convert all or a portion of a traditional IRA to a Roth IRA. The Act eliminates the income limitation on conversions of traditional IRAs to Roth IRAs for taxable years beginning after December 31, 2009.

Other amendments and extensions included in the House and Senate tax reconciliation bills did not make it through the conference process because of cost considerations. These proposals are anticipated to be included in subsequent legislation.

Material discussed in this Tax Letter is meant to provide general information and should not be acted on without obtaining professional advice appropriately tailored to your individual needs.

To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Visit our Web site: www.bdo.com