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Start End-of-Year Tax Planning Now
Income Tax System Similar to Last Year
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As 2006 draws to a close, there is still time to review your income situation and identify tax benefits that could reduce your 2006 tax bill and assist you to plan ahead for 2007. Keep in mind that except for minor tax benefits which were authorized by the last tax bill and are being phased in over four years, this year's tax system will be very similar to last year. But, also keep in mind that several tax benefits expired at the end of 2005 and have not been extended. Some of the benefits that expired include the research and experimentation credit, work opportunity credit, welfare-to-work credit, educator expense deduction, tuition deduction, and the state and local sales tax reduction. These expired tax benefits may be reinstated retroactively.

Tax saving strategies may include such things as considering whether to accelerate into 2006 or defer into 2007, income or deductions. The simulation of accelerating income or deductions will allow you to evaluate the impact that this action may have on your Adjusted Gross Income (AGI) and your ability to maximize itemized deductions that are tied to AGI. For example, if you expect your AGI to be higher in 2006 than in 2007, or if you anticipate being in the same or a higher tax bracket in 2006, you may benefit by deferring income into 2007. Deferring income will be advantageous so long as the deferral does not bump your income to the next tax bracket.

Tax Brackets

Another important item to identify early is your "tax bracket," i.e., the rate at which your last dollar of income is taxed. A comparison of the tax rates and brackets should be made to evaluate alternatives (see table 1).

Table 1: Tax Rates and Tax Brackets for 2006 and 2007

MARRIED COUPLES FILING JOINTLY		MOST SINGLE FILERS		
TAX RATE	2006 TAXABLE INCOME	2007 TAXABLE INCOME ¹	2006 TAXABLE INCOME	2007 TAXABLE ¹
10%	Not over \$15,100	Not over \$15,650	Not over \$7,550	Not over \$7,825
15%	\$15,100-\$61,300	\$15,650-\$63,700	\$7,550-\$30,650	\$7,825-\$31,850
25%	\$61,300-\$123,700	\$63,700-\$128,500	\$30,650-\$74,200	\$31,850-\$77,100
28%	\$123,700-\$188,450	\$128,500-\$195,850	\$74,200-\$154,800	\$77,100-\$160,850
33%	\$188,450-\$336,550	\$195,850-\$349,700	\$154,800-\$336,550	\$160,850-\$349,700
35%	Over \$336,550	Over \$349,700	Over \$336,500	Over \$349,700

¹Estimated amounts

Standard Deduction Planning

Deduction planning is also affected by the standard deduction. (See Table 2). If your itemized deductions are relatively constant and are close to the standard deduction amount, you will obtain little or no benefit from itemizing your deductions each year. But simply taking the standard deduction each year means you lose the benefit of your itemized deductions. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of deductible expenses so that they are higher in one year and lower in the following year, e.g., pay property taxes every other year.

Table 2: Standard Deductions

	2006	2007
Joint or Qualifying Widow(er)	\$10,300	\$10,700
Single	\$5,150	\$5,350
Head of Household	\$7,550	\$7,850
Married Filing Separately	\$5,150	\$5,350
Additional for Elderly/Blind-Married	\$1,000	\$1,050
Additional for Elderly/Blind-Unmarried	\$1,250	\$1,300
Taxpayer Claimed as Dependent ¹	\$850	\$850

¹ If an individual who can be claimed as a dependent on another's return has earned income, the standard deduction is the greater of \$850 or \$300 plus the earned income (but no more than the standard deduction).

Expensing Option

The Section 179 expensing option for depreciable property used in business , i.e., computers, office furniture, equipment, vehicles, or other tangible business property, was increased to \$108,000

to adjust for inflation. Keep in mind that the expensing option is capped at \$25,000 for SUVs with loaded weights between 6,000 and 14,000 pounds.

NOTE: While the \$25,000 expensing limit applies to 6,000-14,000 pound SUVs, the full expensing deduction (\$108,000 for 2006) is available for heavy non-SUVs as long as it is equipped with a cargo area of at least six feet in interior length, and it has an integral enclosure that fully encloses the driver's compartment, e.g., a heavy pick-up and/or it can seat more than nine passengers behind the driver's seat, such as hotel shuttle vans.

Individuals

Generally speaking The Working Families Tax Relief Act of 2004 expanded:

- ☞ Self-employed individuals are allowed to claim 100% of the amount paid for **self-employed health insurance premiums** during the taxable year for insurance that constitutes medical care for themselves, their spouses and dependents as an adjustment (deduction) to gross income, without regard to the 7.5% cap of AGI, required for itemized medical deductions.
Caution: While this benefit has been loosely interpreted to allow self-employed individuals to deduct health insurance premiums, the IRS has interpreted that this benefit only applies to deductions related to the business, i.e., the program must be sponsored by the business and available to all employees.
- ☞ The \$1,000 **child tax credit** through 2010 and the credit reverts to \$500 in 2011.
- ☞ The expanded 10% and 15% **tax brackets** for joint returns, equal to twice the size of the brackets for single filers (see table 1) and reverts to 167 percent in 2011.
- ☞ The increased **standard deduction** (marriage penalty relief) extends through 2010 for married couples filing jointly (equal to twice the standard deduction for single taxpayers) (see table 2) and reverts to 167% in 2011.
- ☞ The **alternative minimum tax (AMT)** exemption amount was increased slightly to \$62,500 and \$42,500, for married filing jointly and singles, respectively. The AMT amounts reverts to \$45,000 and \$33,750 for joint and single filers, respectively, in 2007 unless Congress extends these amounts. The exemptions are phased out as you exceed certain income levels.

Charitable Donations

- ☞ **Donating cars, boats or planes** requires documentation of what the charity actually received from the sale of the donated property and the taxpayer must itemize. This means that the total itemized amount must exceed the standard deduction in order to save taxes from donated property.
- ☞ **Tax-free IRA Distributions for Charity.** Age 70½ or older taxpayers may make up to a \$100,000 tax-free donation of otherwise taxable distributions from traditional IRAs in 2006 and 2007, when the IRA money is paid out directly to a tax-exempt charity. But, the donation cannot be claimed as an income tax deduction since the qualified charitable distribution is federal-income-tax-free. This income exclusion appears financially favorable for seniors who might not otherwise itemize deductions.
- ☞ **Changes for Gifts of Clothing and Household Items.** After 8/17/06, generally you can no longer deduct donations of used clothing and household goods, such as furniture and furnishings, electronics, appliances, linens, and similar items, unless they are in "good used" or better condition. This means proper documentation, such as a photograph or an appraisal, will be required and the taxpayer must itemized, i.e., total itemized deductions must exceed the standard deduction.