

TAX CHANGES OF SIGNIFICANCE

1. Income Tax Rate Structure

For 2006, the first \$7,550 of taxable income for single (S), \$10,750 for head of household (HH) and \$15,100 for married filing jointly (MFJ) is taxed at 10%. The marriage penalty does not exist in the 15% bracket but begins in the upper portion of the 25% bracket. The 2006 upper bracket rates are 25, 28, 33 and 35%.

2. Domestic Production Activities Deduction (DPAD)

For many farmers, Qualified Production Activities Income (QPAI) is net Schedule F income added to the gain from the sale of raised animals used for dairy, breeding or sporting purposes. The amount of the deduction will be the *smallest* of three calculations:

- a. 3% of QPAI
- b. 3% of an individual's adjusted gross income or the taxable income of an entity
- c. 50% of total Form W-2 wages of an employer (probably box 5 wages which show what's subject to Medicare).

This 3% deduction increases to 6% in 2007 and 9% after 2009. This deduction will not reduce self-employment tax. It is calculated on Form 8903 and carries to the front of Form 1040 on line 35 as an above-the-line adjustment to income. If no W-2 wages are paid, then this deduction is zero.

3. Direct Expensing

The amount that can be direct expensed under section 179 is \$108,000 in 2006 with a phaseout beginning at \$430,000 of qualified property placed in service.

4. Child Tax Credit

This remains at \$1,000 through 2010 for each qualifying child under 17. Phase-out begins at \$75,000 modified AGI for singles and \$110,000 for MFJ at a rate of \$50 per \$1,000 income.

5. Adoption Credit

This credit is \$10,960 for 2006. Phase-out range is modified AGI from \$164,410 to \$204,410.

6. Coverdell Education Savings Accounts (ESAs)

These used to be called Education IRAs. The contribution limit remains at \$2,000 on behalf of any beneficiary by the due date of the tax return (without extensions). Contributions can't be made after the beneficiary turns 18. Phases out ratably from \$190,000 to \$220,000 for MFJ or \$95,000 to \$110,000 for Single. Distributions may be used for Qualified Higher Education Expenses including room and board or Qualified Elementary and Secondary School Expenses.

7. Qualified Tuition Programs (QTP or Section 529 Plan)

Allows nondeductible contributions and tax free distributions if used for qualified expenses. While contributions are not deductible for federal income taxes, Michigan's maximum annual deduction is \$10,000 for MFJ and the account balance limit is \$235,000 for each beneficiary. A lump sum contribution of \$60,000 can be made in 1 year but treated as if made over 5 years so it's under the \$12,000 gift limit.

6. Increase in Pension and IRA Contribution Limits

For 2006 IRA limit is \$4,000, SIMPLE limits increased to \$10,000 and the SEP maximum is \$15,000. In 2006 individuals 50 and over can add \$1,000 to the IRA, \$2,500 to SIMPLE limit and \$5,000 for a SEP. In 2006 a nonrefundable saver's credit up to \$2,000 (\$1,000 for single) is allowed for contributions to a qualified retirement plan by lower-income taxpayers. Credit is reduced to zero as AGI increases to \$50,000 for MFJ or \$25,000 for single.

7. Estate and Gift Tax Credit

The estate tax exclusion is \$2,000,000 with a top tax rate of 46% in 2006. The lifetime gift tax exclusion remains at \$1,000,000. The annual gift exclusion amount is indexed and increased to \$12,000 per person in 2006.

8. Alternative Minimum Tax Exemption Amounts

The AMT exemptions in 2006 are \$62,550 for MFJ and \$42,500 for single. The AMT is a required calculation to determine if you owe more tax than determined normally.

10. Income Averaging for Farmers and Fishermen

Starting with tax years beginning December 31, 1997, individuals may use income averaging on only their farm income using leftover tax brackets from the prior three (base) years. Income from sales of land or timber cannot be used in income averaging. Negative taxable income can be used from the base years. The alternative minimum tax is coordinated with farm income averaging so that income averaging will not increase AMT. Whatever AMT is owed before using farm income averaging, the same AMT will be owed after income averaging.

11. Capital Gains

Capital gains rates for sale of capital assets held for 12 months or longer (24 months for breeding cattle and horses) are 5% for that portion of capital gains between taxable income and the top of the 15% bracket (\$30,550 single and \$63,100 married). The rate is 15% for that portion of long-term capital gains which exceeds the top of the 15% ordinary bracket. The tax rate on collectibles remains at a maximum of 28% and at a maximum of 25% for unrecaptured code section 1250 gain (buildings).

12. Sale of Residence

Residential sales, including the residence portion of a farm sale, after May 6, 1997, will be tax free on gains up to \$500,000 for a joint return, or \$250,000 for a single return. Eligibility includes occupying as a principal residence two of the last five years. Hence, a person or couple could use these provisions every two years. Prior carryover rules on exchange of a residence and the one-time \$125,000 exclusion for those over 55 were repealed. Business property such as farm buildings and farmland used in a trade or business cannot be included in this exclusion. Portions of the principal residence depreciated for a home office are subject to recapture.

13. Self-employed Health Insurance Deduction

The deduction of health insurance costs for the self-employed increased to 100% in 2003. SE tax is still paid on this since it is deducted after the SE calculations.

14. Long-term Care Insurance and Services

Qualified long-term care expenses (\$250 per day maximum) and long-term care insurance premiums will be treated as medical expenses and therefore are deductible as an itemized deduction, but only to the degree all itemized medical expenses exceed 7.5% of adjusted gross income. The 2006 annual deduction for premiums is limited by age.

Age	Not more Than 40	More than 40 Not more than 50	More than 50 Not more than 60	More than 60 Not more than 70	More than 70
Limit	\$280	\$530	\$1,060	\$2,830	\$3,530

15. Farmland Preservation Credit in Michigan

Public Act 421 of 2000 reduced property taxes that cannot be claimed for credit from 7% of household income to 3.5% of household income.

16. Tax on Dividend Income

Dividends from a domestic or qualified foreign corporation is taxed at 15% or 5%, similar to long term capital gains. This does not include dividends from credit unions or farmers' cooperatives.

17. Earned Income Credit (EIC)

The EIC is available to workers with qualifying children and for childless workers.

EARNED INCOME RATES, INCOME RANGES AND PHASEOUTS FOR 2006

Earned Income or AGI Range for Taxpayers Not Filing as "Married Filing Jointly" (for 2006)

Qualifying Children	Credit Rate (%)	Maximum Credit	Phaseout	Phaseout Rate (%)	Maximum Credit
None	7.65	\$ 5,380 – 6,740	\$6,740 – 12,120	7.65	\$412
One	34.00	8,080 – 14,810	14,810 – 32,001	15.98	2,747
Two or more	40.00	11,340 - 14,810	14,810 – 36,348	21.06	4,536

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Two or more	40.00	11,340 – 16,810	16,810 – 38,348	21.06	4,536

18. Livestock Replacement

Producers selling livestock due to weather events may get four years to buy replacements rather than two years from the end of the tax year of the event. This is retroactive to 2002 events. This extension to applies to areas eligible for federal assistance due to weather events. The two year rule still exists for areas

not declared a disaster area. Also, for weather related conditions, other farm property can be substituted if it is not feasible to reinvest with property similar or related in use to the converted livestock.

19. Reforestation Expenses

Effective for expenses paid or incurred after October 22, 2004, taxpayers may elect to deduct up to \$10,000 of reforestation expenses with the balance amortized over 84 months.

20. CCC Loans

An election to treat CCC loans on crops as income can be made by reporting the income on line 7a of Schedule F of Form 1040. A statement should be attached to the return showing the details of the loan. After making this election you must generally report all CCC loans in the year of election and later years the same way - as income. However, you can obtain an automatic consent to change the method of your accounting to count the loans as loans rather than income by filing a Form 3115.

21. Nonbusiness Energy Property Credit

For property placed in service after 2005 and before 2008, a taxpayer can claim a lifetime nonrefundable credit of up to \$500 for qualifying improvements to the home. Limited to \$200 for windows, the improvement is 10% of the cost of energy efficient building envelope components which meet the criteria established. Residential energy property expenses which meet established criteria may include up to \$50 for an advanced main air circulating fan, \$150 for a natural gas, propane, or oil furnace or hot water boiler, and/or \$300 for energy efficient property like pumps and air conditioners.

22. Telephone Tax Credit

A credit for federal excise taxes paid is available this year. A safe harbor allows a credit of \$30, for single, \$40 for married, filing jointly and \$10 more per exemption to a maximum of \$60. The credit can also be claimed by adding up the taxes paid rather than using the safe harbor. For taxpayers who are not required to file a federal tax form, the credit can be claimed using Form 1040EZ-T.

23. Health Savings Accounts (HSA)

Taxpayers who have a high deductible health plan (HDHP) for insurance are eligible to set up a HSA. Generally, no other health insurance can be in effect to be eligible for the plan except for some limited situations. Employers can make contributions to this plan which are not subject to income or payroll taxes. Anyone else can make a contribution to a taxpayer's plan and the taxpayer can claim a deduction for the amount contributed to the plan. For 2006, the HDHP must have a deductible of at least \$1,050 for single or \$2,100 for married and a maximum of \$5,250 for single or \$10,500 for married. Maximum contributions are the lesser of the deductible or \$2,700 for single or \$5,450 for married. Distributions can be made for qualified health expenses. Nonqualified distributions are subject to income taxes and a 10% penalty. Contributions cannot be made after age 65

24. Kiddie Tax

Unearned income over \$1,700 on children under age 18 is taxed at their parents' rate. The age in 2005 was 14.