Year End . . . .
Year Round

Tax Planning in a changing environment

Presented By
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What’s New?

Tax Legislation Update
Some Things Never Change

- Alternative Minimum Tax
- Itemized Deductions
- No Flat Tax
- Massive Code Regulations
While Some Things Do

- COLA Adjustments
- Energy Credits
- Charitable
  - Limitations adjusted
  - Vehicle donations
Dependant Exemption

- 2004 Exemption $3150
- 2005 Exemption $3200
### Standard Deduction

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Standard amount</th>
<th>Blind or over 65</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ</td>
<td>$10,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Single</td>
<td>$5,000</td>
<td>$1,250</td>
</tr>
<tr>
<td>HOH</td>
<td>$7,300</td>
<td>$1,250</td>
</tr>
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Tax Brackets

When considering taxable income for the tax brackets, the first dollars are tax exempt up to the total of your standard deduction or itemized deductions (whichever is greater) plus your personal exemptions ($3200 per dependant).

Ex:    MFJ with 4 dependants

Minimum = $10,000 + $12,800

This couple pays no tax until income crosses $22,800.
## Tax Brackets

<table>
<thead>
<tr>
<th></th>
<th>MFJ</th>
<th>Single</th>
<th>HOH</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$14,600</td>
<td>$7,300</td>
<td>$10,450</td>
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<tr>
<td>15%</td>
<td>$59,400</td>
<td>$29,700</td>
<td>$39,800</td>
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<tr>
<td>25%</td>
<td>$119,950</td>
<td>$71,950</td>
<td>$102,800</td>
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</table>
Retirement Contributions

- Allowed contributions continue to increase through 2008
- ROTH contribution thresh-holds remain unchanged
401(k)  403(b)  and  457 plans

For 2005  $14,000  +  $4,000

For 2006  $15,000  +  $5,000
SIMPLE Plans

> 2005  $10,000  +  $2,000
> 2006  $10,000  +  $2,500
Roth and Traditional IRA

- 2005  $4,000 + $500
- 2006  $4,000 + $1,000
Energy Credits

- Four new motor vehicle credits
- Only available for first 60,000 sold
- Home energy credits
- 1/1/2006 - 12/31/2014
Fuel Cell Vehicle Credit

- Hydrogen or chemical conversion
- $8,000 to $40,000 credit
- Must be manufactured and certified
- Original purchaser only
- Additional $1,000-$4000 credit for fuel efficiency rating
- 1/1/2006 - 12/31/2014
Lean Burn Technology Vehicle

› Less than 6000 pounds
› Original purchaser only
› Certification
› $400 - $2400 credit amount based on fuel rating
› Additional $250 - $1,000 credit for lifetime fuel ratings
› 12/31/2010
Alternative Fuel Vehicle

› Natural gas, LP, Hydrogen or Methanol
› Original User
› Credit is 50 - 80% of added vehicle cost
› Max credit = $5000
› 12/31/2010
Hybrid Motor Vehicle Credit

- Less than 8,500 pounds
- Gas and Electric combination
- Original purchaser and certified
- Credit $400 - $2400 based on fuel efficiency
- Additional $250 - $1000 credit for lifetime fuel rating
- 12/31/2009
Residential Energy Improvement

- 10% credit
  - insulation, exterior windows and doors, metal roofs
- 100% credit
  - energy efficient building property, furnaces and hot water boilers
- Maximum credit is the total but not greater than $500
- 12/31/2007
Charitable Donations

- New vehicle donation rules
- 50% AGI limitation waived
- Katrina Legislation
Vehicle Donation Rules

- Greater than $500 FMV
- Deduction limited to sale proceeds
- Valuation letter from donee organization
- 30 day requirement on letter
50% Limitation

August 28, 2005 to December 31, 2005

Cash donations

50% limitation waived

IRA donations
Katrina Legislation

- $500 per individual deduction
- Maximum $2000 deduction
- 2005 or 2006 but not both
- 60 days rent free housing
IRA’s and ROTHs

What, When and How
First Let’s Compare

- Traditional IRA
  - Tax deduction going in
  - RMD required
  - 100% taxable coming out
  - Taxable to heirs
First Let’s Compare

- ROTH IRA
  - No tax deduction going in
  - No RMD required
  - 100% tax-free coming out
  - Non-taxable to heirs


**Required Minimum Distribution**

- 70 1/2 distributions begin
- No new contributions allowed
- Balance on Dec 31 of prior year
  - 12/31 balance divided by 27.4
  - 26.5  25.6  24.7  23.8 and falling
  - still dividing at age 114
Options to Heirs

- Spousal Rollover
- One year
- Five years
- Stretch over life
RMD’s to heirs?

- Heirs have options
- Spouse
  - stretch over their life
  - rollover to their IRA and delay
- Non-spouse
  - stretch over their life
  - no rollover allowed
Tax Impact of IRA’s

- May make social security benefits taxable or increase amount taxed
- Could trigger AMT in extreme cases
- Remains taxable to heirs at potentially higher tax brackets
Taxability of Social Security

- Consider all income plus 1/2 of social security received
  - Single  >$25,000 up to 50% taxable
              >$34,000 up to 85% taxable
  - MFJ     >$32,000 up to 50% taxable
              >$44,000 up to 85% taxable
How Does it Work?

- Pension of $18,500
- Interest and Dividends of $2,000
- Social Security of $23,000
  - Total income plus 1/2 of soc sec = $32,000
  - Taxable social security = $0
  - Total tax on return = $211
Damage Done

- Add an RMD from your IRA of $5600
  - Total income now = $37600
  - $2800 of social security now taxable
  - Tax on the $5600 IRA = $842 (15%)
    - $280 is due to the social security
Temporary Option

- Charitable Gift of IRA
  - August 28 - December 31, 2005
  - Limit on giving lifted
  - Limitation on itemized deduction lifted
  - Beware social security
Conversions to ROTH

- $100,000 AGI limitation

- Advantage
  - Stops need for RMD
  - Earnings grow tax-free

- Disadvantage
  - Must pay the taxes now
  - Could effect social security taxability
When Do I Convert?

- Social security will always be fully taxable
- Ability to pay tax due from some other source
- Control of tax bracket exists
- Heirs in higher brackets
- Control desired
Example: Low Taxable Income

- Income $16,000
- Social Security of $22,000
  - none of social security is taxable
  - room to add $5000 of IRA
Example: Higher Taxable Income

- Reportable income of $60,000
- Social security of $22,000
  - social security full taxable at 85% ($18,700)
- High Itemized deductions
  - doubling up
  - medical expenses
Example: Higher Taxable Income

- AGI = $78,700
  - Itemized deductions = $25,000
  - personal exemptions = $6,400
- Taxable Income = $47,300
  - $12,100 left in 15% bracket
Alternative Minimum Tax
Can you do anything about it?
History Lesson

- Created in 1969
  - 155 wealthy Americans paid $0 in tax
- Designed to close the loop-hole
  - add on tax to bring tax liability up to a set floor
How’s it Work Today?

- Adds back certain items
  - state and local taxes paid
  - certain mortgage interest
  - private activity bond interest
- Apply a separate exemption amount
  - single = $40,250
  - MFJ = $58,000
- Apply 26% tax floor to the result
What are the Triggers?

- Large number of exemptions
- Large state and real estate taxes
- Large miscellaneous deductions
- Large deductible medical expenses
- Exercising incentive stock options
- Large capital gains
What can I Control?

- Defer income
  - put off capital gains / create cap losses
  - time IRA distributions
- Defer taxes
  - Beware double-up with AMT
  - Pay RE taxes in installments
AMT Example

- AGI = $125,000
- Itemized deductions = $38,000
  - RE taxes = $7500
  - State income taxes = $6800
  - Misc deductions = $1800 deductible
- 6 exemptions
- Regular tax = $10,536
AMT Example

- AMT adds back
  - $14,300 of taxes
  - $1800 miscellaneous deductions
- AMT subtracts
  - $58,000 personal exemption amount
- AMT tax = $11,986
- $11,986 - $10,536 = $1450 added tax
What are the tax rules
Section 121 exclusion

- Must use home as principal residence
  - 2 out of 5 years
  - Not required to be consecutive
- Exclude up to $250,000 per owner
- Sales every two years can qualify
Partial Exclusion

- Exceptions to 2 year rule
  - Death
  - Divorce
  - Job relocation
  - Marriage
  - Health
  - Unforseen Circumstances
Like-Kind-Exchanges

- Importance of Intent
- Conversion to Personal Use
  - No minimum before conversion
  - 5 year holding period
One Last Topic

HSA
Health Savings Accounts

- Mimic private Flex Benefit Plan crossed with an IRA
- Requirements
  - high deductible plan
  - not covered by Medicare
  - medical expenses to qualify distributions
  - 65 or older for distributions if no medical expenses.
Health Savings Accounts

- Advantages
  - allows above the line deduction of the contributions to the H.S.A.
  - tax free distributions for medical expenses
  - carry over provisions for excess
  - High deductible plan could reduce premiums
Summary

- Taxes cannot be avoided but they can be controlled.
- Best decisions are based on needs and not necessarily taxes.
- Planning can never be discounted.
Thank You

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