Department of the Treasury
Internal Revenue Service

Publication 553
(Rev. March 2006)
Cat. No. 15101G

Highlights of 2005 Tax Changes

Get forms and other information faster and easier by:

Internet • www.irs.gov

Contents

Introduction

This publication highlights tax law changes that take effect in 2005, 2006, and later years, except those covered in Publication 4492, Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma (see below). The chapters are divided into sections based on when the changes take effect.

Taxpayers affected by Hurricanes Katrina, Rita, or Wilma. Publication 4492 explains the major provisions of the Katrina Emergency Tax Relief Act of 2005 and the Gulf Opportunity Zone Act of 2005. It also discusses certain IRS extended tax deadlines. However, it does not discuss the following recent changes from Notice 2006-17 and Notice 2006-20. You can find these notices in Internal Revenue Bulletin 2006-10 at *www.irs.gov/pub/irs-irb/irb06-10.pdf*.

Casualty and theft losses. In Notice 2006-17, the IRS has extended to **October 16, 2006,** the deadline for making an election to claim a 2005 casualty or theft loss in 2004 if:

- Your loss is attributable to Hurricane Katrina, Rita, or Wilma;
- Your loss occurred in the covered disaster area (see Publication 4492) for the hurricane; and
- The deadline would otherwise be before October 16, 2006.

Extended tax deadlines. In Notice 2006-20, the IRS has extended to **August 28, 2006,** deadlines that apply to filing returns, paying taxes, and performing certain other time-sensitive acts for certain taxpayers affected by Hurricane Katrina. The extension applies to deadlines that occur after August 28, 2005, and before August 28, 2006. The extension applies to affected taxpayers (see Publication 4492) determined by redefining "covered disaster area" to include only the Gulf Opportunity Zone.

Adjusting your withholding or estimated tax payments for 2006. If your tax for 2006 will be more or less than your 2005 tax, you may need to adjust your withholding or estimated tax payments accordingly. If your tax will decrease, you can get the benefit of lower taxes throughout the year. If you will owe more tax, you can avoid a penalty when you file your tax return.

See the following table for forms and publications that will help you adjust your withholding or estimated tax payments. See chapter 8 for information on ordering forms and publications.

To adjust your...	Get Form...	And Publication...
Withholding	**W-4,** Employee's Withholding Allowance Certificate	**919,** How Do I Adjust My Tax Withholding?
Estimated tax payments	**1040-ES,** Estimated Tax for Individuals	**505,** Tax Withholding and Estimated Tax

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service
Business Forms and Publications Branch
SE:W:CAR:MP:T:B
1111 Constitution Ave. NW, IR-6406
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

You can email us at **taxforms@irs.gov*. (The asterisk must be included in the address.) Put "Publications Comment" on the subject line.

Although we cannot respond individually to each email, we do appreciate your feedback and will consider your comments as we revise our tax products.

1. Tax Changes for Individuals

2005 Changes

New Definition of a Qualifying Child

Beginning in 2005, the same definition of "qualifying child" applies, with some exceptions, for each of the following tax benefits.

- Dependency exemption.
- Head of household filing status.
- Earned income credit (EIC).
- Child tax credits.
- Credit for child and dependent care expenses.

In general, all four of the following tests must be met to claim someone as a qualifying child.

Relationship test. The child must be your child (including a stepchild or eligible foster child), brother, sister, stepbrother, stepsister, or a descendant of one of these relatives.

An eligible foster child is any child who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Residency test. The child must live with you for more than half the year. Temporary absences for special circumstances, such as for school, vacation, medical care, military service, or business, count as time lived at home. A child who was born or died during the year is considered to have lived with you for the entire year if your home was the child's home for the entire time he or she was alive during the year. Also, exceptions apply, in certain cases, for divorced or separated parents and parents of kidnapped children.

Age test. The child must be under a certain age (depending on the tax benefit) to be your qualifying child.

Dependency exemption, head of household filing status, and EIC. For purposes of these tax benefits, a child must be under age 19 at the end of the year, or under age 24 at the end of the year if a student, or any age if permanently and totally disabled.

Child tax credit. For purposes of the child tax credit, a child must be under the age of 17 at the end of the year.

Credit for child and dependent care expenses. For purposes of the credit for child and dependent care expenses, a child must be under the age of 13. The child can be any age if he or she was not able to care for himself or herself and lived with you for more than half the year.

Support test. The child cannot have provided over half of his or her own support during the year. For the definition of support, see Publication 501, Exemptions, Standard Deduction, and Filing Information.

Exception. For purposes of the EIC only, the support test does not apply.

More information. For more information about head of household filing status or claiming an exemption for a qualifying child or other dependent, see Publication 501. For more information about the other tax benefits affected by the definition of a qualifying child, see the appropriate publication as follows.

- Publication 596, Earned Income Credit (EIC).
- Publication 972, Child Tax Credit.
- Publication 503, Child and Dependent Care Expenses.

Dependency Exemption

A person who used to qualify as your dependent but who is not your "qualifying child" may still qualify as your dependent as a "qualifying relative". To claim the dependency exemption for a qualifying relative, the person cannot be the qualifying child of any other person and the other tests discussed in Publication 501 must be met.

CAUTION *If you are a dependent of another person, you cannot claim any dependents on your return.*

Special Rule for Divorced and Separated Parents

For purposes of the special rule for divorced or separated parents that applies to the dependency exemption and the child tax credits, the custodial parent is the parent having custody for the greater part of the year. Custody, for this purpose, means the child lives in the parent's main home. The noncustodial parent is the parent who is not the custodial parent. Under this special rule, a child can be treated as the qualifying child or qualifying relative of the noncustodial parent if he or she attaches to his or her tax return Form 8332 (or a similar statement containing the same information) signed by the custodial parent. Other conditions must be met and an exception applies to certain pre-1985 instruments. See the January 2006 revision of Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents, for more information.

Head of Household Filing Status

In general, you can use head of household filing status only if, as of the end of the year, you were unmarried or "considered unmarried" and you paid over half the cost of keeping up a home:

1. That was the main home for the entire year of your parent whom you can claim as a dependent (your parent did not have to live with you), or
2. In which you lived for more than half of the year with either of the following:
   a. Your qualifying child (defined earlier, but without regard to the exception for children of divorced or separated parents). But, if your qualifying child is married at the end of the year, see *Married child,* later.
   b. Any other person whom you can claim as a dependent.

But you cannot use head of household filing status for a person who is your dependent only because:

- He or she lived with you for the entire year, or
- You are entitled to claim him or her as a dependent under a multiple support agreement.

Married child. If your qualifying child is married at the end of the year, both of the following must apply for the child to be your qualifying child for purposes of head of household filing status.

- The child cannot file a joint return unless the return is filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns.
- The child must be a U.S. citizen, U.S. national, or a resident of the United States, Canada, or Mexico. An exception applies for certain adopted children.

Qualifying Widow(er) Filing Status

Beginning in 2005, a foster child no longer qualifies you to use qualifying widow(er) filing status.

New Form 8901

Use new Form 8901, Information on Qualifying Children Who Are Not Dependents, to give the IRS information on any qualifying child for the child tax credit if the child is not your dependent. Complete and file Form 8901 if your qualifying child is not your dependent because either of the following applies.

- You, or your spouse if filing jointly, can be claimed as a dependent on someone else's 2005 return.
- Your qualifying child is married and files a joint return for 2005 (unless that joint return is filed only as a claim for a refund and no tax liability would exist for either spouse if they had filed separate returns).

Earned Income Amount for Additional Child Tax Credit

For 2005, the minimum earned income amount used to figure the additional child tax credit has increased to $11,000.

Social Security and Medicare Taxes

For social security tax, the maximum amount of 2005 wages subject to the tax has increased to $90,000. For Medicare tax, all covered 2005 wages are subject to the tax. For information about these taxes, see Publication 15 (Circular E), *Employer's Tax Guide.*

Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2005, the amount of your interest exclusion is phased out if your filing status is married filing jointly or qualifying widow(er) and your modified adjusted gross income (MAGI) is between $91,850 and $121,850. You cannot take the deduction if your MAGI is $121,850 or more.

For all other filing statuses, your interest exclusion is phased out if your MAGI is between $61,200 and $76,200. You cannot take a deduction if your MAGI is $76,200 or more. For more information, see chapter 10 in Publication 970, Tax Benefits for Education.

Increase in Limit on Long-Term Care and Accelerated Death Benefits Exclusion

The limit on the exclusion for payments made on a *per diem* or other periodic basis under a long-term care insurance contract has increased for 2005. The limit applies to the total of these payments and any accelerated death benefits made on a *per diem* or other periodic basis under a life insurance contract because the insured is chronically ill.

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

- The cost of qualified long-term care services during the period.
- The dollar amount for the period ($240 per day for any period in 2005).

See Section C of Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and its instructions for more information.

Rules for California Domestic Partners

A registered domestic partner in California must continue to report all wages, salaries, and other compensation for his or her personal services on his or her own return. This reporting requirement was not changed by the California Domestic Partners Rights and Responsibilities Act of 2003, which took effect on January 1, 2005. Therefore, a registered domestic partner cannot report half the combined income earned by the individual and his or her domestic partner as a married person filing separately does in California, a community property state.

Increased Section 1202 Exclusion for Gain From Empowerment Zone Business Stock

You generally can exclude up to 50% of your gain on the sale or trade of qualified small business stock held by you for more than 5 years. This is called the section 1202 exclusion. Beginning in 2005, you generally can exclude up to 60% of your gain if you meet the following additional requirements.

1. You sell or trade stock in a corporation that qualified as an empowerment zone business during substantially all of the time you held the stock.
2. You acquired the stock after December 21, 2000.

Item (1) will still be met if the corporation ceased to qualify after the 5-year period that begins on the date you acquired the stock. However, the gain that qualifies for the 60% exclusion cannot be more than the gain you would have had if you had sold the stock on the date the corporation ceased to qualify.

The part of the gain that is included in income is 28% rate gain. See *Capital Gain Tax Rates* in chapter 4 of Publication 550, Investment Income and Expenses.

For more information about the section 1202 exclusion, see *Section 1202 Exclusion* in chapter 4 of Publication 550. For more information about empowerment zone businesses, see Publication 954, Tax Incentives for Distressed Communities.

Health Savings Account (HSA) Deduction Limits Increased

For 2005, the maximum HSA deduction has increased to $2,650 ($5,250 for family coverage). The maximum additional deduction for individuals 55 or older has increased to $600. For HSA purposes, the minimum annual deductible of a high deductible health plan remains at $1,000 ($2,000 for family coverage) and the maximum out-of-pocket expenses limit has increased to $5,100 ($10,200 for family coverage). For more information, see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Archer MSA Deduction Limits Increased

For 2005, the minimum annual deductible of a high deductible health plan has increased to $1,750 ($3,500 for family coverage). The maximum annual deductible of a high deductible health plan has increased to $2,650 ($5,250 for family coverage). The maximum out-of-pocket expenses limit has increased to $3,500 ($6,450 for family coverage). For more information, see Publication 969.

Income Limits Increased for Student Loan Interest Deduction

For 2005, the amount of the student loan interest deduction is phased out if your filing status is married filing jointly and your modified adjusted gross income (MAGI) is between $105,000 and $135,000. You cannot take the deduction if your MAGI is $135,000 or more. For all other filing statuses, the income limits have not changed. For more information, see chapter 4 in Publication 970.

Standard Deduction Amount Increased

The standard deduction for people who do not itemize deductions on Schedule A (Form 1040) is, in most cases, higher for 2005. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2005 Standard Deduction Tables* are shown in Publication 501.

Limit on Itemized Deductions Increased

If your adjusted gross income is above a certain amount, you may lose part of your itemized deductions. In 2005, this amount has increased to $145,950 ($72,975 if married filing separately). See the instructions for Schedule A (Form 1040), line 28, for more information on figuring the amount you can deduct.

Exemption Amount Increased

The amount you can deduct for each exemption has increased to $3,200 in 2005.

You lose all or part of the benefit of your exemptions if your adjusted gross income is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2005, the phaseout begins at:

- $109,475 for married persons filing separately,
- $145,950 for single individuals,
- $182,450 for heads of household, and
- $218,950 for married persons filing jointly or qualifying widow(er)s.

If your adjusted gross income is above the amount for your filing status, use the *Deduction for Exemptions Worksheet* in the Form 1040 or Form 1040A instructions to figure the amount you can deduct for exemptions.

Alternative Minimum Tax (AMT)

The following changes to the AMT went into effect for 2005. For more information, see Form 6251, Alternative Minimum Tax—Individuals, and its instructions.

Exemption amount for a child. The minimum exemption amount for a child under age 14 has increased to $5,850.

Domestic production activities deduction. The domestic production activities deduction is not taken into account in figuring the alternative tax net operating loss deduction (ATNOLD).

Farmers and fishermen. The foreign tax credit of a farmer or fisherman using income averaging on Schedule J no longer needs to be refigured for the AMT. This change also applies to 2004.

AMT foreign tax credit 90% limit repealed. You generally can use your entire AMT foreign tax credit to reduce your pre-credit tentative minimum tax. For tax years beginning before 2005, the amount of alternative minimum tax foreign tax credit was generally limited to 90% of your pre-credit tentative minimum tax.

Katrina additional exemption amount. The additional exemption amount on line 2 of Form 8914, Exemption Amount for Taxpayers Housing Individuals Displaced by Hurricane Katrina, for providing housing for a person displaced by Hurricane Katrina is allowable for the AMT.

Gulf Opportunity (GO) Zone. The following changes apply to the AMT.

- The interest on qualified GO Zone bonds is not a tax preference item.
- No AMT adjustment is required for depreciation of qualified GO Zone property that is eligible for the special depreciation allowance.
- The 90% limit on the ATNOLD does not apply to the portion of an ATNOLD attributable to qualified GO Zone losses. Such portion can be applied to offset up to 100% of alternative minimum taxable income (figured without regard to the ATNOLD and the domestic production activities deduction).

Income Limits Increased for Hope and Lifetime Learning Credits

For 2005, the amount of your Hope or lifetime learning credit is phased out if your modified adjusted gross income (MAGI) is between $43,000 and $53,000 ($87,000 and $107,000 if you file a joint return). You cannot claim an education credit if your MAGI is $53,000 or more ($107,000 or more if you file a joint return). For more information, see chapters 2 and 3 in Publication 970.

Adoption Benefits Increased

Beginning in 2005, the maximum adoption credit has increased to $10,630. Also, the exclusion from income of benefits under your employer's adoption assistance program has increased to $10,630. These amounts are phased out if your modified adjusted gross income (MAGI) is between $159,450 and $199,450. You cannot claim the credit or exclusion if your MAGI is $199,450 or more. See Form 8839, Qualified Adoption Expenses, and its instructions for more information.

Earned Income Credit (EIC) Amounts Increased

The following paragraphs explain the changes to the credit for 2005. For details, see Publication 596.

Earned income amount increased. The maximum amount of income you can earn and still get the credit has increased. You may be able to take the credit if:

- You have more than one qualifying child and you earned less than $35,263 ($37,263 if married filing jointly),
- You have one qualifying child and you earned less than $31,030 ($33,030 if married filing jointly), or
- You do not have a qualifying child and you earned less than $11,750 ($13,750 if married filing jointly).

The maximum amount of adjusted gross income (AGI) you can have and still get the credit also has increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

Investment income amount increased. The maximum amount of investment income you can have and still get the credit has increased to $2,700.

Taxpayers affected by hurricanes. If you were affected by Hurricane Katrina, Rita, or Wilma and your 2005 earned income was less than your 2004 earned income, you may be able to elect to use your 2004 earned income for the EIC to figure your 2005 EIC and additional child tax credit. Also, you may be able to treat as a full-time student for the EIC an individual under age 24 who was unable to attend classes because of one of the hurricanes. For details, see Publication 4492.

Standard Mileage Rate

Business-related mileage. For 2005, the standard mileage rate for all business miles is:

- 40½ cents per mile for the period January 1 through August 31, 2005, and
- 48½ cents per mile for the period September 1 through December 31, 2005.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, Travel, Entertainment, Gift, and Car Expenses.

Medical- and move-related mileage. For 2005, the standard mileage rate for the cost of operating your car for medical reasons or as part of a deductible move is 15 cents per mile. See *Transportation* under *What Medical Expenses Are Deductible* in Publication 502, Medical and Dental Expenses, or *Travel by car* under *Deductible Moving Expenses* in Publication 521, Moving Expenses.

Charitable-related mileage. For 2005, the standard mileage rate for the cost of operating your car for charitable purposes remains 14 cents per mile.

Hurricane Katrina. There are special standard mileage rates in effect in 2005 for the cost of operating your car for providing charitable services solely related to Hurricane Katrina. For the period August 25 through August 31, 2005, the standard mileage rate is 29 cents per mile. For the period September 1 through December 31, 2005, the standard mileage rate is 34 cents per mile.

Temporary Suspension of Limits on Charitable Contributions

Qualified contributions are not subject to the overall limit on itemized deductions or the 50% adjusted gross income (AGI) limit. A qualified contribution is a charitable contribution paid in cash or by check after August 27, 2005, and before January 1, 2006, to a 50% limit organization (other than certain private foundations described in section 509(a)(3)) if you make an election to have the 50% limit not apply to these contributions.

Your deduction for qualified contributions is limited to your AGI minus your deduction for all other charitable contributions. You can carry over any contributions you are not able to deduct for 2005 because of this limit. In 2006, treat the carryover of your unused qualified contributions as a carryover of contributions subject to the 50% limit.

Exception. Qualified contributions do not include a contribution to a segregated fund or account for which you (or any person you appoint or designate) have or expect to have advisory privileges with respect to distributions or investments based on your contribution.

More information. For more information, see Publication 526, Charitable Contributions. Publication 526 includes a worksheet you can use to figure your deduction if any limits apply to your charitable contributions.

Contributions of Cars, Boats, and Airplanes

If you donate a car to a qualified organization after 2004, your deduction generally is limited to the gross proceeds from its sale by the organization. This rule applies if the claimed value of the donated vehicle is more than $500. However, if the organization makes significant intervening use of or materially improves the car, you may be able to deduct its fair market value. In addition, you may be able to deduct the car's fair market value if the organization will give the car, or sell it for a price well below fair market value, to a needy individual to further the organization's charitable purpose.

Before 2005, you could deduct the fair market value of a donated vehicle in most cases.

The new rules also apply to donations of boats, airplanes, and any vehicle manufactured mainly for use on public streets, roads, and highways.

If the claimed value of the car is more than $500, you must have a contemporaneous written acknowledgment of your contribution from the organization and must attach it to your return. Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes, can be used for this purpose.

For more information, see *Cars, Boats, and Airplanes* under *Contributions of Property* in Publication 526.

Deductible Long-Term Premium Care Limits Increased

For 2005, the maximum amount of qualified long-term care premiums you can include as medical expenses has increased. You can include qualified long-term care premiums up to the amounts shown below as medical expenses on Schedule A (Form 1040).

- Age 40 or under – $270.
- Age 41 to 50 – $510.
- Age 51 to 60 – $1,020.
- Age 61 to 70 – $2,720.
- Age 71 or over – $3,400.

Note. The limits on premiums is for each person.

Expenses of Whaling Captains

Beginning in 2005, you may be able to deduct as a charitable contribution the reasonable and necessary whaling expenses paid during the year in carrying out sanctioned whaling activities. The deduction is limited to $10,000 a year. To claim the deduction, you must be recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities.

For more information, see *Expenses of Whaling Captains* in Publication 526.

Automatic 6-Month Extension

You can now use Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, to obtain an automatic 6-month extension of time (generally 4 months if you are "out of the country") to file your individual income tax return.

2006 Changes

Social Security and Medicare Taxes

For social security tax, the maximum amount of 2006 wages subject to the tax has increased to $94,200. For Medicare tax, all covered 2006 wages are subject to the tax. For information about these taxes, see Circular E (Publication 15).

Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2006, the amount of your interest exclusion is phased out if your filing status is married filing jointly or qualifying widow(er) and your modified adjusted gross income (MAGI) is between $94,700 and $124,700. You cannot take the deduction if your MAGI is $124,700 or more.

For all other filing statuses, your interest exclusion is phased out if your MAGI is between $63,100 and $78,100. You cannot take a deduction if your MAGI is $78,100 or more. For more information, see chapter 10 in Publication 970.

Increase in Limit on Long-Term Care and Accelerated Death Benefits Exclusion

The limit on the exclusion for payments made on a *per diem* or other periodic basis under a long-term care insurance contract has increased for 2006. The limit applies to the total of these payments and any accelerated death benefits made on a *per diem* or other periodic basis under a life insurance contract because the insured is chronically ill.

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

- The cost of qualified long-term care services during the period.
- The dollar amount for the period ($250 per day for any period in 2006).

Investment Income of Child Under Age 14

The amount of taxable investment income a child under the age of 14 can have without it being subject to tax at the parent's rate has increased to $1,700 for 2006.

Health Savings Account (HSA) Deduction Limits Increased

For 2006, the maximum HSA deduction has increased to $2,700 ($5,450 for family coverage). The maximum additional deduction for individuals 55 or older has increased to $700. For HSA purposes, the minimum annual deductible of a high deductible health plan has increased to $1,050 ($2,100 for family coverage) and the maximum out-of-pocket expenses limit has increased to $5,250 ($10,500 for family coverage).

Archer MSA Deduction Limits Increased

For 2006, the minimum annual deductible of a high deductible health plan has increased to $1,800 ($3,650 for family coverage). The maximum annual deductible of a high deductible health plan has increased to $2,700 ($5,450 for family coverage). The maximum out-of-pocket expenses limit has increased to $3,650 ($6,650 for family coverage).

Standard Deduction Amount Increases

The standard deduction is, in most cases, higher for 2006. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2006 Standard Deduction Tables* are shown in Publication 505.

Limit on Itemized Deductions Increased

If your adjusted gross income is above a certain amount, you may lose part of your itemized deductions. In 2006, this amount has increased to $150,500 ($75,250 if married filing separately). See Publication 505 for more information on figuring the amount you can deduct.

Phaseout of Reductions of Personal Exemptions and Itemized Deductions

Taxpayers with adjusted gross income above a certain amount may lose part of their deduction for personal exemptions and itemized deductions. Beginning in 2006, the amount by which these deductions are reduced is only 2/3 of the amount of the reduction that would otherwise have applied. See Publication 505 for more information on figuring your deductions.

Exemption Amount Increases

The amount you can deduct for each exemption has increased to $3,300 in 2006.

You lose part of the benefit of your exemptions if your adjusted gross income is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2006, the phaseout begins at:

- $112,875 for married persons filing separately,
- $150,500 for single individuals,
- $188,150 for heads of household, and
- $225,750 for married persons filing jointly or qualifying widow(er)s.

Alternative Minimum Tax (AMT)

Exemption amount for a child. The minimum exemption amount for a child under age 14 increased to $6,050 for 2006.

CAUTION

At the time this publication went to print, Congress was considering legislation that would eliminate the following changes.

Certain credits no longer allowed against the AMT. The credit for child and dependent care expenses, credit for the elderly or the disabled, education credits, mortgage interest credit, and carryforwards of the District of Columbia first-time homebuyer credit are no longer allowed against the AMT, and a new tax liability limit applies. This limit is your regular tax minus any tentative minimum tax (figured without any AMT foreign tax credit).

AMT exemption amount decreased. The AMT exemption amount has decreased to $33,750 ($45,000 if married filing jointly or qualifying widow(er); $22,500 if married filing separately).

Limits Increased for Hope and Lifetime Learning Credits

For 2006, the maximum Hope credit has increased to $1,650 (100% of the first $1,100 of qualified education expenses and 50% of the next $1,100 of qualified education expenses). These dollar amounts are doubled for students attending an eligible education institution in the Gulf Opportunity Zone.

For 2006, the amount of your Hope or lifetime learning credit is phased out if your modified adjusted gross income (MAGI) is between $45,000 and $55,000 ($90,000 and $110,000 if you file a joint return).

You cannot claim an education credit if your MAGI is $55,000 or more ($110,000 or more if you file a joint return). For more information, see chapters 2 and 3 in Publication 970.

Residential Energy Credits

You may be eligible for two new credits, the nonbusiness energy property credit and the residential energy efficient property credit, for making energy saving improvements to your home in 2006. For credit purposes, costs are treated as being paid when the original installation of the item is completed, or in the case of costs connected with the construction or reconstruction of a building, when your original use of the constructed or reconstructed building begins. If less than 80% of the use of an item is for nonbusiness purposes, only that portion of the costs that are allocable to the nonbusiness use can be used to determine the credit.

A home includes a house, houseboat, mobile home, cooperative apartment, condominium, and certain manufactured homes. You must reduce the basis of your home by the amount of credit allowed.

TIP *If you are a member of a qualified condominium management association for a condominium which you own or a tenant-stockholder in a cooperative housing corporation, you are treated as having paid your proportionate share of any costs of such association or corporation. Credits must be allocated based on the ratio of individual qualified costs to total qualified costs in the case of joint occupancy.*

Nonbusiness energy property credit. You may be able to take a credit equal to the sum of:

- 10% of the amount paid in 2006 for qualified energy efficiency improvements installed during 2006, and
- Any residential energy property costs paid in 2006.

However, this credit is limited as follows.

- A total accumulated credit limit of $500 for all tax years.
- An accumulated credit limit of $200 for windows for all tax years.
- A credit limit for residential energy property costs for all tax years of $50 for any advanced main air circulating fan; $150 for any qualified natural gas, propane, or oil furnace or hot water boiler; and $300 for any item of energy efficient building property.

Qualified energy efficiency improvements. Qualified energy efficiency improvements are the following items installed on or in your main home located in the United States if these items are new and can be expected to remain in use for at least 5 years.

- Any insulation material or system which is specifically or primarily designed to reduce the heat loss or gain of a home when installed in or on such home.
- Exterior windows (including skylights).
- Exterior doors.
- Any metal roof installed on a home, but only if this roof has appropriate pigmented coatings which are specifically and primarily designed to reduce the heat gain of the home.

For information on determining if a home is your main home, see Publication 523, Selling Your Home.

CAUTION *To qualify for the credit, qualified energy efficiency improvements must meet certain energy efficiency requirements.*

Residential energy property costs. Residential energy property costs are costs of new qualified energy property that is installed on or in connection with your main home located in the United States. This includes labor costs properly allocable to the onsite preparation, assembly, or original installation of the property. Qualified energy property is any of the following.

- Certain electric heat pump water heaters, electric heat pumps, geothermal heat pumps, central air conditioners, and natural gas, propane, or oil water heaters.
- Qualified natural gas, propane, or oil furnaces or hot water boilers.
- Certain advanced main air circulating fans used in natural gas, propane, or oil furnaces.

CAUTION *To qualify for the credit, qualified energy property must meet certain performance and quality standards.*

Residential energy efficient property credit. You may be able to take a credit of 30% of your costs of qualified photovoltaic property, solar water heating property, and fuel cell property. This includes labor costs properly allocable to the onsite preparation, assembly, or original installation of the property and for piping or wiring to interconnect such property to the home. This credit is limited to:

- $2,000 for qualified photovoltaic property costs,
- $2,000 for qualified solar water heating property costs, and
- $500 for each half kilowatt of capacity of qualified fuel cell property for which qualified fuel cell property costs are paid.

Qualified photovoltaic property costs. Qualified photovoltaic property costs are costs for property that uses solar energy to generate electricity for use in a home located in the United States and used as a home. This includes costs relating to a solar panel or other property installed as a roof or a portion of a roof.

Qualified solar water heating property costs. Qualified solar water heating property costs are costs for property to heat water for use in a home located in the United States and used as a home if at least half of the energy used by the property for such purpose is derived from the sun. This includes costs relating to a solar panel or other property installed as a roof or a portion of a roof. To qualify for the credit, the property must be certified for performance by the nonprofit Solar Rating Certification Corporation or a comparable entity endorsed by the government of the state in which the property is installed.

Qualified fuel cell property costs. Qualified fuel cell property costs are costs for qualified fuel cell property installed on or in connection with your main home located in the United States. Qualified fuel cell property is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means. To qualify for the credit, the fuel cell property must have a nameplate capacity of at least one-half kilowatt of electricity using an electrochemical process and an electricity-only generation efficiency greater than 30%.

CAUTION

Costs allocable to a swimming pool, hot tub, or any other energy storage medium that has a function other than the function of such storage do not qualify for the residential energy efficiency credit.

Electric and Clean-Fuel Vehicles

The clean-fuel vehicle and refueling property deduction expired for vehicles placed in service in 2006. The qualified electric vehicle credit is reduced by 75% for vehicles placed in service in 2006, and no credit will be allowed after 2006. For more information about electric and clean-fuel vehicles, see chapter 12 in Publication 535, Business Expenses.

Alternative Motor Vehicle Credit

You may be able to claim this credit if you place an alternative motor vehicle in service for business or personal use after 2005. An alternative motor vehicle must meet certain requirements and be a new:

- Advanced lean burn technology vehicle,
- Qualified alternative fuel vehicle,
- Qualified fuel cell vehicle, or
- Qualified hybrid vehicle.

For more information, see Form 8910, Alternative Motor Vehicle Credit.

Alternative Fuel Vehicle Refueling Property Credit

You can claim this credit if you place qualified alternative fuel vehicle refueling property in service for business or personal use after 2005. This includes certain property used to store or dispense a clean-burning fuel or recharge motor vehicles propelled by electricity. For more information, see Form 8911, Alternative Fuel Vehicle Refueling Property Credit.

Adoption Benefits Increased

Beginning in 2006, the maximum adoption credit has increased to $10,960. Also, the exclusion from income of benefits under your employer's adoption assistance program has increased to $10,960. These amounts are phased out if your modified adjusted gross income (MAGI) is between $164,410 and $204,410. You cannot claim the credit or exclusion if your MAGI is $204,410 or more.

Earned Income Credit (EIC) Amounts Increased

The following paragraphs explain the changes to the credit for 2006.

Earned income amount increased. The maximum amount of income you can earn and still get the credit has increased for 2006. You may be able to take the credit if:

- You have more than one qualifying child and you earn less than $36,348 ($38,348 if married filing jointly),
- You have one qualifying child and you earn less than $32,001 ($34,001 if married filing jointly), or
- You do not have a qualifying child and you earn less than $12,120 ($14,120 if married filing jointly).

The maximum amount of adjusted gross income (AGI) you can have and still get the credit also has increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

Investment income amount increased. The maximum amount of investment income you can have and still get the credit has increased to $2,800 for 2006.

Nontaxable combat pay election extended. You can elect to have your nontaxable combat pay included in earned income when you figure your earned income credit for 2006. This election was previously due to expire at the end of 2005 but has been extended through 2006. For more information about the election, see Publication 596.

Earned Income Amount for Additional Child Tax Credit

For 2006, the minimum earned income amount used to figure the additional child tax credit has increased to $11,300.

Standard Mileage Rate

Business-related mileage. For 2006, the standard mileage rate for all business miles is $44\frac{1}{2}$ cents per mile. Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463.

Medical- and move-related mileage. For 2006, the standard mileage rate for the cost of operating your car for medical reasons or as part of a deductible move is 18 cents per mile. See *Transportation* under *What Medical Expenses Are Includible* in Publication 502 or *Travel by car* under *Deductible Moving Expenses* in Publication 521.

Charitable-related mileage. The special standard mileage rate in effect for 2006 for the cost of operating your car for providing charitable services solely related to Hurricane Katrina is 32 cents per mile.

Qualified Contributions Expired

For 2006, you can no longer elect to treat gifts by cash or check as qualified contributions on Schedule A. Qualified contributions for which you made this election were not subject to the 50% of adjusted gross income limit or the overall limit on itemized deductions.

Deductible Long-Term Care Premium Limits Increased

For 2006, the maximum amount of qualified long-term care premiums you can include as medical expenses has increased. You can include qualified long-term care premiums up to the amounts shown below as medical expenses on Schedule A (Form 1040).

- Age 40 or under – $280.
- Age 41 to 50 – $530.
- Age 51 to 60 – $1,060.
- Age 61 to 70 – $2,830.
- Age 71 or over – $3,530.

Note. The limits on premiums is for each person.

Expired Tax Benefits

The following tax benefits have expired and will not apply for 2006.

- Deduction from adjusted gross income for educator expenses.
- Tuition and fees deduction.
- Deduction for state and local general sales taxes.
- District of Columbia first-time homebuyer credit (for homes purchased after 2005).

CAUTION

At the time this publication went to print, Congress was considering legislation that would reinstate these benefits. You can visit www.irs.gov *for current information on tax changes.*

2.

Tax Changes for Businesses

2005 Changes

Self-Employment Tax

The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2005 has increased to $90,000. All net earnings of at least $400 are subject to the Medicare part of the tax.

Depreciation and Section 179 Deduction

Increased section 179 limits. The maximum section 179 deduction you can elect for property you placed in service in 2005 has increased to $105,000 for qualified section 179 property ($140,000 for qualified enterprise zone property, qualified renewal community property, and qualified New York Liberty Zone property). This limit is reduced by the amount by which the cost of section 179 property placed in service during the tax year exceeds $420,000. For qualified section 179 Gulf Opportunity (GO) Zone property acquired after August 27, 2005, the maximum section 179 deduction is higher than the deduction for most section 179 property. See chapter 2 of Publication 946, How To Depreciate Property.

Depreciation limits on passenger automobiles, trucks or vans, and electric vehicles. The total depreciation deduction (including the section 179 deduction) you can take for a passenger automobile (that is not a truck or van or an electric vehicle) that you use in your business and first place in service in 2005 is $2,960. For a truck or van (such as a minivan or a sport utility vehicle) built on a truck chassis, the total depreciation deduction you can take is $3,260. For an electric vehicle, the total depreciation deduction you can take is $8,880. See *Maximum Depreciation Deduction* in chapter 5 of Publication 946.

CAUTION

These limits are reduced if the business use of the vehicle is less than 100%.

Limited applicability of special depreciation allowance. The additional special depreciation allowance (including the increased limits for passenger automobiles) only applies to certain property placed in service in 2005. You can claim a special allowance for certain aircraft, certain property with a long production period, and qualified New York Liberty Zone property you placed in service in 2005. You can also claim a special allowance for qualified GO Zone property you acquired after August 27, 2005. See chapter 3 of Publication 946.

Recovery periods for depreciation of certain natural gas gathering and transmission lines and electric transmission property. Natural gas gathering lines placed in service after April 11, 2005, are treated as 7-year property under the Modified Accelerated Cost Recovery System (MACRS). In addition, natural gas distribution lines and certain electric transmission property placed in service after April 11, 2005, are treated as 15-year property under MACRS. For each type of property, the original use of the property must begin with you after April 11, 2005. This treatment does not apply to property placed in service under a binding contract in effect before April 12, 2005, or to property you manufacture, construct, or produce for your own use if you began the manufacture, construction, or production of the property before April 12, 2005. See chapter 4 of Publication 946.

Domestic Production Activities Deduction

You may be able to claim a domestic production activities deduction (DPAD) for tax years beginning after 2004. For 2005, your DPAD is generally 3% of the smaller of:

- Your qualified production activities income, or
- Your adjusted gross income for an individual, estate, or trust (taxable income for all other taxpayers) figured without the DPAD.

However, your DPAD generally cannot be more than 50% of the Form W-2 wages you paid to your employees.

For more information, see Form 8903, Domestic Production Activities Deduction.

Recapture of Section 197 Amortization

If you sell or otherwise dispose of multiple amortizable section 197 intangibles after August 8, 2005, in a single transaction or series of related transactions, ordinary income recapture is figured as if all such intangibles were a single asset. Section 197 intangibles include patents, copyrights, governmental licenses and permits, covenants not to compete, franchises, trademarks, and trade names. For more information, see Publication 535, chapter 9.

Outright Sales of Timber by Landowners

Outright sales of timber held for more than 1 year by landowners qualify for capital gains treatment after 2004. For more information, see the instructions for Part III of Form T.

Exception to Oil Depletion Deduction for Independent Producers

For tax years ending after August 8, 2005, the 50,000 barrels-per-day limit for purposes of determining if an independent producer of oil or gas can use the percentage depletion method increased to 75,000 barrels, based on the average, rather than the actual, daily runs for the tax year. For more information, see Publication 535, chapter 10.

Deduction for Qualified U.S. Refineries

For property placed in service after August 8, 2005, you may elect to deduct 50% of the cost of any qualified refinery property located in the United States. For more information, see Internal Revenue Code section 179C.

Research Credit Expanded

The research credit has been expanded as follows.

- The credit may be claimed on 20% of costs paid or incurred after August 8, 2005, for qualified research undertaken by an energy research consortium.
- The 65% limit on contract research expenses has been increased to 100% if paid or incurred after August 8, 2005, for qualified energy research to an eligible small business, university, or federal laboratory.

For more information, see Form 6765, Credit for Increasing Research Activities.

CAUTION

At the time this publication went to print, the research credit had expired for amounts paid or incurred after 2005, but Congress was considering legislation to reinstate the credit. You can visit www.irs.gov *for current information on tax changes.*

Investment Credit Expanded

The investment credit has been expanded to include the following new credits for periods after August 8, 2005.

- Qualifying advanced coal project credit.
- Qualifying gasification project credit.

For more information, see Form 3468, Investment Credit.

Distilled Spirits Credit

The distilled spirits credit is a new general business credit available to distillers, importers, and eligible wholesalers of distilled spirits for the cost of financing the federal excise tax on bottled distilled spirits. The credit applies to tax years beginning after September 30, 2005. See Form 8906, Distilled Spirits Credit, for more information.

Nonconventional Source Fuel Credit

New Form 8907, Nonconventional Source Fuel Credit, must be filed to claim this credit for tax years beginning after 2004. For tax years ending after 2005, this credit will be treated as a general business credit. In certain circumstances, the credit has been extended to facilities that produce coke and coke gas fuel. For more information, see Form 8907.

Biodiesel and Renewable Diesel Fuels Credit

You can claim this new general business credit for certain:

- Biodiesel produced and sold or used in your trade or business after 2004, and
- Renewable diesel sold or used in your trade or business after 2005.

The fuel may be in a qualified mixture. A small agri-biodiesel producer credit is also available for tax years ending after August 8, 2005. For more information, see Form 8864, Biodiesel and Renewable Diesel Fuels Credit.

Renewable Electricity, Refined Coal, and Indian Coal Production Credit

The renewable electricity production credit was extended for qualified facilities placed in service before January 1, 2008. The credit has been expanded to include electricity from qualified hydropower production for facilities placed in service after August 8, 2005. The credit period is increased to 10 years for open-loop biomass (using agricultural livestock waste), geothermal, solar energy, small irrigation power, landfill gas, and trash combustion facilities placed in service after August 8, 2005. For tax years ending after August 8, 2005, certain cooperatives can elect to allocate any part of the renewable electricity, refined coal, and Indian coal production credit among its patrons. See Form 8835, Renewable Electricity, Refined Coal, and Indian Coal Production Credit, for more information.

Qualified Railroad Track Maintenance Credit

For tax years beginning after 2004 and before 2008, certain taxpayers may be able to claim a credit for expenditures made to maintain railroad track (including roadbed, bridges, and related track structures) owned or leased by a Class II or Class III railroad. For more information, see Form 8900, Qualified Railroad Track Maintenance Credit.

Electing S Corporation Status

For tax years beginning after 2004, the maximum number of shareholders that an S corporation may have has increased from 75 to 100.

For purposes of the 100 shareholder limit, members of a family are treated as one shareholder. A family is defined as the common ancestor, the lineal descendants of the common ancestor, and the spouses (or former spouses) of the lineal descendants or the common ancestor. For more information, see Internal Revenue Code section 1361(c)(1).

Nonqualified Deferred Compensation Plans

All amounts deferred after 2004 under a nonqualified deferred compensation (NQDC) plan for all tax years are currently includible in gross income and subject to additional taxes to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. This change may also apply to deferrals made prior to 2005 under certain circumstances. Federal income tax withholding and new reporting requirements also apply to NQDC. See section 5 of Publication 15-A, Employer's Supplemental Tax Guide, for more information.

Fringe Benefit Parking Exclusion and Commuter Transportation Benefit

You can generally exclude a limited amount of the value of qualified parking and commuter highway vehicle transportation and transit passes you provide to an employee from the employee's wages subject to employment taxes. For 2005, the monthly exclusion for qualified parking has increased to $200 and the monthly exclusion for commuter highway vehicle transportation and transit passes has increased to $105. See *Qualified Transportation Benefits* in section 2 of Publication 15-B, Employer's Tax Guide to Fringe Benefits.

Increase to FUTA Tax Deposit Requirement

The deposit threshold for FUTA tax has increased from $100 to $500. The $500 threshold applies to FUTA tax deposits required for taxes reported on Form 940 and 940-EZ, Employer's Annual Federal Unemployment (FUTA) Tax Return, and 940-PR, Planilla Para La Declaración Anual Del Patrono—La Contribución Federal Para El Desempleo (FUTA), for periods beginning after 2004.

Increase to Withholding on Supplemental Wage Payments Exceeding $1,000,000

For payments made after 2004, the flat withholding rate on supplemental wage payments that exceed $1,000,000 during the year has increased to 35%. See section 7 of Publication 15 (Circular E) for more information.

Form 7004 Revised

Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns, replaces the following extension forms for tax years which end on or after December 31, 2005.

- Form 2758, Application for Extension of Time To File Certain Excise, Income, Information, and Other Returns.
- Form 8736, Application for Automatic Extension of Time To File U.S. Return for a Partnership, REMIC, or for Certain Trusts.
- Form 8800, Application for Additional Extension of Time To File U.S. Return for a Partnership, REMIC, or for Certain Trusts.

All returns listed on page 1 of Form 7004 are eligible for an automatic 6-month extension of time to file from the due date of the return. See the instructions for Form 7004 for details.

2006 Changes

Self-Employment Tax

The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2006 has increased to $94,200. All net earnings of at least $400 are subject to the Medicare part of the tax.

Depreciation and Section 179 Deduction

Increased section 179 limits. The maximum section 179 deduction you can elect for property you placed in service in 2006 has increased to $108,000 for qualified section 179 property ($143,000 for qualified enterprise zone property, qualified renewal community property, and qualified New York Liberty Zone property). This limit is reduced by the amount by which the cost of section 179 property placed in service during the tax year exceeds $430,000. For qualified section 179 Gulf Opportunity (GO) Zone property acquired after August 27, 2005, the maximum section 179 deduction is higher than the deduction for most section 179 property. See chapter 2 of Publication 946.

Depreciation limits on electric vehicles. The total depreciation deduction (including the section 179 deduction) you can take for an electric vehicle is $8,980. This limit is reduced if the business use of the vehicle is less than 100%.

Meal Expenses When Subject to "Hours of Service" Limits

Generally, you can deduct only 50% of your business-related meal expenses. You can deduct a higher percentage for meal expenses while traveling away from your tax home for business purposes if the meals take place during or incident to any period subject to the Department of Transportation's "hours of service" limits. (These limits apply to workers who are under certain federal regulations.) The percentage increases to 75% for 2006. Business meal expenses are covered in chapter 1 of Publication 463. Reimbursements for employee meal expenses are covered in chapter 13 of Publication 535.

Deduction for Energy Efficient Commercial Building Property

For property placed in service in 2006 or 2007, you can deduct the cost of energy efficient building property. The maximum deduction for any building for all tax years is $1.80 multiplied by the square footage of the building. Energy efficient building property includes property installed as part of:

- Interior lighting systems;
- Heating, cooling, ventilation, and hot water systems; and
- The building envelope.

The property must be certified as being part of a plan to reduce annual energy and power costs for those systems by at least 50% in comparison to a reference building that meets certain requirements. For more information, see Internal Revenue Code section 179D.

Work Opportunity Credit and Welfare-to-Work Credit Expired

Generally, the work opportunity credit and the welfare-to-work credit have expired for wages paid to individuals who began working for you after 2005.

CAUTION *At the time this publication was going to print, Congress was considering legislation that may reinstate and extend these credits.*

Hurricane Katrina exception. You can claim the work opportunity credit after 2005 only for wages paid to Hurricane Katrina employees. For more information, see Form 5884, Work Opportunity Credit.

Alternative Motor Vehicle Credit

You may be able to claim this credit if you place an alternative motor vehicle in service for business or personal use after 2005. An alternative motor vehicle must meet certain requirements and be a new:

- Advanced lean burn technology vehicle,

- Qualified alternative fuel vehicle,
- Qualified fuel cell vehicle, or
- Qualified hybrid vehicle.

For more information, see Form 8910.

Alternative Fuel Vehicle Refueling Property Credit

You can claim this credit if you place qualified alternative fuel vehicle refueling property in service for business or personal use after 2005. This includes certain property used to store or dispense a clean-burning fuel or recharge motor vehicles propelled by electricity. For more information, see Form 8911.

Energy Efficient Home Credit

An eligible contractor may claim a credit of up to $2,000 for each energy efficient home constructed and substantially completed by the contractor after August 8, 2005. The home must also be acquired in 2006 or 2007 from the contractor by a person for use as a residence in the United States. The credit is allowed in the tax year the home was acquired from the contractor. Construction includes substantial reconstruction and rehabilitation. For a manufactured home, the manufactured home producer is treated as an eligible contractor. The home must be certified as having a level of annual heating and cooling at least 50% below the annual level of a comparable dwelling unit with the building envelope components accounting for at least a 10% reduction. For certain manufactured homes, the 50% requirement is reduced to 30%, or it does not apply if the home meets the requirements of the Energy Star Labeled Homes program. For more information, see Form 8908, Energy Efficient Home Credit.

Investment Credit for Energy Property Expanded

For periods in 2006 and 2007, the investment credit for energy property has been expanded to include the business installation of qualified fuel cells, stationary microturbine power plants, and equipment that uses solar energy for illumination. In addition, the credit percentage has increased to 30% for solar energy property placed in service in 2006 and 2007. For more information, see Form 3468.

Renewable Electricity, Refined Coal, and Indian Coal Production Credit

The credit has been expanded to include Indian coal sold after 2005 over a 7-year credit period. See Form 8835 for more information.

Energy Efficient Appliance Credit

For tax years beginning in 2006 and 2007, qualified producers and manufacturers of certain energy efficient appliances may be able to claim a tax credit for dishwashers, clothes washers, and refrigerators that meet certain energy efficient standards and are produced or manufactured during the calendar year ending with or within the tax year. For more information, see Internal Revenue Code section 45M.

Clean Renewable Energy Bond Credit and Gulf Bond Credit

New credits are available if you are a holder of a clean renewable energy bond or Gulf tax credit bond. If you hold a clean renewable energy bond or Gulf tax credit bond on one or more credit allowance dates of the bond, you are allowed a credit in the amount of 25% of the annual credit on each credit allowance date. For more information on these credits, see Form 8912, Clean Renewable Energy Bond Credit and Gulf Bond Credit, when it is released in 2006.

Fringe Benefit Parking Exclusion

You can generally exclude a limited amount of the value of qualified parking you provide to an employee from the employee's wages subject to employment taxes. For 2006, the monthly exclusion for qualified parking has increased to $205. See *Qualified Transportation Benefits* in section 2 of Publication 15-B.

Withholding Income Tax on Wages of Nonresident Aliens

For wages paid after December 31, 2005, employers must use a new procedure to figure federal income tax withholding on wages of nonresident aliens. For more information, see Publication 15 (Circular E).

Annual Employment Tax Filing for Small Employers

To reduce burden on small employers, the IRS has simplified the rules for filing employment tax returns to report social security, Medicare, and withheld federal income taxes. Starting with calendar year 2006, certain employers must file new Form 944, Employer's ANNUAL Federal Tax Return, instead of the Form 941, Employer's QUARTERLY Federal Tax Return. The IRS will be sending a notice to each employer that must file Form 944. Generally, the first annual Form 944, for calendar year 2006, is due January 31, 2007.

Two Spanish versions of Form 944 will be available, Forma 944-PR, Planilla para la Declaración Federal ANUAL del Patrono, for employers in Puerto Rico, and Forma 944(SP), Declaración Federal ANUAL de Impuestos del Patrono o Empleador, for employers in the United

States. Employers in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands use Form 944-SS, Employer's ANNUAL Federal Tax Return.

For more information about annual employment tax filing and tax deposit rules, see Treasury Decision 9239. You can find T.D. 9239 on page 401 of Internal Revenue Bulletin 2006-6 at *www.irs.gov/pub/irs-irbs/irb06-06.pdf*.

Expired Tax Benefits

In addition to certain provisions discussed earlier, the following tax benefits have expired as shown below.

- Indian employment credit (for tax years beginning after 2005).
- Accelerated depreciation for qualified Indian reservation property (for property placed in service after 2005).
- 15-year recovery period for qualified leasehold improvements and qualified restaurant improvements (for property placed in service after 2005).
- Credit for electricity produced from a facility using solar energy (for a facility placed in service after 2005).
- Expensing of environmental remediation costs (except for qualified contaminated sites in the Gulf Opportunity Zone) (for costs paid or incurred after 2005).
- Suspension of the 100% of net income limit on percentage depletion for oil and gas from marginal wells (for tax years beginning after 2005).
- Deduction for corporate donations of computer technology or equipment (for donations made in tax years beginning after 2005).
- Certain tax incentives based on the designation of the District of Columbia Enterprise Zone (for any period after 2005).
- Possessions corporation tax credit (for tax years beginning after 2005).

CAUTION *At the time this publication went to print, Congress was considering legislation that would reinstate many of these benefits. You can visit* www.irs.gov *for current information on tax changes.*

3. IRAs and Other Retirement Plans

2005 Changes

Individual Retirement Arrangements (IRAs)

For more information about IRAs, see Publication 590, Individual Retirement Arrangements (IRAs).

Traditional IRA contribution and deduction limit. The contribution limit to your traditional IRA for 2005 has increased to the smaller of:

- $4,000, or
- Your taxable compensation for the year.

If you were age 50 or older in 2005, the most that can be contributed to your traditional IRA for 2005 is the smaller of:

- $4,500, or
- Your taxable compensation for the year.

Roth IRA contribution limit. If contributions on your behalf were made only to Roth IRAs, your contribution limit for 2005 is generally the smaller of:

- $4,000, or
- Your taxable compensation for the year.

If you were age 50 or older in 2005 and contributions on your behalf were made only to Roth IRAs, your contribution limit for 2005 is generally the smaller of:

- $4,500, or
- Your taxable compensation for the year.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced.

Modified AGI limit for traditional IRA contributions increased. For 2005, if you were covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced if your modified adjusted gross income (AGI) is:

- More than $70,000 but less than $80,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $50,000 but less than $60,000 for a single individual or head of household, or

- Less than $10,000 for a married individual filing a separate return.

For all filing statuses other than married filing separately, the upper and lower limits of the phaseout range has increased by $5,000.

Increase in limit on salary reduction contributions under a SIMPLE IRA. For 2005, salary reduction contributions that your employer could make on your behalf under a SIMPLE IRA has increased to $10,000.

Additional salary reduction contributions to SIMPLE IRAs for persons 50 and older. For 2005, additional salary reduction contributions could be made to your SIMPLE IRA if:

- You were age 50 or older in 2005, and
- No other salary reduction contributions could be made for you to the plan for the year because of limits or restrictions, such as the regular annual limit.

For 2005, the additional amount is the smaller of:

- $2,000, or
- Your compensation for the year reduced by your other elective deferrals for the year.

Modified AGI. Beginning in 2005, the domestic production activities deduction is added back to income when figuring modified AGI.

Modified AGI for conversion purposes. Beginning in 2005, modified AGI for conversion purposes will not include required distributions from qualified retirement plans (including IRAs).

Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560, Retirement Plans for Small Business.

Limits on contributions and benefits. For 2005, the maximum annual benefit for a participant under a defined benefit plan has increased to the smaller of:

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years, or
- $170,000.

For 2005, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant has increased to the smaller of:

- 100% of the compensation actually paid to the participant, or
- $42,000.

Compensation limit. For 2005, the maximum compensation used for figuring contributions and benefits has increased to $210,000.

Elective deferrals (401(k) plans). For 2005, the limit on elective deferrals for participants in 401(k) plans and SARSEPs (excluding SIMPLE plans) is $14,000.

Catch-up contributions. For 2005, a plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions of up to $4,000.

The catch-up contribution a participant can make for a year cannot exceed the smaller of:

- $4,000, or
- The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560.

Elective deferral (SARSEPs) limit. The limits on elective deferrals and catch-up contributions for participants in SARSEPs are discussed earlier under *Elective deferrals (401(k) plans).*

Deduction limit increased. The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2005, the maximum combined deduction for a participant's elective deferrals and other SEP contributions has increased to $42,000.

Contribution limit increased. For 2005, the annual limit on the amount of employer contributions to a SEP has increased to the smaller of:

- 25% of an eligible employee's compensation, or
- $42,000.

Compensation limit. For 2005, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions has increased to $210,000.

SIMPLE Plans

The following changes apply to SIMPLE plans. For more information, see Publication 560.

Salary reduction contributions. For 2005, the limit on salary reduction contributions to a SIMPLE plan has increased to $10,000.

Catch-up contributions. For 2005, a SIMPLE plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions of up to $2,000.

The catch-up contribution a participant can make for a year cannot exceed the smaller of:

- $2,000, or

- The excess of the participant's compensation over the salary reduction contributions that are not catch-up contributions.

403(b) Plan Changes

The following changes apply to 403(b) plans. For more information, see Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans).

Increase in the limit on elective deferrals. For 2005, the limit on elective deferrals has increased to $14,000.

Catch-up contributions. If you are age 50 or older by the end of 2005, you may be permitted to make additional catch-up contributions of up to $4,000 to your 403(b) plan.

Limit on annual additions. For 2005, the limit on annual additions has increased to $42,000.

Catch-up Contributions to Thrift Savings Plan (TSP)

Participants in the TSP who are age 50 or older at the end of the year generally can make catch-up contributions to the plan. For 2005, the maximum catch-up contribution has increased to $4,000. For more information, see Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits.

2006 Changes

Individual Retirement Arrangements (IRAs)

For more information about IRAs, see Publication 590.

Traditional IRA contribution and deduction limit. If you will be age 50 or older in 2006, the most that can be contributed to your traditional IRA for 2006 will be the smaller of:

- $5,000, or
- Your taxable compensation for the year.

Roth IRA contribution limit. If you will be age 50 or older in 2006 and contributions on your behalf are made only to Roth IRAs, your contribution limit for 2006 will generally be the smaller of:

- $5,000, or
- Your taxable compensation for the year.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced.

Modified AGI limit for traditional IRA contributions increased for a married couple filing a joint return. For 2006, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA will be reduced (phased out) if your modified adjusted gross income (AGI) is:

- More than $75,000 but less than $85,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $50,000 but less than $60,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

.

Additional salary reduction contributions to SIMPLE IRAs for persons age 50 or older. For 2006, additional salary reduction contributions can be made to your SIMPLE IRA if:

- You will be age 50 or older in 2006, and
- No other salary reduction contributions can be made for you to the plan for the year because of limits or restrictions, such as the regular annual limit.

For 2006, the additional amount is the smaller of:

- $2,500, or
- Your compensation for the year reduced by your other elective deferrals for the year.

Qualified Roth Contribution Programs

For tax years beginning after 2005, 401(k) and 403(b) plans can create a qualified Roth contribution program so that participants may elect to have part or all of their elective deferrals to the plan designated as after-tax Roth contributions.

Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560.

Limits on contributions and benefits. For 2006, the maximum annual benefit for a participant under a defined benefit plan has increased to the smaller of:

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years, or
- $175,000 (subject to cost-of-living increases).

For 2006, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant has increased to the smaller of:

- 100% of the compensation actually paid to the participant, or
- $44,000 (subject to cost-of-living increases).

Compensation limit. For 2006, the maximum compensation used for figuring contributions and benefits has increased to $220,000.

Elective deferrals (401(k) plans). For 2006, the limit on elective deferrals for participants in 401(k) plans and SARSEPs (excluding SIMPLE plans) is $15,000.

Catch-up contributions. For 2006, a plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions of up to $5,000.

The catch-up contribution a participant can make for a year cannot exceed the smaller of:

- $5,000, or
- The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560.

Deduction limit increased. The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2006, the maximum combined deduction for a participant's elective deferrals and other SEP contributions has increased to $44,000.

Contribution limit increased. For 2006, the annual limit on the amount of employer contributions to a SEP has increased to the smaller of:

- 25% of an eligible employee's compensation, or
- $44,000 (subject to cost-of-living increases).

Compensation limit. For 2006, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions has increased to $220,000.

SIMPLE Plans

The following change applies to SIMPLE plans. For more information, see Publication 560.

Catch-up contributions. For 2006, a SIMPLE plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions up to $2,500.

403(b) Plan Changes

The following changes apply to 403(b) plans. For more information, see Publication 571.

Increase in the limit on elective deferrals. For 2006, the limit on elective deferrals has increased to $15,000.

Catch-up contributions. If you are age 50 or older by the end of 2006, you may be permitted to make additional catch-up contributions of up to $5,000 to your 403(b) plan.

Limit on annual additions. For 2006, the limit on annual additions has increased to $44,000.

Catch-up Contributions to Thrift Savings Plan (TSP)

Participants in the TSP who are age 50 or older at the end of the year generally can make catch-up contributions to the plan. For 2006, the maximum catch-up contribution has increased to $5,000. For more information, see Publication 721.

4.

Exempt Organizations

2005 Changes

Acknowledgment Required for Contributions of Cars, Boats, and Airplanes

Qualified organizations that receive car donations after 2004 must give the donor a written acknowledgment of the contribution. Form 1098-C (Copies B and C) can be used for this purpose. This rule applies if the claimed value of the donated vehicle is more than $500.

For contributions for which you completed an acknowledgment in 2005, file Copy A of Form 1098-C with the Internal Revenue Service by February 28, 2006 (March 31, 2006, if you file electronically).

Boats, airplanes, and other vehicles. This rule also applies to donations of boats, airplanes, and any vehicle manufactured mainly for use on public streets, roads, and highways. However, this rule does not apply to donations of inventory.

Penalty. There is a penalty for knowingly furnishing a false or fraudulent acknowledgment or knowingly failing to furnish a required acknowledgment in the manner, at the time, and showing the information required. For details about this penalty, see Notice 2005-44 on page 1287 of Internal Revenue Bulletin 2005-25 at *www.irs.gov/pub/irs-irbs/irb05-25.pdf*.

Completing and filing Form 1098-C. For help in completing and filing Form 1098-C, see the 2005 General Instructions for Forms 1099, 1098, 5498, and W-2G and the 2005 Instructions for Form 1098-C. The General Instructions provide the requirements for filing on paper, electronically, or on magnetic media, while the Instructions for Form 1098-C give specific instructions for completing the form. To order these instructions and Form 1098-C, see *How to Get Tax Help,* later.

CAUTION *Because paper forms are scanned during processing, you cannot file with the IRS Forms 1096 or 1098-C that you print from the IRS website.*

Notice of Income From Donated Intellectual Property

A taxpayer who contributes qualified intellectual property to a charity may be entitled to a charitable deduction, in addition to any initial deduction allowed in the year of contribution, based on a specified percentage of the qualified donee income received by the donee with respect to the qualified intellectual property. Any additional charitable deductions attributable to qualified donee income may be allowed in the year of the contribution or in later years. The donee organization may be required to file Form 8899, Notice of Income From Donated Intellectual Property, if the property produces net income for the year. The donee must file the form with the IRS and provide a copy of the form to the donor.

More information. Form 8899 and instructions is now available at *www.irs.gov*.

5. Estate and Gift Taxes

2005 Changes

Annual Exclusion for Gifts To Spouses Increased

The annual exclusion for gifts made to spouses who are not U.S. citizens has increased to $117,000.

Maximum Estate and Gift Tax Rate Reduced

For estates of decedents dying, and gifts made, in 2005, the maximum rate for the estate tax and the gift tax reduced to 47%.

Changes to State Death Taxes

For estates of decedents dying after 2004, the credit for state death taxes is replaced with a deduction for state death taxes.

2006 Changes

Estate Tax Applicable Exclusion Amount Increased

An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate exceeds the applicable exclusion amount for the year of death, which has increased as shown below.

Year	Exclusion Amount
2006, 2007, and 2008	$2,000,000
2009	3,500,000

Annual Exclusion for Gifts Increased

The annual exclusion for gifts of present interests made to a donee during the calendar year has increased to $12,000.

The annual exclusion for gifts made to spouses who are not U.S. citizens has increased to $120,000.

Maximum Estate and Gift Tax Rate Reduced

For estates of decedents dying, and gifts made, after 2005, the maximum rate for the estate tax and the gift tax is as follows.

Year	Maximum Tax Rate
2006	46%
2007, 2008, and 2009	45%

Generation-Skipping Transfer (GST) Exemption Increased

The generation-skipping transfer (GST) lifetime exemption has increased to $2,000,000. The annual increase can only be allocated to transfers made during or after the year of the increase.

6. Excise Taxes

Various excise tax provisions of the Internal Revenue Code were added or affected by American Jobs Creation Act of 2004, The Energy Policy Act of 2005, and the Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2005 (SAFETEA). Some of the major changes to the forms and publications are highlighted below. Explanations of the changes are included in the following products.

- Form 720, Quarterly Federal Excise Tax Return
- The Instructions for Form 720
- Form 4136, Credit for Federal Tax Paid on Fuels
- Form 8849, Claim for Refund of Excise Taxes
- Publication 510, Excise Taxes for 2006

Heavy Highway Vehicle Use Tax (Form 2290)

Repeal of Installment Agreement

The election to pay in installments has been repealed, beginning with Form 2290 for the period July 1, 2005, through June 30, 2006.

Changes Effective for the Third Quarter of 2005

Taxable Tires

Super single tires designed for steering are taxable at the rate of $.0945, retroactive to January 1, 2005. Taxpayers must file Form 720X to report the $.04725 tax rate increase on super single tires designed for steering reported on Forms 720 for the first and second calendar quarters of 2005.

Changes Effective for the Fourth Quarter of 2005

Gas Guzzler Tax

The gas guzzler tax on limousines with a gross unloaded vehicle weight of greater than 6,000 pounds is repealed, effective for sales, uses, or leases by the manufacturer, producer, or importer.

Fishing Rods and Fishing Poles

Fishing rods and fishing poles (and component parts) taxed at a rate of 10% will have a maximum tax of $10 per article.

Truck, Trailer, and Semitrailer Chassis and Bodies, and Tractors

Tractors that have a gross vehicle weight of 19,500 pounds or less and a gross combined weight of 33,000 pounds or less are excluded from the 12% retail tax.

Kerosene for Use in Aviation

The taxation and claims relating to kerosene for use in aviation have been revised. The terminology has changed from aviation-grade kerosene to kerosene for use in aviation. Generally, kerosene is taxed at $.244 per gallon unless a reduced rate applies.

Undyed Diesel Fuel and Undyed Kerosene, Use on a Farm

Registered ultimate vendors claims for undyed diesel fuel and undyed kerosene (other than kerosene for use in aviation) sold for use on a farm for farming purposes have been eliminated. Ultimate purchasers may use Schedule C (Form 720), Schedule 1 (Form 8849), or Form 4136 to make these claims.

Leaking Underground Storage Tank (LUST) Tax

The LUST tax rate ($.001) generally applies to removals, entries, and sales of dyed diesel fuel, dyed kerosene, kerosene for use in aviation (nontaxable uses and foreign trade), gasoline blendstocks, kerosene used for a feedstock purpose, and diesel fuel or kerosene used in Alaska. The following IRS Nos. have been added to Form 720.

- IRS No. 105, Dyed diesel fuel, LUST tax.
- IRS No. 107, Dyed kerosene, LUST tax.
- IRS No. 111, Kerosene for use in aviation, LUST tax on nontaxable uses, including foreign trade.
- IRS No. 119, LUST tax, other exempt removals.

The LUST tax will not be credited or refunded, except for exported taxable fuel. The rates on Schedule C (Form 720), Schedules 1 and 2 (Form 8849), and Form 4136 have been reduced by $.001 to reflect this change. Lines have been added to Schedule C (Form 720), Schedule 1 (Form 8849), and Form 4136 to make claims for exported taxable fuel.

Changes Effective for the First Quarter of 2006

Air Transportation Taxes

For amounts paid during 2006, the tax on the use of international air travel facilities will be $14.50 per person for flights that begin or end in the United States, or $7.30 per person for domestic segments that begin or end in Alaska or Hawaii (applies only to departures). For amounts paid for each domestic segment of taxable transportation of persons by air, the domestic segment tax is $3.30 per segment for transportation that begins in 2006.

Arrow Shafts

The tax on arrow shafts has increased to $.40 per arrow shaft.

Renewable Diesel

Renewable diesel will generally be treated the same as biodiesel for credit purposes. The renewable diesel mixture credit is $1.00 per gallon of renewable diesel.

Diesel-Water Fuel Emulsion

A reduced rate of tax on a diesel-water fuel emulsion applies if certain conditions are met. IRS No. 104 has been added to Form 720. Claims can be made for nontaxable uses of a diesel-water fuel emulsion and for diesel fuel used to produce a diesel-water fuel emulsion.

Taxable Tires

Three new IRS Nos. have been added to report taxable tires instead of IRS No. 66.

- IRS No. 108, Taxable tires other than biasply or super single tires.
- IRS No. 109, Taxable tires, biasply or super single tires (other than super single tires designed for steering).
- IRS No. 113, Taxable tires, super single tires designed for steering.

Claims for Exempt Sales of Fuel by Registered Credit Card Issuers

Claims for gasoline, undyed diesel fuel, and undyed kerosene used exclusively by a state or local government or nonprofit educational organization can be made by the registered credit card issuer if the fuel was purchased with a credit card issued to the state or local government or nonprofit educational organization. Other conditions must be met.

Changes Effective for the Second Quarter of 2006

Reinstatement of the Oil Spill Liability Tax

The oil spill liability taxes (IRS Nos. 18 and 21) have been reinstated beginning April 1, 2006.

7. Foreign Issues

2005 Changes

Foreign Tax Credit

If you claim the credit for foreign taxes on an accrual basis, you must generally use the average exchange rate for the tax year to which taxes relate. However, in tax years beginning in 2005 and later years, you can elect to use the exchange rate in effect on the date the taxes were paid. For details, see Publication 514, Foreign Tax Credit for Individuals.

Alternative Minimum Tax Foreign Tax Credit 90% Limit Repealed

Beginning in 2005, you generally can use your entire alternative minimum tax foreign tax credit to reduce your pre-credit tentative minimum tax. For tax years beginning before 2005, the amount of alternative minimum tax foreign tax credit was generally limited to 90% of your pre-credit tentative minimum tax. See Form 6251 and its instructions.

Phaseout of Extraterritorial Income Exclusion

The extraterritorial income (ETI) exclusion provisions are being phased out, generally for transactions after 2004. For transactions during 2005, taxpayers may claim 80% of the otherwise applicable ETI exclusion. The phaseout of the ETI exclusion provisions does not apply to transactions in the ordinary course of a trade or business under a binding contract if such contract is between the taxpayer and an unrelated person (as defined under the ETI exclusion provisions) and such contract is in effect on September 17, 2003, and at all times thereafter.

For more information, see the 2005 Form 8873, Extraterritorial Income Exclusion, and instructions.

Residents of Japan

Beginning in 2005, if you are a nonresident alien and a resident of Japan, you generally cannot claim the following benefits. The new U.S.-Japan income tax treaty, which became effective on January 1, 2005, does not allow them.

- Exemptions for spouse and dependents.
- Qualifying widow(er) filing status.
- Single filing status for people who are married, have a child, and do not live with their spouse.

However, if you choose to have the old U.S.-Japan treaty apply in its entirety for 2005, you may be able to claim these benefits on your 2005 Form 1040NR, U.S. Nonresident Alien Income Tax Return.

New Rules for Partnership Withholding on Effectively Connected Income (ECI)

For partnership tax years beginning after May 18, 2005, new regulations under section 1446 provide the rules for a partnership to withhold tax on ECI allocated to a foreign partner. See *Partnership Withholding on Effectively Connected Income* in Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entries.

New Rules for Publicly Traded Partnership (PTP) Withholding on Distributions to Foreign Partners

For partnership tax years beginning after May 18, 2005, a PTP can no longer elect to withhold tax based on ECI allocable to its foreign partners. The PTP must withhold on the distribution of that income to its foreign partners.

For more information, see *Publicly Traded Partnerships* under *Partnership Withholding on Effectively Connected Income* in Publication 515.

2006 Changes

Exception From the Filing Requirement for Nonresident Aliens

Generally, the requirement to file a return has been eliminated for nonresident aliens who earn wages effectively connected with a U.S. trade or business that are less than the amount of one personal exemption ($3,300 for 2006). For more information, see Notice 2005-77, 2005-46 I.R.B. 951. You can find Notice 2005-77 on page 951 of Internal Revenue Bulletin 2005-46 at *www.irs.gov/pub/irs-irbs/irb05-46.pdf*.

Source of Compensation for Labor or Personal Services

In tax years beginning after July 13, 2005, new rules apply in determining the source of compensation for labor or personal services performed as an employee. If you file your tax returns on a calendar year basis, the new rules apply to your returns for 2006 and later years.

Under the new rules, compensation (other than fringe benefits) is sourced on a time basis. Fringe benefits (such as housing and education) are sourced on a geographical basis. For more information, see Regulations section 1.861-4 on page 429 of Internal Revenue Bulletin 2005-35 at *www.irs.gov/pub/irs-irbs/irb05-35.pdf*.

Phaseout of Extraterritorial Income Exclusion

The extraterritorial income (ETI) exclusion provisions are being phased out, generally for transactions after 2004. For transactions during 2006, taxpayers may claim 60% of the otherwise applicable ETI exclusion. The phaseout of the ETI exclusion provisions does not apply to transactions in the ordinary course of a trade or business under a binding contract if such contract is between the taxpayer and an unrelated person (as defined under the ETI exclusion provisions) and such contract is in effect on September 17, 2003, and at all times thereafter.

For more information, see the 2005 Form 8873 and instructions.

New Rules for Acceptance Agents

New rules apply to acceptance agents. There are four major changes to the rules.

- Applicants are subject to suitability checks.
- Acceptance agent agreements must be renewed every 4 years.
- Agreements in effect under the old procedures will expire on December 31, 2006. Acceptance agents will need to apply under the new procedures to maintain their approved status.
- Acceptance agents may request that their names be added to a public list of agents published periodically by the IRS.

For more information, see Rev. Proc. 2006-10 on page 293 of Internal Revenue Bulletin 2006-2 at *www.irs.gov/pub/irs-irbs/irb06-02.pdf*.

8.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate independently represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate toll free at 1-877-777-4778;
- Call, write, or fax the Taxpayer Advocate office in your area;
- Call 1-800-829-4059 if you are a TTY/TDD user; or
- Visit *www.irs.gov/advocate*.

For more information, see Publication 1546, How To Get Help With Unresolved Tax Problems (now available in Chinese, Korean, Russian, and Vietnamese, in addition to English and Spanish).

Free tax services. To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Internet. You can access the IRS website 24 hours a day, 7 days a week, at *www.irs.gov* to take the following actions.

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2005 refund. Click on *Where's My Refund*. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2005 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using our Form W-4 calculator.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to *www.irs.gov/localcontacts* or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 and press 2 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2005 refund, call 1-800-829-4477 and press 1 for automated refund information or call 1-800-829-1954. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2005 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day to ask tax questions or get help with a tax problem. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. You can set up an appointment by calling your local Center and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to *www.irs.gov/localcontacts* or look in the phone book under *United States Government, Internal Revenue Service*.

Mail. You can send your order for forms, instructions, and publications to the address below and receive a response within 10 business days after your request is received.

National Distribution Center
P.O. Box 8903
Bloomington, IL 61702-8903

CD-ROM for tax products. You can order Publication 1796, IRS Federal Tax Products CD-ROM, and obtain:

- A CD that is released twice so you have the latest products. The first release ships in late December and the final release ships in late February.
- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions (FAQs).
- Tax Topics from the IRS telephone response system.
- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-Free and email technical support.

Buy the CD-ROM from National Technical Information Service (NTIS) at *www.irs.gov/cdorders* for $25 (no handling fee) or call 1-877-233-6767 toll free to buy the CD-ROM for $25 (plus a $5 handling fee).

CD-ROM for small businesses. Publication 3207, The Small Business Resource Guide, CD-ROM for 2005, has a new look and enhanced navigation features. This year's CD includes:

- Helpful information, such as how to prepare a business plan, find financing for your business, and much more.
- All the business tax forms, instructions, and publications needed to successfully manage a business.
- Tax law changes for 2005.
- IRS Tax Map to help you find forms, instructions, and publications by searching on a keyword or topic.
- Web links to various government agencies, business associations, and IRS organizations.
- "Rate the Product" survey—your opportunity to suggest changes for future editions.

An updated version of this CD is available each year in early April. You can get a free copy by calling 1-800-829-3676 or by visiting *www.irs.gov/smallbiz*.

Index

To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

■