General Income Tax Changes for Tax Years 2005 and 2006

Donald J. Breece, Farm Management Specialist, OSU Extension Center at Lima

Charitable Contributions of Vehicles, Boats, and Aircraft

If you donate a vehicle (including a boat or aircraft) to a qualified organization after December 31, 2004, your deduction 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, you generally can deduct its fair market value if the organization:

- Makes significant intervening use of the vehicle,
- Materially improves the vehicle, or
- Transfers the vehicle to a needy individual in direct furtherance of the donee's charitable purpose of relieving the poor and distressed or underprivileged who are in need of a means of transportation.

Boats, aircraft, and other vehicles.

These rules apply to donations of boats, aircraft, and any vehicle manufactured mainly for use on public streets, roads, and highways.

Acknowledgement required.

If the claimed value of the car is more than $500, you must have a written acknowledgement of your donation from the organization and must attach it to your return. If you do not have an acknowledgement, you cannot deduct your contribution.

The acknowledgement must include the following information.

1. Your name and taxpayer identification number.
2. The vehicle identification number or similar number.
3. A statement certifying the car was sold in an arm's length transaction between unrelated parties.
4. The gross proceeds from the sale.
5. A statement that your deduction may not be more than the gross proceeds from the sale.
6. The date of the contribution.

However, if there was significant intervening use of or material improvement to the car by the organization, the acknowledgement does not have to include the information in items 3, 4, and 5 above. Instead, it must contain a certification of the intended use of or material improvement to the car and the intended duration of that use and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of that use or improvement.

This acknowledgement must be provided within 30 days of the sale of the car or, if there is significant intervening use or material improvement of the car by the organization, within 30 days of the contribution.

The organization also must provide this information to the IRS.

More information.

More information can be found in Notice 2005-44 and the 2005 revision of Publication 526, Charitable Contributions (to be available mid-December 2005).

Uniform Definition of a Qualifying Child

Beginning in 2005, one definition of a qualifying child will apply for each of the following tax benefits.

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

Tests To Meet

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 an adopted child, stepchild, or eligible foster child), brother, sister, stepbrother, stepsister, or a descendent of one of these relatives.

An adopted child includes a child lawfully placed with you for legal adoption even if the adoption is not final.

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

Residency test.

A child must live with you for more than half of the year. Temporary absences for special circumstances, such as for school, vacation, medical care, military service, or detention in a juvenile facility 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 children of divorced or separated parents and parents of kidnapped children.

Age test.

A 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 the age of 19 at the end of the year, or under age 24 at the end of 2005 if a student, or any age if permanently and totally disabled.

A student is any child who, during any 5 months of the year:

1. Was enrolled as a full-time student at a school, or
2. Took a full-time, on-farm training course given by a school or a state, county, or local government agency.

A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence school, or night school.

Child tax credit.

For purposes of the child tax credit, a child must be under the age of 17.

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 or any age if permanently and totally disabled.

Support test.

A child cannot have provided over half of his or her own support during the year.

Exception.

For purposes of the EIC only, the *Support test* does not apply.

Qualifying Child of More Than One Person

Sometimes a child meets the tests to be a qualifying child of more than one person. However, only one person can treat that child as a qualifying child. If you and someone else (other than your spouse if filing jointly) have the same qualifying child, you and the other person(s) can decide who will claim the child. If you cannot agree on who will claim the child and more than one person files a return using the same child, the IRS may disallow one or more of the claims using the tie-breaker rule explained in Table 1, next.

Table 1. When More Than One Person Files a Return Claiming the Same Qualifying Child (Tie-Breaker Rule).

IF . . .	THEN the child will be treated as the qualifying child of the. . .
only one of the persons is the child's parent,	parent.
both persons are the child's parent,	parent with whom the child lived for the longer period of time. If the child lived with each parent for the same amount of time, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income (AGI).
none of the persons are the child's parent,	person with the highest adjusted gross income.

Dependency Exemption

To claim the dependency exemption for a qualifying child, all four tests listed earlier under *Tests To Meet* must be met. The child generally must also 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. If married, he or she 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.

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 child cannot be the qualifying child of any other person and all five dependency tests discussed under *Dependency Tests* in Publication 501 must be met.

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

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 all 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* below.
    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.

1. 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.
2. 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.

Earned Income Credit (EIC)

You may be able to claim the earned income credit (EIC) in 2005 if you have:

1. 2 or more qualifying children and your earned income is less than $35,263 ($37,263 if married filing jointly for 2005),
2. 1 qualifying child and your earned income is less than $31,030 ($33,030 if married filing jointly for 2005), or
3. No qualifying children and your earned income is less than $11,750 ($13,750 if married filing jointly for 2005). For purposes of the EIC, a qualifying child must meet the *Relationship test*, *Residency test* (without regard to the exception for children of divorced or separated parents), and *Age test*, earlier. A qualifying child does not have to meet the *Support test* for purposes of the EIC. But, if your qualifying child is married at the end of the year, see *Married child* next.

Married child.

A child who is married at the end of the year is a qualifying child for purposes of the EIC only if you can claim him or her as your dependent (see *Dependency Exemption*, earlier) or this child's other parent claims him or her as a dependent under the rules for children of divorced or separated parents in Publication 501, Exemptions, Standard Deduction, and Filing Information.

Child Tax Credit

You may be able to take the child tax credit if you have a qualifying child that meets all four of the tests listed earlier under *Tests To Meet*. For additional rules that you must meet, see Publication 972, Child Tax Credit.

Credit for Child and Dependent Care Expenses

Generally, a qualifying person for purposes of the credit for child and dependent care expenses is:

- Your qualifying child (defined earlier, but without regard to the exception for parents of kidnapped children), or

- Your dependent or spouse who is physically or mentally incapable of caring for himself or herself and who lived with you for more than half of the year.

For purposes of the credit for child and dependent care expenses, a qualifying child and dependent are determined without regard to the exception for children of divorced or separated parents and the child is treated as a qualifying person only for the custodial parent.

For additional rules that you must meet, see Publication 503, Child and Dependent Care Expenses. However, you no longer need to meet the *Keeping Up a Home test* discussed in Publication 503.

Earned Income Credit Amounts Increase

Earned income amount.

The maximum amount of income you can earn and still get the credit is higher for 2005 than it is for 2004. You may be able to take the credit for 2005 if:

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

The maximum amount of investment income you can have in 2005 and still get the credit increases to $2,700.

Electric and Clean-Fuel Vehicles

For 2005, the proposed 50% reduction of the maximum electric vehicle credit and the clean-fuel deduction has been eliminated. You can claim the maximum electric vehicle credit allowed for a qualified electric vehicle you place in service in 2005. You can claim the maximum deduction allowed for qualified clean-fuel vehicle or other clean-fuel property placed in service in 2005.

Exemption Amount Increased

The amount you can deduct for each exemption has increased from $3,100 in 2004 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 instructions to figure the amount you can deduct for exemptions.

Retirement Savings Plans

Traditional IRA income limits. If you have a traditional individual retirement account (IRA) and are covered by a retirement plan at work, the amount of income you can have and not be affected by the deduction phaseout increases. The amounts vary depending on filing status.

Limit on elective deferrals. The maximum amount of elective deferrals under a salary reduction agreement that can be contributed to a qualified plan increases to $14,000 ($18,000 if you are age 50 or over). However, for a SIMPLE plan, the amount increases to $10,000 ($12,000 if you are age 50 or over).

IRA deduction expanded. The amount you, and your spouse if filing jointly, may be able to deduct as an IRA contribution will increase to $4,000 ($4,500 if age 50 or older at the end of 2005).

Social Security and Medicare Taxes

For 2005, the employer and employee will continue to pay:

1. 6.2% each for social security tax (old-age, survivors, and disability insurance), and
2. 1.45% each for Medicare tax (hospital insurance).

Wage limits. For social security tax, the maximum amount of 2005 wages subject to the tax is $90,000. For Medicare tax, all covered 2005 wages are subject to the tax.

Standard Deduction Amount Increased

The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2005 than it was for 2004. 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 taxpayer.

The basic standard deduction amounts for 2005 are:

- Head of household — $7,300
- Married taxpayers filing jointly and qualifying widow(er)s — $10,000
- Married taxpayers filing separately — $5,000
- Single — $5,000

The standard deduction amount for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $800 or the sum of $250 and the individual's earned income.

Standard Mileage Rates

For tax years beginning in 2005, the allowable deductions for the standard mileage rate for the period January 1, 2005, through August 31, 2005, are as follows:

- **Business miles.** The standard mileage rate for the cost of operating your car increases to **40.5** cents a mile for all business miles driven.
- **Charitable services.** The standard mileage rate allowed for use of your car when you use your car to provide charitable services to a charitable organization is **14** cents a mile.
- **Charitable services** — **Hurricane Katrina relief services.** If you used your vehicle in giving services to a charitable organization to provide relief related to Hurricane Katrina, the standard mileage rate allowed for use of your car is **29** cents a mile for miles driven after August 24, 2005, and before September 1, 2005.
- **Medical reasons.** The standard mileage rate allowed for use of your car for medical reasons is **15** cents a mile.
- **Moving.** The standard mileage rate for determining moving expenses is **15** cents a mile.

The allowable deductions for the standard mileage rate for the period September 1, 2005, through December 31, 2005, are as follows:

- **Business miles.** The standard mileage rate for the cost of operating your car increases to **48.5** cents a mile for all business miles driven.
- **Charitable services.** The standard mileage rate allowed for use of your car when you use your car to provide charitable services to a charitable organization remains at **14** cents a mile.
- **Charitable services** — **Hurricane Katrina relief services.** If you used your vehicle in giving services to a charitable organization to provide relief related to Hurricane Katrina, the standard mileage rate allowed for use of your car is **34** cents a mile.
- **Medical reasons.** The standard mileage rate allowed for use of your car for medical reasons is **22** cents a mile.
- **Moving.** The standard mileage rate for determining moving expenses is **22** cents a mile.

Earned Income Credit Amounts Increase in 2006

Earned income amount.

The maximum amount of income you can earn and still get the credit is higher for 2006 than it is for 2005. You may be able to take the credit for 2006 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 has also 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.

The maximum amount of investment income you can have in 2006 and still get the credit increases to $2,800.

Exemption Amount Increased in 2006

The amount you can deduct for each exemption has increased from $3,200 in 2005 to $3,300 in 2006.

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 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.

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

Social Security and Medicare Taxes

For 2006, the employer and employee will continue to pay:

1. 6.2% each for social security tax (old-age, survivors, and disability insurance), and
2. 1.45% each for Medicare tax (hospital insurance).

Wage limits. For social security tax, the maximum amount of 2006 wages subject to the tax has increased from $90,000 to $94,200. For Medicare tax, all covered 2006 wages are subject to the tax.

Standard Deduction Amount Increased (2006)

The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2006 than it was 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 taxpayer.

The basic standard deduction amounts for 2006 are:

- Head of household — $7,550
- Married taxpayers filing jointly and qualifying widow(er)s — $10,300
- Married taxpayers filing separately — $5,150
- Single — $5,150

The standard deduction amount for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $850 or the sum of $300 and the individual's earned income.

Standard Mileage Rates (2006)

For tax years beginning in 2006, the allowable deductions for the standard mileage rate are as follows:

- **Business miles.** The standard mileage rate for the cost of operating your car increases to **44.5** cents a mile for all business miles driven.
- **Charitable services.** The standard mileage rate allowed for use of your car when you use your car to provide charitable services to a charitable organization is **14** cents a mile.
- **Charitable services** — **Hurricane Katrina relief services.** If you used your vehicle in giving services to a charitable organization to provide relief related to Hurricane Katrina, the standard mileage rate allowed for use of your car is **32** cents a mile.
- **Medical reasons.** The standard mileage rate allowed for use of your car for medical reasons is **18** cents a mile.
- **Moving.** The standard mileage rate for determining moving expenses is **18** cents a mile.