TaxSMART

PERSONAL YEAR-END TAX PLANNING STRATEGIES

Tax Calendar

November-December 2005:
Time for 2005 Year-End and 2006 Tax Planning. This is especially true if you have substantial increases in income or fewer deductions. Tax planning provides an opportunity to make adjustments before year's end that can improve your tax situation and minimize potential penalties. Please call for an appointment.

December 31, 2005:

- Last day to pay deductible expenses for 2005 return (this doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2005).
- Last day to make minimum required withdrawal of funds from a Traditional IRA Account and avoid a penalty if you turned age 70½ before 2005.
- Last day to set up a Keogh Retirement Account if you plan to make a 2005 Contribution.

January 16, 2006:

- Fourth-Quarter 2005 Federal Estimated Tax Payment due unless 2005 return is filed by January 31, 2006. Caution: Some states may have different filing dates.

January 31, 2006:
Deadline for providing 1099s and W-2s to those people you paid during 2005. If you're a business owner or rental property owner, and you paid $600 or more for the services of individuals (other than employees) during the year, you need to provide 1099s for those workers by January 31, 2006. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by February 28, 2006. If you would like this firm to prepare these documents for you, please give us a call.

February 28, 2006:
Deadline for filing (sending) 1099s and W-2s to the government.

April 3, 2006:
Last day to withdraw funds from your Traditional IRA if you turned age 70½ in 2005 and you haven't taken your 2005 Distribution yet. In addition, this is the last day to withdraw funds from your SEP or Keogh plan if you're retired and turned age 70½ in 2005. Failure to take the required distributions can result in substantial penalties.

April 17, 2006:

- Deadline for individuals to file a 2005 Federal Return or request an extension of time to file.
- First Installment of 2006 Federal Estimated Tax Payment due.
- First Installment of 2006 Defined Benefit Pension Plan Contributions due.

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Year-End Planning Strategies to Lower Your Taxes

The following is a checklist that might help you save taxes if you act before the year's end. Not all strategies will apply to everyone, but many clients will benefit from more than one item. Not all available strategies are listed either.

If you are over 70½ years of age and have retirement plans, make sure you take the required minimum distribution before the end of the year. If you turned 70½ in 2005, you can wait until next year to take your distribution, provided you take it before April 3, 2006. You will still need to take another distribution for 2006, so if you delay the 2005 distribution until 2006, you will essentially be doubling your distributions for that year. The penalty for failing to make the proper distribution is an additional tax equal to 50% of the amount of the underdistribution.

If you anticipate having a tax liability for 2005, you can increase your withholding for the balance of the year and eliminate or reduce underpayment penalties.

If you have stocks that have declined in value, you may wish to sell them before the end of the year and use the loss to offset other gains for the year or to produce a deductible loss. The net capital loss on a tax return is limited to $3,000 for the year, but any excess loss carries over to future years.

If a job-related bonus is expected to be paid around the end of the year, you might be able to defer that income into the following year if that is appropriate in your situation. See if your employer is willing to put off payment until just after the first of the year.

If itemizing deductions, a taxpayer can increase those deductions for the year by prepaying certain taxes. Consider one or more of the following:

- Prepaying the next installment of your property taxes, or
- Pay your 4th quarter state tax estimate in December.
- If your sales tax deduction is greater than your state income tax deduction, or if you live in a state with no state income tax and you are planning a large purchase (such as a car) in the future, it might be appropriate to make that purchase in 2005. This is because 2005 is the last year for the sales tax deduction under the current law.

CAUTION: *This strategy will not work if you are subject to the AMT, since taxes are not deductible for AMT purposes.*

Reduce your gift and estate taxes by making gifts before the year's end. For 2005, the amount you may give without creating a gift tax filing requirement is $11,000 per person. You can make gifts each year to an unlimited number of

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Year-End Tax Tips and Strategies

Dear Client:

With 2006 just around the corner, it's time to get your year-end planning and tax preparation in gear. This edition provides year-end tax strategies that can help you minimize your tax liability.

This newsletter also discusses the benefits of the Katrina Emergency Act, which was passed by Congress late in September. Along with a number of tax incentives to residents of the disaster area, it also includes provisions that apply to all taxpayers whether or not they resided within the disaster area.

Another big headliner is the energy tax incentives available for the purchase of hybrid vehicles. These will be in effect in 2006. Please contact our office if you are planning to make a hybrid purchase so we can ensure that you maximize the tax benefits that are available.

Don't miss the opportunity to reduce your tax burden by not planning ahead. We offer year-round tax planning services and can help you make the most of available tax strategies.

We look forward to assisting you with your tax needs.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

(Continued) Year-End Planning Strategies to Lower Your Taxes

individuals, but you can't carry over unused annual gift tax exclusions from one year to the next. For 2006, the annual gift exclusion is expected to rise to $12,000.

Consider using a credit card to prepay expenses that can generate deductions for this year.

If taxed by the AMT, you might consider deferring payments that would qualify as a "miscellaneous" itemized deduction, since you will receive no benefit for those expenses. On the other hand, if you are not taxed by the AMT, consider accelerating those expenses.

If you're thinking of making non-cash charitable donations, do so before the end of the year to maximize your charitable deduction. And remember that if you write a check to make a charitable donation, it must be mailed by December 31 to count as a current year deduction.

These are some year-end strategies to help minimize your tax liability. You may wish to contact this office for a year-end planning session, so we can tailor a plan that best serves your needs.

Since You Asked…

Q– My wife and I are getting a divorce. As part of the property settlement, she will keep the home. What are the possible tax consequences that may arise?

ANSWER – When property is divided up in a divorce, there are no immediate tax consequences. Therefore, the transfer of your interest in the home to your spouse will not result in a taxable gain or loss to you or her. However, let's say she assumes the home at the community basis. Generally, community basis is what you jointly paid for the home plus the cost of improvements you've made. Thus, she would be responsible for reporting any gain in excess of the community basis when and if she sells the home. If she qualifies, she can exclude the first $250,000 of gain; any part of the gain in excess of the exclusion will be taxable to her. As part of your divorce tax strategy, and assuming you qualify for the home gain exclusion, you might want to consider selling the home jointly. This will convert the asset to cash, which can then be divided up as part of the settlement. By doing so, you would have a combined $500,000 home gain exclusion and will only be taxed on the amount, if any, in excess of this larger exclusion amount.

How Katrina Tax Incentives Can Benefit You

Late in September, Congress passed the Katrina Emergency Act. This Act provides a vast number of tax benefits to individuals who were residents of the disaster area. In addition, it includes provisions that apply to all taxpayers whether or not they resided within the disaster area. The following is a brief summary of those provisions:

Increased charitable contributions – Generally, most charitable contributions are limited to 50% of a taxpayer's adjusted gross income (AGI). To provide an incentive for larger charitable contributions, that 50% limit has been increased to 100% for cash contributions made between August 28 and December 31, 2005, with a five-year carryover provision subject to the 50% limit for contributions in excess of the 100% of the AGI limitation for 2005. There may be other complications so consult our office if you anticipate making a substantial contribution. In addition, the contributions made during August 28 through December 31 of 2005 are not subject to the overall itemized deductions phase-out that applies to high-income taxpayers.

Additional exemption for housing Katrina displaced individuals – Taxpayers who provide free housing in 2005 or 2006 for at least 60 days to qualified Katrina displaced individuals will be entitled to an additional exemption of $500 for each individual but it is not to exceed $2,000 for the year. For higher-income taxpayers, these additional exemptions do not phase out like the regular taxpayer, spouse, and dependent exemptions. The deduction can be claimed in either 2005 or 2006, but not both years, by the taxpayer for the same individual.

Recontribution of home purchase withdrawals – Certain retirement plans or IRA withdrawals made after February 28, 2005 and before August 29, 2005 for home purchases in the Katrina disaster area that were cancelled due to Hurricane Katrina, can be returned to a qualified plan or IRA tax-free and without penalty. Under normal tax law provisions, these types of distributions cannot be recontributed and if they are not used towards purchasing a home, they are subject to the 10% early withdrawal penalty. Any amount of the withdrawn funds (not to exceed the total amount withdrawn) can be recontributed at any time during the period beginning on August 25, 2005 and ending on February 28, 2006.

Work Opportunity Credit for Katrina displaced individuals – Employers may claim the work opportunity tax credit if they hire individuals who:

- On August 28, 2005, had a principal place of abode in the Katrina core disaster area, and who are hired during the two-year period beginning on August 28, 2005 for positions where the principal place of employment is located in the core disaster area, or
- On August 28, 2005 had a principal place of abode in the core disaster area, who are displaced from those abodes because of Katrina, and who are hired during the period beginning on August 28, 2005 and ending on December 31, 2005.

Energy and Tax Savings Opportunity

With gas prices going through the roof, now is the perfect time to take advantage of the energy tax incentives available for the purchase of hybrid vehicles. If you purchase and place into service a certified hybrid vehicle during 2005, you are entitled to a deduction equal to 100% of the purchase price (limited to a maximum deduction of $2,000). You are not required to use the vehicle for business to receive the deduction and it is an above-the-line deduction, which means you don't need to itemize your deductions to take advantage of it. If you use the vehicle for business, you can include the business use portion of that deduction in your business expenses. Bottom line: if you are in the 25% tax bracket, you can save as much as $500 in taxes!

If you wait until 2006 to buy a hybrid vehicle, the deduction has been replaced with a tax credit that is made up of two separate credits: the increased fuel economy credit, ranging from $400 to $2,400, and the lifetime fuel savings credit, ranging from $250 to $1,000. Since these are tax credits, they directly offset your regular income tax and can provide a larger overall tax benefit, provided you are not taxed by the Alternative Minimum Tax (AMT). Unfortunately, under the law taking effect in 2006, the credit cannot be used to offset AMT. In addition, each manufacturer is limited to producing 60,000 vehicles on which these credits are available. Thus, before you sign on the dotted line, you need to:

(1) Make sure you are not in the AMT and can benefit from the credit,

(2) Verify the amount of credit available for the vehicle you are purchasing, and

(3) Make sure the credit is not limited because the manufacturer has exceeded the 60,000 car limit.

Additionally, you should evaluate whether the extra cost usually commanded for hybrid vehicles can be recouped by a combination of the tax benefit and anticipated fuel cost savings over the period you expect to drive the vehicle.

Standard Mileage Tax Strategy – If you use a vehicle for business, you have the option of deducting the actual expenses including fuel, repairs, insurance, etc., or deducting a standard amount for each business mile driven. The standard mileage rate is determined periodically by the IRS using average costs of operating a vehicle. With the increase in fuel costs, the IRS has raised the business mileage rate to 48.5 cents per mile. By using the standard mileage rate with a high fuel-efficient vehicle, it is conceivable that you could deduct more than the actual cost of operating the vehicle.

Please contact this office prior to making a hybrid purchase to ensure you will achieve the tax benefits promoted by a dealership in their sales pitch.

IRS Splits Mileage Rates for 2005

Recognizing the increased cost of operating vehicles due to higher fuel prices, the IRS has increased the standard mileage allowance to 48.5 cents per mile for business miles driven between September 1 and December 31 of 2005. The business allowance remains at 40.5 cents per mile for January through August of 2005. This unusual split mileage allowance for the year adds complexity, because it requires taxpayers using the optional mileage allowance to keep separate records for the two periods in 2005.

Medical travel and moving allowances have also been increased for the last four months of 2005. The allowance for charitable travel is set by statute and generally remains unchanged. The table below summarizes the mileage allowances for 2005.

2005 Mileage Rate Table (cents per mile)

Type of Use	Jan – Aug	Sept - Dec
Business Travel	40.5	48.5
Medical Travel	15.0	22.0
Charitable Travel	14.0	14.0
Moving	15.0	22.0

Special Rate for Hurricane Katrina Disaster – A taxpayer who uses a vehicle in providing donated services to a charity for relief related to Hurricane Katrina during the period of August 25, 2005 to December 31, 2006 can compute the charitable mileage deduction using 70% of the standard business mileage rate in effect at the time the vehicle is used. For example, the rate for Katrina relief-related charity miles driven from September 1 to the end of 2005 is 34 cents per mile (70% x 48.5¢). The IRS will not announce the 2006 mileage rates until late 2005 or early 2006.