

TO the WISE

TIPS, TECHNIQUES AND STRATEGIES FOR A WELL-PLANNED RETIREMENT

CONTENTS

- ▶ Tax Calendar
- ▶ Maximizing Your Retirement Savings
- ▶ Home Improvements Can Be Medical Expense Deductions
- ▶ Don't Be Without An Estate Plan!
- ▶ Attention Homeowners: It's Time to Start Saving Energy!
- ▶ Since You Asked...

MAXIMIZING YOUR RETIREMENT SAVINGS

Retirement creeps up faster than we think and comfortable retirement depends upon having financial security during your “Golden Years”. So unless you are independently wealthy, you need to set aside a nest egg for your retirement. Congress has provided a variety of tax-favored retirement savings plans for taxpayers to use, and the amount that can be contributed to these savings plans is increasing each year. If you are age 50 and over, you are even allowed to make larger “catch-up” contributions.

Pension Plan Contribution Limits

		2005	2006
Traditional IRA⁽¹⁾ Roth IRA⁽¹⁾	Under Age 50	\$4,000	\$4,000
	Age 50 and Over	\$4,500	\$5,000
Employer 401(k) Plans Employer 403(b) Plans Employer Elective SEP	Under Age 50	\$14,000	\$15,000
	Age 50 and Over	\$18,000	\$20,000
Self-Employed Retirement Plans	Lesser of 25% of Compensation OR	\$42,000	\$43,000 ⁽²⁾

(1) Limits apply to aggregate contributions to all IRAs (i.e., a taxpayer can contribute \$4,000 to a traditional IRA or to a Roth IRA or split the \$4,000 between the two plans).

(2) The amount is estimated. The IRS had not published the 2006 inflation-adjusted amount by press time.

IRA contributions may be limited by your adjusted gross income (AGI). Nondeductible contributions can be made to traditional IRA accounts without concerns about income limitations. Deductible traditional IRA contributions can also be made without any regard for income, provided the taxpayer or spouse is not an active participant in an employer-sponsored pension plan. If either spouse is an active participant in an employer's plan, then the traditional IRA deductible amount is ratably phased out based on the AGI. The phase-out ranges are as follows:

Filing Status	2005	2006
Single or Head of Household	\$50,000 – 60,000	\$50,000 – 60,000
Joint or Surviving Spouse	\$70,000 – 80,000	\$75,000 – 85,000
Married Separate	\$ 0 – 10,000	\$ 0 – 10,000

Special rule for spouses who are active participants – For an individual who is not an active participant but whose spouse is, the traditional IRA is phased out for the non-active participant if the combined AGI is between \$150,000 and \$160,000.

For Roth IRAs, the income phase-out is not inflation-adjusted and ranges between \$150,000 and \$160,000 for joint filing taxpayers, \$0 to \$10,000 married separate taxpayers who live with their spouse and \$95,000 to \$110,000 for all others.

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MAXIMIZING YOUR RETIREMENT SAVINGS (CONTINUED)

Beginning in 2006, assuming your employer's 401(k) permits, you can designate the 401(k) plan contributions to be "Qualified Roth" contributions. Like a Roth IRA, there is no tax benefit at the time of the contribution, but all distributions when you retire, including earnings, will be tax-free.

If you have questions regarding any of these plans, we encourage you to call.

DON'T BE WITHOUT AN ESTATE PLAN!

For anyone with assets, an estate plan should be in place in the event of death or incapacitation. Your age, marital status or financial situation doesn't matter; having a sound estate plan will make this difficult time less taxing for the ones you leave behind or those who must take care of you if you are incapacitated.

A little advance preparation on your part could save your family from additional expenses and a long drawn-out process in court. With an estate plan, you can ensure that your hard-earned money is distributed to the beneficiaries of your choice, probate is avoided, and that the government's cut is minimized. All too often these things are put off until it's too late and the attorneys and the judge make those decisions for you.

Although an estate plan is recommended, at the very least, you should have a will, healthcare directive and power of attorney in place before something happens to you. If you already have one in place, make sure it is updated on a regular basis, especially when there is a significant event in your life. For those of you who still need to plan out your estate, please call this office for assistance.



HOME IMPROVEMENTS CAN BE MEDICAL EXPENSE DEDUCTIONS

Generally, improvements you make to your home are not currently deductible and can only be used to offset any gain from your home when you sell it. However, that is not the case for medically necessary home improvements which can be taken as a medical deduction on your tax return. Such improvements include ramps for wheelchair access, a lift or elevator and rails for a handicapped person, or a therapy spa for an arthritis sufferer.

The costs of such expenses are deductible as a medical expense to the extent the expense exceeds any resulting increase in value of the property. For example, suppose you make a qualifying improvement costing \$6,000 and the improvement increases the value of your home by \$4,000. The resulting deductible medical expense is \$2,000, which is the difference between the total cost and the increase in home value. Some medically-required improvements may not increase the value of the property or may even decrease the value, in which case the full value of the improvement would be allowed as a deduction.

The only catch here is that to take advantage of this benefit you must itemize your deductions. And remember, medical deductions are only allowed to the extent they exceed 7.5% of your AGI for regular tax purposes and 10% of your income for Alternative Minimum Tax purposes. If you are anticipating making such improvements, it may be appropriate to group them all in one year to overcome the AGI limitations.



ATTENTION HOMEOWNERS: IT'S TIME TO START SAVING ENERGY!

The Energy Act of 2005 includes new and substantial tax incentives for individuals to make energy-saving (and some energy-creating) improvements to their homes. The incentives come in the form of tax credits which can reduce your federal tax bill on a dollar-for-dollar basis. Even better, the credits are not phased out at higher-income levels.

The best part about the new law is that you don't have to determine whether a home improvement creates or saves enough energy because the manufacturer will certify the materials that come with their products. All you have to do is shop around for the best deal.

Because these credits are rather complex and have a number of limitations, it is important for you to understand the credit limits. The credits fall into two distinct categories: (1) Energy-saving improvements to an existing home, and (2) Residential energy-efficient property.

“ENERGY-SAVING IMPROVEMENTS” are energy-efficient building envelope components that meet the criteria for the component established by the 2000 International Energy Conservation Code. The component must be installed in or on a dwelling unit (including a manufactured home meeting certain federal standards). The dwelling unit must be owned and used by the taxpayer as his principal residence, the improvement's original use must commence with the taxpayer, and the improvement can reasonably be expected to remain in use for at least 5 years.

The credit for energy-saving improvements is further broken down into two sub-categories. The credits under this provision are limited to a lifetime maximum of \$500.

Building envelope components – These items qualify for a credit of 10% of their cost, subject to the overall credit lifetime maximum of \$500, of which only \$200 of the \$500 limit can be from windows and skylights. Qualifying components include:

- Any insulation material or system specifically and primarily designed to reduce the heat loss or gain of a dwelling unit when installed in or on such dwelling unit;
- Exterior windows (including skylights);
- Exterior doors; and
- Any metal roof installed on a dwelling unit, but only if the roof has appropriate pigmented coatings specifically and primarily designed to reduce the heat gain of the dwelling unit and meets the Energy Star program requirements.

Qualified energy property – These items qualify for a 100% credit, but the credit is limited by each qualifying item as noted:

- Energy-efficient building property (electric heat pump water heater, electric heat pump, geothermal heat pump, central air conditioner, and natural gas, propane, or oil water heater meeting specific energy efficiency standards). No more than \$300 of the cost is credit-eligible.
- A qualified natural gas, propane, or oil furnace or hot water boiler (no more than \$150 of the cost is credit-eligible); or
- An advanced main air-circulating fan (no more than \$50 of the cost is credit-eligible).

RESIDENTIAL PROPERTY THAT USES SOLAR POWER OR FUEL CELLS TO CREATE ELECTRICITY. This is a personal tax credit available for the purchase of residential energy-efficient property

that uses solar power or fuel cells to create electricity. The credit amount depends on whether the property is solar or fuel cell property.

Qualifying solar water heating property – Property to heat water for use in a dwelling unit used as a main or second residence by the taxpayer, and at least half of the energy used by the property for such purpose, is derived from the sun. The annual credit is 30% of the qualified property's cost, limited to a maximum of \$2,000.

Qualified photovoltaic property – Property that uses solar energy to generate electricity for use in a dwelling unit used as a main or second residence by the taxpayer. The annual credit is also 30% of cost, limited to \$2,000.

Qualified fuel cell property – A fuel cell power plant, which is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts fuel into electricity using electrochemical means, has an electricity-only generation efficiency of greater than 30%, and generates at least 0.5 kilowatts of electricity. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the U.S. and used by the taxpayer as a principal residence. The credit is \$500 for each 0.5 kilowatt of capacity with no annual maximum.

Limited Carryover – The portion of the credit that is not allowed because of the nonrefundable personal credit limitation (explained below) may be carried to the following tax year and added to the credit allowable for that year. There is no carryforward of credits that are unused because of the \$2,000/\$500 per 0.5 kilowatt dollar limitations.

OTHER LIMITATIONS: There are other limitations that apply to these new credits:

Installation and Payments – None of the credits can be taken until the energy credit item's installation is complete. Therefore, expenses paid in 2006, where the installation is not completed until 2007, will not be counted as paid until 2007. Under this rule, installation that is completed after December 31, 2007 will not qualify for the credits.

Nonrefundable – These credits are nonrefundable personal credits. Thus, if they exceed your tax liability, the excess is not refundable. Nonrefundable personal credits will no longer offset the Alternative Minimum Tax (AMT) after 2005. So without Congressional action, these credits will generally not benefit anyone to the extent they are subject to the AMT.

Jointly-Owned Property – Special proration rules apply in the case of jointly-owned property, tenant-stockholders in cooperative housing corporations, and condominiums.

Mixed-Use Property – If less than 80% of the property is used for non-business purposes, only that portion of expenditures that is used for non-business purposes is taken into account. Thus, if the business use of a dwelling unit, such as a home office, is 20% or less, the full amount of the expenditures is eligible for the credit.

Subsidized Financing – Expenditures made from subsidized energy financing are ineligible for the credit.

Check with our office first to verify the tax benefits before signing on with a contractor or salesperson. Be sure to contact us so we can determine the benefits based on your particular tax situation. And remember, these credits are only for 2006 and 2007; don't be premature and don't wait too long!

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 70^{1/2} 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

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.

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 70^{1/2} 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 70^{1/2} in 2005. Failure to take the required distributions can result in substantial penalties.

April 17, 2006:

- Deadline for Individuals to file 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.

TO the WISE

SINCE YOU ASKED...

Question: I use a considerable amount of over-the-counter medication to combat my arthritis. To save on my prescription medication, I order it online from a foreign country. Can I deduct the cost of the over-the-counter drug if my doctor gives me a prescription for it? A friend also told me that prescribed drugs brought in from a foreign country are not deductible. Is that true?

Answer: Taxes can become complicated, even with something as simple as a medical deduction. Generally, only the cost of prescribed drugs can be taken as a deduction for medicine and drugs on your tax return. Tax law defines a prescribed drug as one that requires a prescription by a doctor for its use by an individual. Thus, even if your doctor prescribed an over-the-counter drug, it would not be deductible (with the exception of insulin). Prescription drugs acquired or imported illegally are also not deductible. Thus, even if prescribed, medications that are brought in (or ordered and shipped) from another country are not deductible.

Although a tax deduction isn't allowed for non-prescription medications, you may be reimbursed tax-free for their costs if your employer offers a health flexible spending account plan in which you participate. Under these arrangements, you can receive tax-free reimbursements for your over-the-counter medications as well as domestic prescriptions. This even helps individuals who don't itemize their deductions and those whose medical deductions are limited because of the 7^{1/2}% of income limitation on medical expenses.

Increase the amount you set aside for next year in your employer's health flexible spending account so that you can get tax-free reimbursements for over-the-counter drugs such as aspirin and antacids. Also, keep in mind that the cost of nutritional supplements, vitamins, herbal supplements, etc. cannot be included in medical expenses unless recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a physician.

Question: I am retired and age 74. I began taking my minimum IRA distributions since I turned 70^{1/2}. I almost forgot to take my distribution last year, and I am concerned about the ramifications should I miss taking a distribution in some future year?

Answer: The penalty for not taking a distribution in a tax year is an additional tax of 50% of the amount that should have been taken that year based upon the Required Minimum Distribution (RMD) rules. Your RMD is determined by taking the IRA balance on December 31 of the prior year and dividing that total by your remaining life expectancy from the IRS table. If you have more than one IRA, figure the RMD for each one and then combine them to get the total required distribution for the year. The penalty is 50% of the RMD and can be severe if the IRA balances are large. The good news is that the IRS will generally, upon request, abate and refund the penalty, provided you show that you have made a corrective distribution in the subsequent year. However, you must first pay the penalty and request the abatement.