WINTER 2005

Client Newsletter

End-of-Year Tax Planning

As the end of the year rolls around, there are a number of tax and investment decisions that should be considered. Some items relate to your job while others are personal decisions.

Retirement and Benefit Plans

Many employers have 401(k) plans or other deferred compensation plans, cafeteria plans, dependent care benefits, medical reimbursement plans, or medical premium plans. Initial participation or continued participation in these plans must be selected before the beginning of the New Year. Most employers will forward the necessary documents sometime in November. It will be up to you to select the level of participation before signing and returning the documents. From an income tax standpoint, participation means a savings of income tax by lowering your gross income. The cafeteria plans, premium only plans, dependent care benefits, and medical reimbursement plans also reduce income subject to FICA and Medicare tax.

The decision to participate in these plans is strictly yours. Participating in some of the programs can be scary because it requires you to guess how much you will spend. If your guess is too high, you could lose the money you have deferred because the system is based on a "use it or lose it" concept. There is good news for 2005. There is an opportunity to have an extra 2.5 months to use the prior year's allotment if your employer modifies the cafeteria plan to include this 2.5-month period. This takes a little uncertainty out of the decision.

Here are some reasons why participating in a tax deferred plan may be beneficial. A medical reimbursement plan or a pre-tax health insurance plan can give you a tax break through a lower taxable income. If you're single, pay $1,200 per year in health insurance, and your post-tax wage is $35,000, your federal income tax savings would be $180 plus $91.80 of FICA taxes. As your income increases, the amount of savings could increase as well.

Dependent care can be very costly. Using the dependent care benefits through an employer, a family with one child can take a larger deduction ($5,000) through the deferral than the amount of day care expense payments that can be used toward the child-care credit ($3,000). The amount of savings will depend on your tax rate.

A new feature exists for 401(k) plans beginning in 2006. If your plan makes the change, the plan can allow you to put some or all of your 401(k) contribution in a Roth 401(k) rather than the normal 401(k) plan. This change is not for everyone, but for certain people it will make sense. A Roth IRA allows you to put money into an IRA account that will grow tax-free as long as you do not take the earnings out before the allotted amount of time. Furthermore, all distributions are nontaxable as long as you adhere to the distribution rules. The money you have invested, not including the earnings, may be withdrawn at any time. Investing in a Roth IRA through your employer will allow you to put more money in the Roth IRA than you could on your own. The maximum deferral for 2006 is $15,000 plus an additional $5,000 for those who are age 50 and older. Ask your employer if your plan has been amended to receive Roth IRA contributions.

Your participation decisions, made prior to the beginning of the tax year, are locked in for the entire year. However, most plans have a safe harbor that allows changes to be made during the year when significant life-changing events occur. These status changes may include divorce, a death in the family, or illness. Each plan must be examined to find the specific situations allowed by that plan.

Personal Tax Decisions

Moving to the personal year-end steps, you may have to decide whether to sell investments to take advantage of low capital gain rates or to offset existing losses with capital gains. The maximum capital gains rate for investments is normally 15%, but if you are in the 15% tax bracket, you may pay only 5% on the capital gains. If you have property you are considering selling, talk to me before you sell. I can advise you about the tax consequences of the sale.

Other personal items to consider before the end of the year are charitable contributions. Contributions are deductible when you itemize. With the devastating events in Louisiana and Mississippi, you may have made or are contemplating a contribution. Making the contribution before the end of 2005 will give you a deduction in 2005. Your donation may be money or property. If you donate property, be sure to take the property to an agency that will give you a receipt. A receipt is necessary as your substantiation for the deduction regardless of whether it is money or property. The IRS is keeping a watchful eye on charitable deductions. There are new procedures for deductions of automobiles given to charitable organizations. The deduction will be limited to the amount the charitable organization receives from the sale of the vehicle if the vehicle is sold within 30 days of the donation and has not been substantially modified or sold to low income buyers at below market value. Each vehicle donation will require the organization to notify the IRS regarding the treatment of the vehicle. Look for a Form 1098-C to be issued by the organization when you donate a vehicle.

The timing of the payment of real estate taxes can impact the overall tax picture. If you itemize and have been paying your taxes at the same time each year, continuing that schedule will produce similar results as in the past unless something has changed in your income or expense structure for the year. If you have not itemized in the past and you increased the mortgage on your home, changed your occupation to a job that requires you to incur deductible job-related expenses, or you gave a substantial amount to charity, you should discuss your deduction possibilities with me before the end of the year. I can advise you regarding the benefits of paying the property taxes in the current year or the coming year.

If your marital status changed during the year, the refund or balance due you are accustomed to may be different. If you did not change your withholding to match your marital status, you may owe more than usual if you are now single. If you married during the year and continued to withhold at the singe rate, your refund may be larger than you were expecting. No matter which way you changed, it is a good idea to review the change with me before the end of the year.

Paying school tuition before or after the new year can affect the Hope or Lifetime Learning credit. The Hope Credit is only allowed in the freshman or sophomore year of the student and only for a total of two years. Making the most of the credit is important. The Lifetime Learning Credit may be used when the Hope Credit is no longer available. Parents who pay for the tuition in the calendar year prior to the year of graduation may save themselves from losing the benefits. In the year of graduation, many students are no longer dependents of their parents. Paying the final semester's tuition in December rather than January can make a big difference to the parent.

Teachers can still reduce income by up to $250 of unreimbursed classroom expenses. Stock up on classroom needs such as bulletin board materials, stickers and stars, and other incidentals before the end of the year.

The standard mileage rate will have two different rates for this year. Business miles incurred before September 1, 2005, are paid at a rate of 40.5 cents per mile. The rate climbs to 48.5 cents per mile from September 1 to December 31, 2005. Medical and moving mileage increase from 14 cents per mile prior to September 1 to 22 cents per mile from September 1 to December 31, 2005.

2006 Update

In 2006, there are a few new changes to consider. The Energy Tax Incentives Act of 2005 created some new incentives to be energy conscious. One of the incentives is the Alternative Motor Vehicle Credit. The government will pay you to buy a more fuel efficient vehicle. The vehicles, of course, must be specially certified. There are four alternative credits depicting power from different sources. The most recognizable will be the Hybrid Motor Vehicle Credit. This credit covers vehicles that have been eligible for the hybrid vehicle deduction which has been repealed for 2005. The credit of $400 to $2,400 will be based on the fuel efficiency of the new vehicle compared to a vehicle of similar weight from 2002. There is an additional conservation credit component ($250–1,000) based on the lifetime fuel savings that is attached to each of the four credits.

Credits for home energy enhancements have also returned. Solar heating panels, qualified fuel cells, and solar water heaters are among the items that may qualify for the credit. The maximum credit available is $2,000 for solar water heating property and an additional $2,000 for photovoltaic property (electricity from light). The credit for qualified fuel cells is limited to $500 for each .5 kilowatt of capacity but has no overall maximum. Before you remodel or upgrade your home next year, check with me to see what qualifies.

The following pages contain a chart to get you ready for tax season. Check the applicable entries and gather the necessary documents so that you can make the most of your tax appointment.

Your Business Card Here

TAX APPOINTMENT WORKSHEET

Event	Documents or Information Needed
1. Married or divorced in 2005	Married – prior year return of both spouses Divorced – copy of the divorce decree
2. Birth or adoption	Social Security cards and adoption papers
3. Death of child or spouse	Date of death
4. Additional members of household	Date of occupancy and relationship
5. Job change	Start date – Name of new employer – W-2s from new and old employers
6. Unemployment	Unemployment Form
7. Retirement contribution	Type of plan – Amount of contribution
8. Retirement distributions	Form 1099-R
9. Social Security benefits	Form 1099-SSA
10. Sale of stocks, bonds, etc.	Form 1099-B or other sale documents; basis or original costs
11. Purchase of stocks, bonds, etc., personal residence, or other real estate	Purchase documents; closing papers
12. Inheritance	Will; K-1 from the estate
13. Trade any property	Date of trade, property given up and property received, basis and FMV; Qualified intermediary sales agreements or closing papers
14. Start or end a small business	Formation or termination dates; Property contributions or distributions
15. Lawsuit settlements	Date received; reason for the settlement; 1099-MISC
16. Rental property	Income; expenses; new property purchased
17. Prizes	Form 1099-MISC; value of prizes not included on Form 1099-MISC
18. Lottery or gambling winnings	Total amount won whether on W-2Gs or not; total amount of losses

19. Health insurance, medical, dental, or drug expenses	Health insurance premiums; if it is an employer-sponsored plan, know whether it is paid with pretax dollars; totals of other medical, dental, and drug expenses
Health insurance	Pre-taxed (ie. cafeteria plan, §125, POP)
Medical miles (14 cents/mile)	Before 9/1/05 –
Medical miles (22 cents/mile)	On or after 9/1/05 –
20. State income or property taxes paid	Prior year's income tax return; property tax bills; closing papers from the purchase or sale of property; letter from the state regarding any change in a prior filed return
21. Purchase or refinance a home	Closing papers from purchase; Forms 1098
22. Charitable contributions of money, property, or out-of-pocket expenses	Date and type of contributions, knowledge that receipts from the organizations have been received; mileage log for charitable work
Charitable miles	During 2005 –
Katrina-related mileage	During 2005 –
23. Job-related expenses	Mileage log, travel, or miscellaneous expense amounts for items related to employment
Business miles (40.5 cents/mile)	Before 9/1/05 –
Business miles (48.5 cents/mile)	On or after 9/1/05 –
24. Educational or student loan interest expenses	Form 1098-T for parents or children; interest record for student loans
25. Child or disabled spouse care	The name, address, and ID number of the day care provider; the amount paid to the provider; if the provider comes into your home a W-2 may be required.