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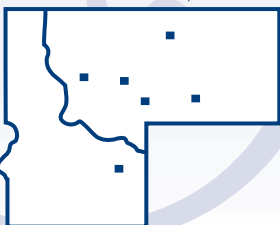
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*THE GALUSHA REPORT
presents information on
tax and business matters
of general interest. Since
the information is presented
in summary form, we urge
you to consult your tax
or business advisor
before taking action.*

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New Changes in Independent Contractor Exemption Certification Laws

If you're an independent contractor or if you hire independent contractors, it's important for you to understand recent changes in Montana state law.

As before, Montana requires all independent contractors to either purchase workers' compensation or have an exemption certificate. However, under SB108, a new law signed by Governor Schweitzer on April 28, 2005, an independent contractor with an exemption certificate is presumed to be an *independent contractor*. Under the old law, independent contractors were presumed to be employees, and companies or individuals who hired them could be retroactively assessed for penalties, payroll taxes and workers' compensation coverage.

The new law is intended to clarify the workers' compensation status of independent contractors and protect companies or individuals hiring them.



In addition, Montana law requires a separate registration application from all companies and independent contractors in the *construction industry who have employees*. If you do not have employees, you are not required to register.

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If you're an independent contractor with a valid certificate issued under the old law — and your certificate is not more than 30 days from expiration — you may receive a \$10 credit toward a new one.* To apply for a new certificate, you are now required to:

1. Pay \$125 instead of the old rate of \$17.
2. Complete the Independent Contractor Exemption Certificate (ICEC) application.
3. Complete the Waiver of Workers' Compensation Benefits.
4. Submit documentation verifying you are in business.

*Certificates acquired under the old law will continue to be held to the provisions of the old law.

New Tax Laws in Montana



With each new legislative session comes new laws that may affect you. These are some of the tax laws recently introduced during the Montana 59th Legislative Session and signed into law by Governor Schweitzer.

“This is good news for the hundreds of Montanans currently serving our country in the Middle East.”

Taxes Paid to Foreign Country

Montana taxpayers used to be allowed a credit for taxes paid to a foreign country. For tax years beginning after 2005, the Montana credit will be disallowed if the taxpayer claimed the federal credit for the taxes paid to a foreign country.

Tax Filing and Payment Relief for Active Duty Military

The due date for filing a Montana individual income tax return by members of the military and their spouses has been extended. If a member of the military is serving in a combat zone or a contingency operation, the tax and filing of the return is deferred up to 180 days after the termination of the person's military service period. If the person suffered an injury while serving in the combat zone or contingency operation, the 180-day period begins after the period of qualified hospitalization due to the injury. In addition, interest and penalties will not accrue on any tax owed during this period. This law conforms with the current Internal Revenue Code for federal income tax returns and was effective beginning with the 2004 tax year. This is good news for the hundreds of Montanans currently serving our country in the Middle East.

Qualified Endowment Tax Credit Recapture

Taxpayers, whether individual or corporate, who claim a qualified endowment tax credit are now subject to a recapture provision if the taxpayer recovers a charitable gift during any tax year. The qualified endowment tax credit is available for charitable gifts to qualified endowments. These endowments are permanent, irrevocable funds held by a Montana corporation or an established organization that is tax exempt under Internal Revenue Code Section 501(c)(3). If a charitable gift to a qualified endowment is recovered, the taxpayer must include as income the amount that was deducted in any prior year that is attributable to the charitable gift to the extent the deduction reduced the income tax. In addition, the taxpayer must increase the amount of tax due by the amount of the credit that was allowed in the tax year in which the credit was taken. This law applies to tax years beginning after December 31, 2004 (tax year 2005) and terminates on December 31, 2007.

Carryforward of Contractors' Gross Receipts Tax Credit

Contractors claiming the gross receipts tax credit on their Montana corporate or personal income tax return will now be allowed to carry forward the entire amount of the credit not utilized in the year earned for up to five years. The credit must be carried first to the earliest tax year in which the credit may be applied and then to each succeeding tax year.

Kristi Brum, Accountant — Missoula office

However, certain jobs may require you to register in order to have your bid considered. A list of registered individuals and businesses is available in hard copy, on the State Bulletin or at www.mtcontractor.com, where you can also find more information on this topic.

If you are considering hiring an independent contractor, there are two ways to find out their status: (1) Ask for a copy of the exemption certificate (along with W-9 form) before the work has started, (2) Call the state's Independent Contractor Unit at 406-444-1446 to verify.

“The new law is intended to clarify the workers’ compensation status of independent contractors and protect companies or individuals hiring them.”

If you hire an independent contractor, you are required to keep copies of these items on file:

- Form W-9
- Independent Contractor Exemption Certificate
- Helpful but not required are documentations verifying the independent contractor is in business (i.e., business cards, letterhead)

Idaho residents should keep in mind that the ramifications of independent contractor law vary from state to state. As always, please contact your accountant at Galusha, Higgins & Galusha for personal assistance.

Shari Oliver, Payroll Specialist — Missoula office



Domestic Manufacturing Deduction

Manufacturers and other small businesses are getting a new break this year with the Domestic Manufacturing Deduction (DMD) established by the American Jobs Creation Act of 2004.

The best part about the DMD is that the deduction is available to more than just traditional manufacturers. Qualifying production activities include the manufacture, production, growth, or extraction of tangible personal property or computer software; film production; production of electricity, natural gas or water; construction or renovation of real property and infrastructure; and engineering and architectural services.

The DMD is equal to three percent of the lesser of taxable income derived from qualifying production activities or taxable income for the year but is limited to 50 percent of W2 wages

paid by the employer for the tax year. The DMD will be three percent for 2005 and 2006, six percent for 2007 through 2009, and nine percent thereafter. The DMD is available to C corporations, S corporations, and partnerships; however, partners or shareholders in an S corporation receive the benefit of the deduction at the individual level.

Although the DMD is intended for domestic manufacture, goods produced do not have to be manufactured entirely in the United States. Only 20 percent of the producer's total cost of the property sold has to have been incurred in the United States in order for the producer to receive the deduction.

Daniel Adams, Accountant — Missoula office

Do You Have a Plan?

Most people do not like to consider the prospect of their eventual death. However, without proper planning, you may be giving up your right to specifically choose how your assets are distributed, and your accumulation of wealth could be eaten away by a substantial tax burden. A good estate planning team made up of accountants, lawyers and other professionals can give you peace of mind by answering the myriad questions related to estate taxation and helping you formulate a wealth transfer plan that suits your goals.

One commonly asked question is: “How large does my estate have to be before I need to worry about estate taxes?” The answer to that question is changing every year. Currently, we have a federal transfer tax system, which imposes an excise tax on the transfer of assets either during life or at death. The estate, gift, and generation-skipping transfer (GST) taxes form a unified transfer tax system. This system is being phased out and will eventually be repealed in 2010, due to the Economic Growth and Tax Relief Act of 2001. However, on December 31, 2010, all provisions in the 2001 Act are scheduled to sunset. Thus, unless the law is reenacted, the estate, gift, and GST tax

law will revert to the law in place before 2001. For 2005, an estate tax return will need to be filed if the gross estate exceeds \$1,500,000. In 2006, that threshold will jump to \$2,000,000, and in 2009, it will be set at \$3,500,000.

OTHER COMMON QUESTIONS RELATED TO ESTATE PLANNING INCLUDE:

1. *Should I be utilizing the annual gift tax exclusion?*
2. *Should my will be revised to reflect the latest changes in estate tax laws?*
3. *Can I arrange the ownership and assignment of life insurance to minimize estate taxes?*
4. *Should I consider lifetime or testamentary charitable gifts?*
5. *Should I consider the establishment of a family corporation, partnership or LLC?*

If you have any concerns about your estate plan, please contact us. We will work with you to formulate a comprehensive, well-thought-out plan to meet your individual goals.

Heidi L. Rohrlach, CPA — Missoula office

Employee Benefit Plan Audit Requirements

Generally, companies with employee benefit plans with 100 or more eligible participants at the beginning of the plan year file a Form 5500 for “large plans.” Plans that file a Form 5500 for a “large plan” are required to have an audit by an independent qualified public accountant. If a plan has less than 100 eligible participants at the beginning of the plan year, it is considered a “small plan” and may be exempt from audit requirements.

In their audits of employee benefit plans, the Department of Labor (DOL) has been targeting delinquent contributions of employee deferrals. The general rule is that participant contributions become plan assets as of the earliest date on which such contributions can reasonably be segregated from the employer’s general

assets, and no later than 15 business days into the next month. Noncompliance with the general rule is considered a prohibited transaction. The DOL is looking at the date the assets can be segregated, based on when a company regularly transfers the assets to the plan. For example, if an employer is required to deposit payroll taxes within three business days after payroll and is able to meet this requirement, then the DOL feels that the employer should also be able to segregate the employee contributions within three business days. Therefore, although the general rule appears to be 15 business days into the next month, the DOL’s stance is much more stringent.

When late deposits occur, they must be reported on the Form 5500 as a prohibited

transaction. The employer (plan sponsor) is then required to make a correction by paying an excise tax. Currently, the excise tax is calculated on the lost earnings; however, the DOL is looking at changing the wording of the ruling and the calculation of the excise tax. If changed, the excise tax will be calculated on the late contribution amount, which will make penalties much more costly in the future. It is recommended that employers alleviate the possibility of penalties by making employee contributions to the employee benefit plan within seven business days.

To ensure that your company is in compliance with any requirements for an employee benefit plan, please give Galusha, Higgins & Galusha a call to assist you.

*Stephanie Holt, Accountant
Missoula office*

Deferred Compensation Arrangements

With the American Jobs Creation Act of 2004 (AJCA) passed by Congress, nearly every arrangement that defers the payment of compensation to a future period was affected, except for qualified retirement savings arrangements such as 401(k) or profit-sharing plans. Any nonqualified arrangement that defers compensation may be subject to these changes, including voluntary or mandatory deferred compensation plans, performance-based deferred compensation, stock appreciation rights, phantom stock, below-market stock options, or similar arrangements. Any pre-January 1, 2005, deferrals are grandfathered under the old rules unless such deferrals were materially modified after October 3, 2004.

Here is a brief summary of the key changes that impact nonqualified deferred compensation arrangements:

- ▶ Elections to defer compensations must generally be made at the beginning of the calendar year for which the services are performed.
- ▶ Plan payouts are generally more restrictive, i.e., may be made only on account of death, disability, separation of service, or at a defined point in time, as specified either in the plan document or in the deferred compensation election.
- ▶ Acceleration of payments is generally prohibited, except for a change in control, unforeseeable emergency, or other permitted situations as provided in IRS guidance.
- ▶ Deferred compensation arrangements must now be in writing, with all these new requirements incorporated into the written document.
- ▶ Significant penalties apply if the deferred compensation arrangement does not comply with these new rules.



Because of the late issuance of the AJCA, your business may have not had a chance to make changes to its nonqualified deferred compensation arrangements in accordance with the new rules. The Internal Revenue Service has provided transition relief, which requires a deferred compensation arrangement subject to these new rules to operate in “good-faith compliance” as of January 1, 2005. It also requires any action, including plan amendments, to be made no later than December 31, 2005.

Since many deferred compensation arrangements are affected by these new rules, please call us so that we can assist you in reviewing your plans for compliance.

Debbie Lawton, CPA — Missoula office

“ . . . nearly every arrangement that defers the payment of compensation to a future period is affected . . . ”

Individual Alternative Minimum Tax



AMT (alternative minimum tax) was originally enacted to ensure high-income taxpayers paid at least a minimum amount of federal taxes. However, the absence of an inflation adjustment for AMT, coupled with recent reductions in the regular income tax, has forced many middle-income taxpayers into an AMT situation.

In addition, temporary provisions intended to mitigate the effects of AMT expire at the end of 2005. Without legislative action, the 2006 AMT exemptions will reduce from \$58,000 to \$45,000 for joint returns and from \$45,000 to \$35,750 for unmarried taxpayers.

AMT for individuals is a “parallel” tax system. Taxable income is calculated under regular rules and AMT rules. If regular tax is less than AMT, the difference is assessed as AMT. The impact of AMT can be evaluated and minimized with year-end tax planning.

“The impact of AMT can be evaluated and minimized with year-end tax planning.”

A few strategies available to reduce AMT preference amounts include:

- ▶ *Postponing fourth-quarter state estimated tax payment until after December 31st,*
- ▶ *Electing the 150 percent declining balance depreciation method with respect to one or more classes of property under IRC 168(b)(5),*
- ▶ *Accelerating the sale of certain assets depreciated under the 200% percent declining balance method which have not been fully depreciated,*
- ▶ *Using the percentage-of-completion method for long-term contracts when the completed contract method is permitted under IRC 460(e),*
- ▶ *Electing to capitalize certain research and experimental costs and amortize ratably over 10 years under IRC 174(a),*
- ▶ *Avoiding the exercise of incentive stock options defined under IRC 422(b), and*
- ▶ *Utilizing proceeds obtained from a home equity line of credit for home improvement purposes only.*

A plan to protect the middle class from AMT is currently under debate. Congress recently introduced several proposals to amend the Internal Revenue Code of 1986 and modify AMT on individuals. H.R. 1538 proposes increases and inflation adjustments for AMT exemptions. H.R. 703 “AMT Middle Class Fairness Act of 2005” proposes inflation adjustments for AMT exemptions and allowance of a state and local tax deduction for AMT purposes. H.R. 1186 “AMT Repeal Act of 2005” proposes a repeal of AMT starting in 2006. However, bills have been slow moving and a resolution remains uncertain.

To discuss your own AMT situation, call your accountant at Galusha, Higgins & Galusha.

Wayne Hiatt, CPA, Shareholder — Missoula office



Doing Business in More than One State:

The Tax Implications

The proliferation of e-commerce has opened the doors for businesses to expand and reach new markets faster than ever before. Through a Web site, a small company in Montana is able to sell its product to customers in all 50 states. Many companies don't realize when they expand and do business in multiple states that they may be exposing themselves to potential tax liability.

“ Expanding a business across state borders can be profitable but can also increase exposure to potential tax liability. ”

Much like the way the federal government is free to tax its citizens regardless of where they reside, state and local governments have the ability to tax not only businesses that reside in their jurisdictions but any company conducting business within their borders. Multistate taxation is complex because companies selling or providing services in different states face different rules and taxes in each state. If you find your business facing multistate tax issues, here are a few things to consider:

What are the taxes your business could be liable for?

States impose a variety of taxes, including income, franchise, excise, sales and use taxes, and license and fees. These taxes could be a registration fee to do business in their jurisdiction; a one-time filing fee; or an annual fee. These taxes can be based on income, sales, gross receipts, capital stock or use of goods.

What jurisdictions have an ability to impose taxes on your business?

Provisions of the United States Constitution, legislative mandates and judicial decisions restrict the ability of a state to impose a tax on a company. Usually, there has to be a minimal connection or nexus between the taxpayer or the taxpayer's activities and the taxing state for the state to impose a tax. This connection could include having an office or property, having employees, or transacting sales of products or services in the taxing state.

What has the federal government done to relieve interstate taxation?

Congress enacted the federal Interstate Income Tax Law, which prohibits state and local governments from imposing a net income tax on income from interstate

commerce if the taxpayer's only business activity is the "solicitation of orders" for tangible personal property and if the orders are approved and filled outside the state. This relieves potential double taxation of the same income.

The Internet Tax Freedom Act, signed into law on October 21, 1998, implemented a three-year moratorium on discriminatory state taxes and multiple state taxation of the same income on products or services bought over the Internet. This has provided relief for many Internet retailers from double income taxation, but does not prevent states from imposing sales tax. This moratorium was extended for an additional two years in 2001 and again in December of 2004, and is currently extended until November 1, 2007.

Expanding a business across state borders can be profitable but can also increase exposure to potential tax liability. If you are concerned how multistate tax issues could affect your growing business, please contact your Galusha, Higgins & Galusha tax advisor.

Miranda Ming, CPA — Missoula office



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EASE THE BURDEN

Get a jump start on your tax preparation by developing a system for organizing your records and receipts.

- 1** Organize early. It will make it easier if you stay organized during the year.
- 2** Set up an efficient and convenient file system, i.e., accordion file or colored file folders, for record keeping by category. Use these categories to organize and sort your receipts.
- 3** On the outside of the file, attach a list of important tax dates you want to remember.
- 4** Review the income, deductions and tax credit items from last year's return. Identify areas you need to track this year.
- 5** While on business travel, utilize hotel stationery envelopes to keep travel receipts organized for that trip. Write the dates and list expenses on the front of the envelope.
- 6** Keep a travel log accessible in your car to track business and medical travel expenses and mileage. (We have these free logs available in our office. Call and we'll send you one.)

Visit the GH&G Web site at www.ghg-cpa.com to learn more about our services and the industries we serve. Online links provide easy access to "RSM McGladrey Advantage," an industry-leading newsletter targeted for the executive leadership of mid-sized companies. You'll also find links to "Fundamentals," a quarterly publication keeping not-for-profit and governmental entities abreast of the latest industry news and information, and many other newsletters of interest.

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