

The Galusha Report

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Do the New Tax Cuts Affect You? If You Pay Taxes, Yes.

New Tax Reconciliation Act loosens the reins on business expensing, capital gains, and much more.

Tom Rygg, CPA – Havre Office

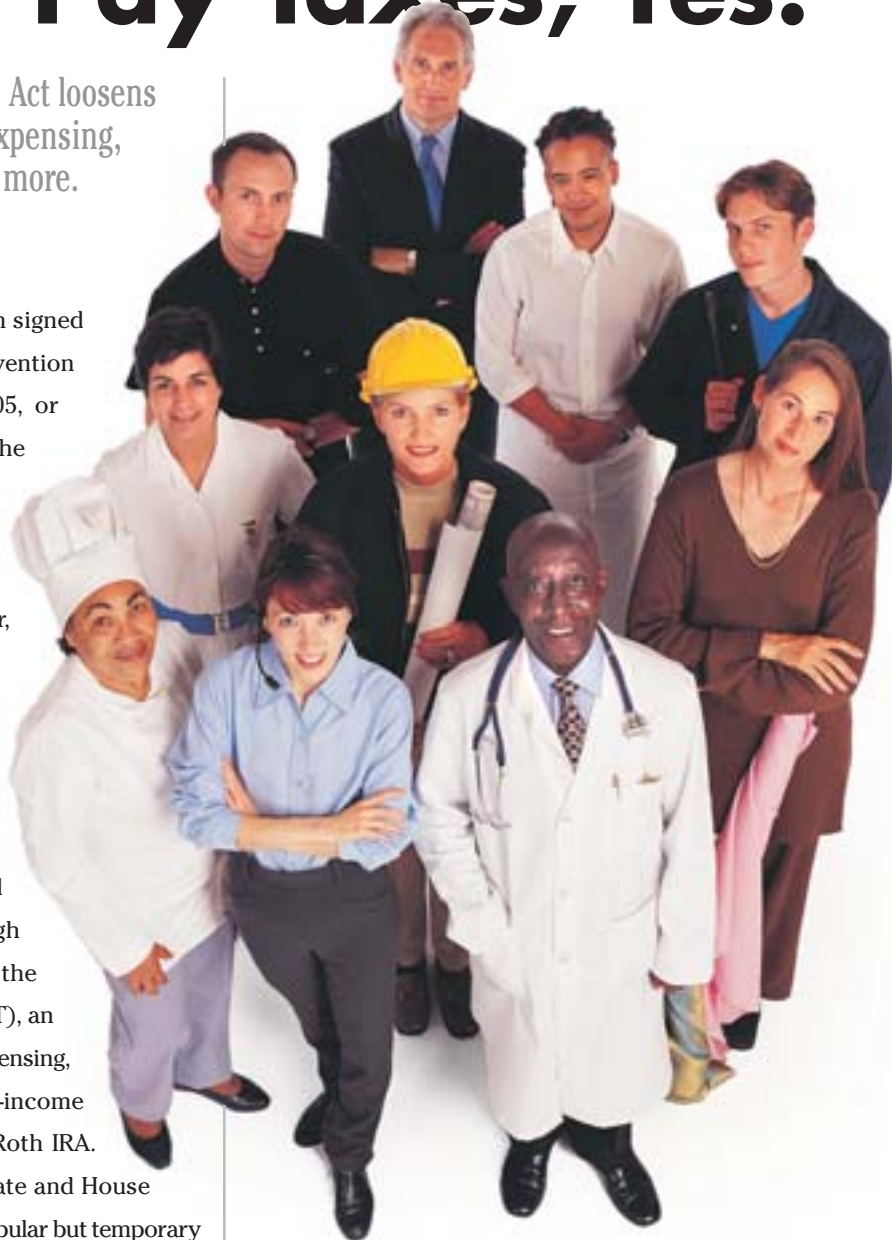
On May 17, President Bush signed into law the Tax Increase Prevention and Reconciliation Act of 2005, or the Tax Reconciliation Act. The new act affects a wide variety of tax situations, from personal finance to AMT relief to Roth conversions. If you are a taxpayer, it's worth paying attention.

Extensions on Capital Gains and Other Changes. In a nutshell, the new law offers significant tax relief, including an extension of dividend and capital gains tax cuts through 2010, immediate relief from the alternative minimum tax (AMT), an increase in small business expensing, and an opportunity for high-income taxpayers to convert to a Roth IRA.

To stay under budget, Senate and House members removed a few popular but temporary incentives, including an extension of the state and local sales tax deduction, the teachers' classroom expense deduction, research and development provisions, and some employment tax credits.

AMT Relief. The Tax Reconciliation Act extends the provision allowing taxpayers to use nonrefundable personal credits (such as dependent care and education credits)

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In Your
Business
and Ours,
**INFORMATION
is Everything.**

— Tom Copley, President

Welcome to the second edition of the new Galusha Report. We hope you've found our new design and format useful. While a new look is nice, we're finding our readers also appreciate the wealth of information this simple newsletter provides. Whether you run a small business, organize your family's tax situation, or provide leadership for your organization's financial future, you know information is everything.

That's why we've gathered even more facts, knowledge and data for this new edition. Here, we cover a wide spectrum of legislative implications, business strategies and tax planning, starting with the new Tax Reconciliation Act (p. 1). On page 6, check out our update on new gift tax exclusions, which allow individuals to give more without additional taxes. And among other timely tax subjects, we've also included some handy tips for those using QuickBooks® (p. 7) to prepare their individual or business financial reports.

Again, if you have any questions about the articles or topics covered here, call one of our offices listed on the back. As always, they're great sources of information, too. ☎



INDUSTRY FOCUS:

Long-Term Healthcare and the Deficit Reduction Act

New Medicaid rules could impact the transfer of family-owned businesses, farms and ranches.

Curtis Barnekoff, CPA – Havre Office

The Deficit Reduction Act of 2005, signed into law by President Bush last February, contains important changes to the Medicaid eligibility rules for long-term care coverage. These changes could impact the transfer of family-owned businesses, farms and ranches.

The "Look-Back" Period. Medicaid officials review gifts, asset sales, and asset transfers to determine if an individual made any uncompensated or under-compensated transfers, at which point they may determine a penalty period for such transfers. The Act increases this "look-back" period from three to five years. Medicaid can now review asset transfers up to five years prior to an individual applying for long-term nursing home care. The penalty is computed by dividing the uncompensated or under-compensated amounts by the state average monthly nursing home care cost. This computation will determine the number of months the penalty period will last. The penalty

period will begin when the individual has applied and is otherwise qualified for Medicaid. During the penalty period the individual is eligible for long-term nursing home care coverage, but Medicaid will not pay for these nursing home costs.

What Does This Mean For You? This new change may impact how you invest your transferred assets. As the recipient of a gift, should you invest the money in a separate account in anticipation of having to pay for your parents' future nursing home costs? Who will pay the nursing home costs during the penalty period if multiple cash gifts were made and nobody saved any money? Generally, asset transfers after February 8, 2006, are subject to Deficit Reduction Act of 2005. State compliance with this law will vary, although ultimately all states will have to comply to receive federal reimbursements.

As the recipient of a gift, should you invest the money in a separate account in anticipation of having to pay for your parents' future nursing home costs?

These new rules create additional complexity in this area. We suggest that you review your plans with your GH&G consultant and your attorney before taking action. ☎

ENACTED, REPEALED, RE-ENACTED: Estate Tax Laws Face Constant Changes



Our advice? Keep up.

Richard Dolezal, CPA – Havre Office

Staying ahead of the continual changes in estate tax planning is a tall order. Since 2001, the Economic Growth and Tax Relief Reconciliation Act has gone through more phases than the moon. Here are some of the latest changes.

Individual Estate Value. An individual's estate value may be taxable the year that individual dies. The deceased individual's estate value is compared to the applicable estate tax exclusion amount for that year.

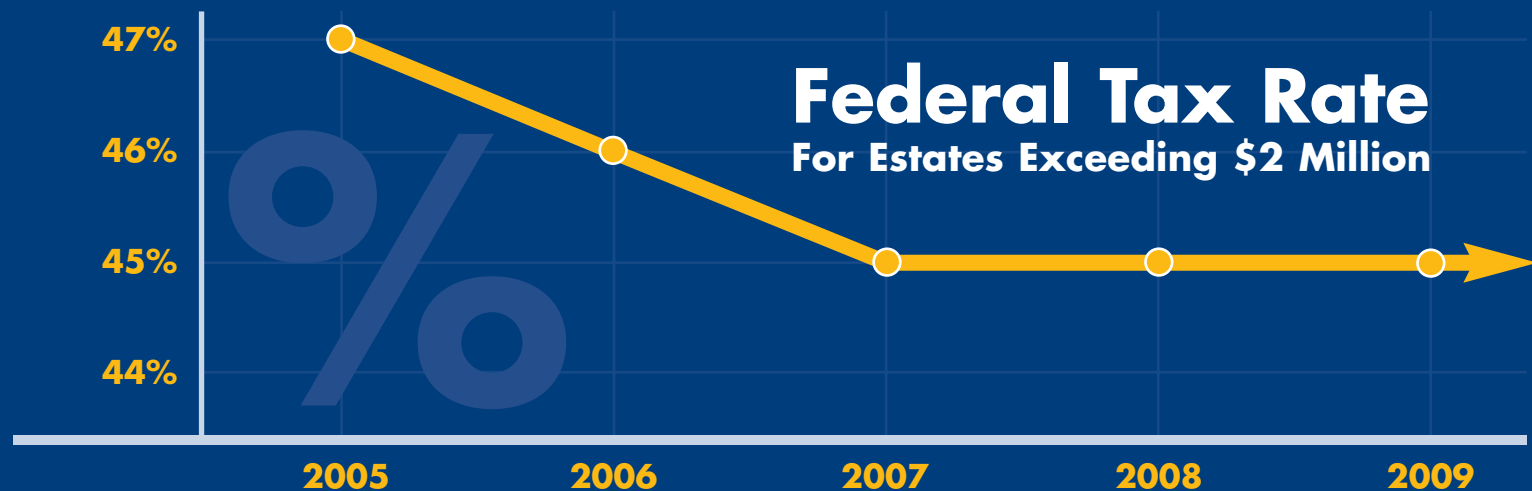
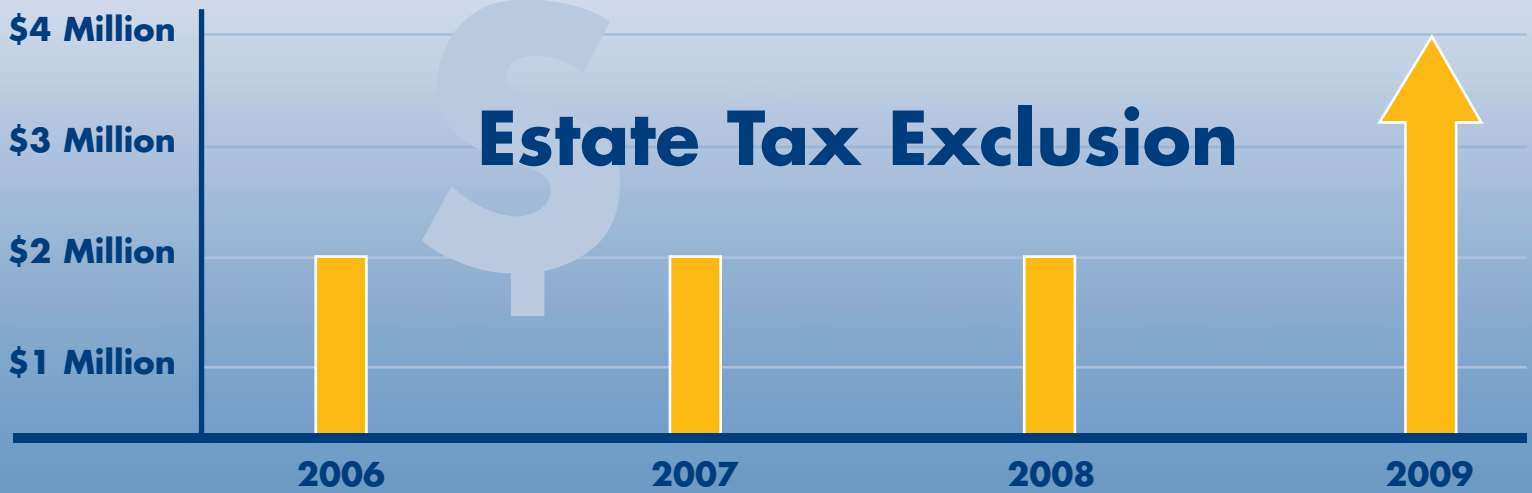
If the estate's value exceeds the estate tax exclusion amount, then the excess is taxed at that year's applicable federal tax rate.

In September, Congress scheduled a vote to repeal the estate tax law. After Hurricane Katrina, the vote never happened.

Increased Exclusions for 2006. The estate tax exclusion increases to \$2 million for 2006 through 2008, and is scheduled to increase

to \$3.5 million in 2009. (However, the estate tax law is scheduled to be repealed in 2010, for one year.) For estates exceeding \$2 million in 2006, the federal tax rate is 46 percent, down 1 percent from 2005. For 2007 through 2009, the rate will decrease another point to 45 percent.

And if Congress Changes its Mind? At this time, it is not known whether Congress will repeal the estate tax law or establish a permanent estate tax exclusion amount and federal estate tax rate. If they don't, both will revert to the 2001 amounts — \$1 million in exclusions and a federal tax rate of 55 percent. ☒





What's AMT?

THE ALTERNATIVE MINIMUM TAX (OR AMT) is an additional tax some people pay on top of regular income tax. The goal of AMT was to prevent people with very high incomes from using special tax benefits to pay little or no tax. But the tax reaches more and more people each year, including some without high incomes or special tax benefits.

HOW DOES AMT WORK? It creates an alternative set of rules for calculating income tax to determine the minimum amount of tax that someone with your income should pay. If you're already paying at least that much through regular income tax, you don't pay AMT. But if your regular tax falls below this minimum, you pay the alternative minimum tax to make up the difference. ☞

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to offset their AMT liability. (See the sidebar to the left to learn more about the AMT.) For 2006 only, the AMT exemption will increase significantly, from \$45,000 to \$62,550 for married couples and \$33,750 to \$42,500 for single taxpayers.

Dividends and Capital Gains. Under present law, the maximum tax rates for most dividends and capital gains is 15 percent for qualifying taxpayers. Those in the 10- and 15-percent tax brackets are eligible for an even lower rate of 5 percent, falling to zero in 2008. As originally enacted in 2003, these temporary cuts were scheduled to expire at the end of 2008. The Tax Reconciliation Act extends these cuts for two more years, through 2010.

Small Business Expensing. Since 2003, Congress has enhanced small business expensing under Code Sec. 179 several times to encourage business investment. Under prior law, the \$100,000 expense amount (\$108,000 for 2006 after being indexed for inflation) was scheduled to expire after 2007. The Tax Reconciliation Act extends the increased expensing through 2009, after which it will revert back to \$25,000. The limit for qualifying property of \$400,000 (\$430,000 for 2006 after being indexed for inflation) is extended also, but will revert to \$200,000 after 2009. ☞

Roth IRAs. Current tax law prohibits the conversion of a regular IRA to a Roth IRA if the taxpayer's modified adjusted gross income (AGI) is greater than \$100,000. The Tax Reconciliation Act removes this limit for tax years after 2010. Amounts converted from a regular IRA to a Roth IRA are taxed as a distribution and not subject to the 10 percent early withdrawal penalty. However, earnings in a Roth IRA are permanently tax-free and Roth IRAs have no required minimum distributions at age 70½. Taxpayers who convert in 2010 can elect to recognize the conversion income over the next two years.

Kiddie Tax. The "Kiddie Tax," as it is called, requires a child's unearned income, such as dividends and interest, to be taxed at the parents' tax rate, which is usually a higher rate. Under current law, the Kiddie Tax applies if the child is under age 14, has a net unearned income over \$1,700, and the parent can claim the child as a dependent. The Tax Reconciliation Act raises the age limit to under 18 years. This provision is effective immediately for the entire 2006 tax year.

The new law extends small business expensing thresholds, allows high-income taxpayers a Roth conversion, and makes over 20 other significant changes.

Information Reporting. Currently, payers of interest on tax-exempt bonds are not subject to the information reporting requirements. The Tax Reconciliation Act eliminates that exception and requires information reporting for interest paid on tax-exempt bonds.

A number of tax relief provisions are scheduled to expire after 2010. Considering that the current federal budget deficit is at an all-time high, it's uncertain whether Congress will extend them. Therefore, the possibility of higher tax rates should be considered in any long-term strategies. See your GH&G advisor to make sure you are taking full advantage of the new tax cuts. ☞

WHAT'S THE BUZZ ON ENERGY TAX CREDITS?

Contemplating a remodel or new construction? Paying attention to efficiency can save more than energy.

Darcy Dee Reum, CPA – Havre Office

You've decided the timing is right for that remodel or new building you've been planning. Now's the time to talk with your CPA. Why? Several new federal and Montana tax incen-

tives offer credits when you improve the energy efficiency of your home or office.

How Can My CPA Help Me with My Remodel?

By helping you identify the energy-efficient improvements that can save you as much as \$500 on your next return. The new federal tax credit applies to primary residences only, and can include such easy upgrades as insulation material for minimum heat loss/gain, efficient




ENERGY SAVINGS = TAX SAVINGS

Just a few of the many places in your home where you save money on your tax bill.

- ▶ **Installation of Efficient Windows**
- ▶ **Heat Loss/Gain-Resistant Insulation**
- ▶ **Metal Roof with Specially Pigmented Coating**
- ▶ **Electric or Geothermal Heat Pump**
- ▶ **High-Efficiency Air Conditioner or Furnace**
- ▶ **Exterior Doors**
- ▶ **Hot Water Heaters**

windows or skylights, a metal roof, or a high-efficiency furnace or water heater. What's more, federal tax credits are also available for alternative energy sources such as solar water heating, photovoltaic and fuel cell property, and for manufacturers of energy-efficient homes or appliances.

Saving is in the Details. In Montana, an additional \$500 credit per taxpayer is available, (up to \$1,000 for married taxpayers filing jointly) for improvements on a wide range of structures. These include single and multiple dwellings, mobile or manufactured homes, and any building used for commercial, industrial, or agricultural purposes. Up to 25 percent of improvement costs can apply towards the credit. In short, it's all in the details. If you're planning to build or remodel, just contact your GH&G professional advisor to learn more about the new energy tax incentives. 



Know Before You Give: New Gift Tax Updates

Exclusion increase could prove beneficial

Richard Dolezal, CPA - Havre Office

Annual gifting exclusions are a good number to keep your eye on, especially before you start writing checks. For instance, in 2006 the annual gift exclusion amount increased to \$12,000, up \$1,000 from a year ago.

What is the Annual Gift Exclusion? The exclusion allows an individual to gift money or property to other individuals without incurring a tax or using up the individual's \$1 million lifetime gift tax exclusion (see below). A married couple can each gift \$12,000 to another person, or make a split gift of \$24,000.

Lifetime gifting caps. An individual may gift up to \$1 million in his or her lifetime, without incurring a gift tax. A married couple can gift up to \$1 million each, or make a combined gift up to \$2 million.

If you're interested in estate tax planning or gift tax planning, make an appointment with your GH&G consultant. They have the knowledge to answer individual questions and offer solutions. ☑

NEW GIFT TAX EXCLUSION FAVORS THE GENEROUS

2006 joint taxpayers:
\$24,000

2006 single taxpayer:
\$12,000

2005:
\$11,000



Six Things to Know Before Paying Commodities In-Kind

Wendy Gerky, Accountant – Havre Office



Many agricultural businesses choose to pay employees with in-kind wages such as livestock, grain or other commodities which are not subject to Social Security tax. But new qualification rules have made this process more complex. This list is a good place to start.

- 1. Have a written employment agreement stating that the relationship exists. Include the quantity or percentage of the commodity to be paid in-kind.**
- 2. Make sure the commodity was raised or produced by you, the employer, not purchased.**
- 3. Confirm the commodity's fair market value on the date paid, and fill out a W-2 for it.**
- 4. Make sure the employee gains full ownership of the commodity, holding it for a period of time before selling it. There's no hard-and-fast rule regarding a time frame, but the longer the better.**
- 5. Ship the commodity by itself, separate from others you might be distributing. And make sure the employee pays carrying costs such as storage fees and delivery of the commodity to market. (The employee can deduct these costs on a tax return.)**
- 6. Don't forget to deduct the in-kind wages as a business expense!**

Of course, there's more to know. A potential drawback, for instance, is that the employee's Social Security benefits may be reduced or eliminated, a factor that should be addressed and agreed upon first. It's a good idea to contact your GH&G advisor to learn more about paying in-kind wages. The IRS guidelines are strict and technical, and a professional's opinion can save time and money later. ☑

What changes more often than accounting guidelines? Accounting software.

Susan Helgeson, LPA – Havre Office

QuickBooks has become increasingly popular with many of our small business clients over the past several years. While relatively user-friendly, recurring difficulties can pop up.

One of the most widespread problems has the simplest solution: *Double-check to see that you entered the correct date (or range of dates) before saving your transaction or generating your report.* QuickBooks will pre-fill the dates with “intelligent defaults” – the dates it assumes you want. When software assumes something, it could spell trouble.

Specialized Modules. For clients who use the specialized modules – payroll, inventory, accounts receivable, or accounts payable – transactions must be entered *through* those modules in order for QuickBooks to track the information accurately. For example, *if you entered a bill due to a vendor, you must pay the bill through the Accounts Payable module – you must “Pay Bills.”* If you simply “Write Checks,” or go directly to the check register and write a check, QuickBooks will not match the payment to the bill you previously entered. The same is true for payroll. If you simply “Write Checks” or write a check directly from the check register instead of using “Pay Employees,” QuickBooks won’t recognize the check as a paycheck, leaving it out of your employment reports, tax liabilities, and the employee’s W-2. Payroll tax payments must be made using “Pay Payroll Liabilities” in order to maintain accurate balances.

New Accounts. To add a new general ledger account (when you acquire a new loan, for example), do not enter an amount in the “Opening Balance” box. If you also record a deposit (which records the loan



advance in your check register), the loan balance is doubled up. *The “Opening Balance” box should only be used when you originally set up your QuickBooks company.*

Bank Reconciliations. When reconciling your bank balance, do not let QuickBooks adjust your balance to force the reconciliation. If you run out of time to locate and correct the differences, click the “Leave” button, come back and finish it later.

Correcting Transactions. Once you have given GH&G a copy of your QuickBooks to prepare your tax returns, do not add, change, or delete any transactions dated on or before the year’s end (for example, the calendar year ended December 31, 2006). This is particularly true for a partnership or corporation, since the return includes a balance sheet. If the beginning balances do not match those of the prior year’s end, they must be corrected before the current year’s return can be prepared. If a prior year transaction needs to be corrected, call your GH&G professional and let them know what needs to be changed; they’ll help you determine the appropriate course of action.

Voiding a Check? Don’t. If you find it necessary to void a check, it is not always best to use the “Void Check” feature – it deletes

the check as though it never happened. Particularly if the check was originally issued in a prior year, *make a deposit in the current year for the amount of the check that needs to be voided.* Use the memo field to record the check number and original date of the voided check. Then, if the check needs to be reissued, do so using the current date. This process preserves the deduction in the year it originally occurred. You should follow the same process to void and reissue a payroll check, as employment tax reporting is highly date-sensitive.

You Worked Hard on Those Figures. We highly recommend you routinely back up your QuickBooks company using a removable media device, such as a CD, DVD, flash drive, or external hard drive. The more transactions you have, the more frequently you should back it up. Also, try to restore the information back to QuickBooks, to be sure the backup was successful.

When in Doubt, Call Us. A short phone call to GH&G can often save you time and frustration later. Or, try the Remote Access feature, which gives your GH&G professional temporary access to your QuickBooks company via the Internet. Setup takes only a few minutes. ☎

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Drive Your Way to More TAX ADVANTAGES

Business vehicle expenses dos and don'ts.

Naomi M. Coey – Bozeman Office

There's no question that if you've got a car, you've got expenses. Chances are, way more expenses than you'd like. Not to mention the hundreds of gallons of gas you'll pump this year. The question is, can you deduct it? And if so, how?

Expenses or Mileage? When you are deducting vehicle expenses, you can either claim the actual vehicle expenses incurred that depreciate your vehicle's value, or use the mileage method, which includes depreciation by factoring it into the standard mileage rate. Of course, there are more variables to consider. Such as interest related to the purchase of the vehicle. Or state and local taxes, which are deductible under either method.



Should you deduct standard mileage or actual expenses? It all depends.

See Your GH&G Advisor to Make Sure You Make the Right Choice. Before calling, it will be helpful to know these facts: the date you put your vehicle into service; vehicle cost; loan details, such as the amount of payments and the interest rate; total mileage, separated into business and personal use; and costs of fuel, maintenance, repairs, insurance and taxes. Your GH&G advisor will then help you decide how to properly deduct your auto expenses. ☑

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