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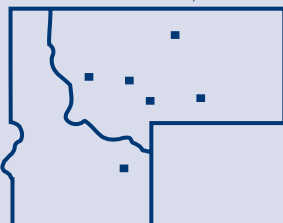
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*THE GALUSHA REPORT presents information on tax and business matters of general interest. Since the information is presented in summary form, we urge you to consult your tax or business advisor before taking action.*

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## AMERICAN JOBS CREATION ACT *of 2004*

Tax planning for 2004 and next year just got a little more complicated, but the news is very good for most people, especially businesses. Just weeks after passing one tax cut (Working Families Tax Relief Act of 2004), Congress has passed another (American Jobs Creation Act), and this tax law is one of the largest in years.

While many of its tax breaks are business-oriented, it also has some important tax incentives for individuals. The following is a brief discussion of the act's far-reaching effects on taxpayers.

### **Business Incentives**

*Small Businesses.* Small businesses are real winners in the new tax law. Congress has created a new deduction for "manufacturers." The great thing about this new deduction is that you don't have to be a traditional manufacturer of products like auto, steel and paper. Because Congress chose to define "manufacturer" very broadly, many other types of businesses also qualify for the new deduction, including construction firms, engineering and architectural firms, computer software companies, agricultural processors, and many service providers. The deduction starts at 3 percent and grows to 9 percent by 2010. Because of the way Congress designed the deduction, it effectively reduces the overall corporate tax rate.

Small businesses also get a helping hand from enhanced expensing. Two years ago, Congress raised the small business expensing threshold from \$25,000 to \$100,000 and indexed it for inflation. Unfortunately, the \$100,000 limit was temporary. It was scheduled to expire at the end of next year. The new law extends the \$100,000 limit for two more years and has been indexed to \$102,000 for 2004.

*S Corporations.* This type of entity is sure to be even more popular under the new tax law. Instead of 75 shareholders, S corporations can have 100 shareholders. One family can also elect to be treated as a single shareholder. If you're thinking of starting a business or converting your business to a different structure, the new rules make S corporations very attractive.

*International Taxes and FSC/ETI Repeal.* The new tax act was designed to help American exporters. Several years ago, the World Trade Organization ruled that our foreign sales corporation/extraterritorial income regime (FSC/ETI) was an illegal trade subsidy. The European Union, one of America's largest trading parties, started penalizing our exports, with penalties increasing every month. That's one of the reasons Congress passed the new tax law, which repeals all of the FSC/ETI rules.

In addition, Congress has aimed at encouraging job creation at home by creating some incentives for multinationals to bring their earnings back to the United States.

### **Tax Cuts for Individuals**

The tax cuts for individuals aren't as generous as the ones for business in this new law. That's because the law began as a business bill. Congress had already enacted many individual tax cuts in the Working Families Tax Relief Act of 2004.

*Continued on page 4*

## Payne Financial Group Plans for the Future with GH&G



<b>Client:</b>	<i>Ken Laddusaw, CFO / Payne Financial Group, Inc.</i>
<b>Business:</b>	<i>Insurance, surety bonds, employee benefits and financial services</i>
<b>Location:</b>	<i>Offices in Montana, Eastern Washington and Wyoming</i>
<b>Size:</b>	<i>200 people</i>
<b>Length of Relationship:</b>	<i>Since inception in 2001</i>
<b>Services Provided:</b>	<i>Audit of financial statements and 401(K) plan, tax preparation and planning, special projects</i>

What does innovation have to do with insurance? A lot, if you're Payne Financial Group, Inc. Formed in 2001, this full-service independent insurance agency has been winning industry attention ever since for its innovative approach to business. Most recently, Payne Financial Group was selected to join an elite group of independent insurance agencies in an industrywide best practices study.

### Creating the New Firm

The firm's success didn't happen overnight. Its roots go back well into the last century. Payne Financial Group was established when three of Montana's leading risk management and insurance agencies came together to create this new firm:

- Terry Payne & Company, founded in 1972, which was the preeminent risk management firm in Montana and specialized in risk services for large commercial accounts;
- Hoiness LaBar Insurance, an agency established in 1921 that was the market leader in Billings and northern Wyoming; and
- Montana International Insurance, formed in 1946, the market leader in Helena and several other communities.

"We came together as Payne Financial Group for a common purpose," said Ken Laddusaw, Chief Financial Officer. "We wanted to offer our clients more resources and services across the board, while maintaining a very personal, one-to-one way of doing business."

Laddusaw credited GH&G with helping Payne Financial Group navigate the complicated tax and financial reporting requirements when the company was first formed. "If you've ever gone through

a merger or acquisition, you know how complex the accounting can be when you combine companies," said Laddusaw. "GH&G was a terrific partner to have at our side when we created PFG from three different agencies. And it certainly helped that GH&G had a prior history with us as the accounting firm for two of the agencies."

### Payne Financial Group Today

Payne Financial Group, Inc. now ranks in the top 100 independent insurance agencies nationwide. It provides insurance, surety bonds, employee benefits and financial services to clients across the West. The agency has 200 employees in offices across Montana, eastern Washington and Wyoming. It continues to operate under the Hoiness LaBar Insurance and Montana International Insurance names in some communities.

"Our state-of-the-art information technology delivers operational efficiency, while our dedicated claims management and loss control services add real value for clients," said Laddusaw. "We have the ability to handle the largest commercial accounts with custom risk management services, and yet provide the smallest personal lines account with quality service, too."

### A Focus on Innovation

Forging a new company from three predecessor agencies, with 14 offices spread across three states, led to an innovative approach to managing the business.

A recent industry award described a number of the agency's innovations, among them:

- A decentralized structure that emphasizes teamwork, not location;

- A professional development program delivered through an internal "university;"
- Specialty practices offering risk management services to specific industries; and
- A Select Business Division geared to entrepreneurial businesses.

"We're always looking for innovative ways to improve client service," said Laddusaw. "And that means being flexible, staying open to new ideas, and moving fast to take advantage of opportunities."

### Independent Ownership and Employee Shareholders

Laddusaw pointed to another factor that defines Payne Financial Group. "Our company culture is dedicated to independent ownership, with many employees having a big stake in the agency," said Laddusaw.

"Having employee shareholders is a key factor in our success as Payne Financial Group. GH&G helps us administer this critical part of our financial structure."

For instance, GH&G provides guidance on the complex financial reporting requirements and income tax issues associated with the stock option plan, which includes statutory incentive stock options. GH&G also goes a step beyond income tax returns by calculating each shareholder's basis in their PFG stock each year and including this information in the K-1 reports to shareholders.

GH&G also performs the annual audit of PFG's financial statements, generates the state and federal income tax returns, and

*Continued on next page*

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conducts the annual audit of the Payne Financial Group Savings and Retirement plan and trust.

#### **GH&G as Business Partner**

“GH&G has the expertise we need in all these areas,” said Laddusaw. “They’re really a business partner who works with us as we plan and manage the agency for long-term growth. Along with taking care of our current accounting and financial requirements, we need an accounting firm that can look ahead and help us anticipate the future. That’s what GH&G does.”

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*“Along with taking care of our current accounting and financial requirements, we need an accounting firm that can look ahead and help us anticipate the future.”*

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The American Jobs Creation Act of 2004 improved the method of income averaging for farmers; this has also been extended to fishermen. The new act will affect any sole proprietor, partnership or S corporation engaged in the trade or business of farming, including operating a nursery or sod farm and raising or harvesting ornamental, fruit, nut or other crop trees. C corporations, trusts or estates do not qualify for income averaging. Landlords who are engaged in a farming business and take rental income based on a share of production from the tenants are allowed to average the income, but fixed rental income is not allowed to be averaged.

Income averaging allows farmers to even out their income over the prior three years. This allows the farmer to possibly stay within a lower tax bracket, therefore reducing the amount of tax liability. In the past, if the farmer had elected income averaging, the regular tax liability was reduced, but the amount of AMT owed sharply increased. Because AMT was figured using the amount of income before averaging and then applying income averaging tax liability, there was usually a large amount of AMT owed. Therefore, in the past, income averaging was not advantageous to the taxpayer.

The American Jobs Creation Act of 2004 coordinated income averaging and AMT. The Act refined the income averaging rule, and now regular tax is figured without averaging for AMT purposes only, thus reducing the AMT tax liabilities for farmers. A farmer will receive the full benefit of income averaging under these rules, because income averaging can be used to reduce the regular tax, while the AMT rules ignore the tax reduction resulting from income averaging when determining AMT liability.

Income averaging for farmers and fishermen becomes effective for tax years beginning after December 31, 2003.

*Amy Iverson, Accountant – Billings Office*

## **Why Save All Those Records?**

“Paperless” is the buzzword in business these days. Storing paper documentation has become so cumbersome and expensive — besides being quite inefficient. However, you must observe caution when destroying valuable paper records. Business documents create an important history of your transactions with customers, vendors and creditors. In order to resolve any future questions, you’ll need these records.

Your business records should be easily accessible to authorized personnel. Business records should be maintained for a minimum period of time according to the recommended record retention periods. (See insert.) Please note that retention rules may also vary from state to state. However, in certain circumstances involving pending or potential litigation, extended

record retention periods may apply. Your accounting advisor or legal counsel should be consulted prior to discarding documents that may be subject to an extended retention period.

Special retention requirements may also apply to documents or information maintained electronically. For instance, the Internal Revenue Service has special computer retrieval requirements when business records are maintained on a computerized system. Again, you should confer with your tax advisor at GH&G regarding any applicable IRS requirements.

*Cathy Givler, CPA – Executive Office*

**Military Families and Teachers.** Both receive tax breaks. Combat pay, which is generally excluded from gross income, can now be included when calculating the earned income credit for 2004 and 2005. Both the child tax credit and the earned income credit are increased. Educators can continue to receive the above-the-line deduction for purchasing qualifying supplies for their classrooms.

**State Sales Taxes.** For many years, taxpayers could deduct both their state income taxes and their state sales taxes. Congress did away with the sales tax deduction back in 1986, but the new law brings it back in part. The new law gives you an option to take a deduction for the higher of state/local income tax payments or state/local sales tax paid during the year. You'll need to calculate if your state income taxes or state sales taxes are higher. If you pay both, your state income taxes will probably be higher, but if you've made a couple of expensive purchases this year, your sales taxes may be higher.

**Charitable Donations.** The new law cracks down on charitable donations, especially car and truck donations. Vehicle donation programs are very popular. In exchange for donating your old car or truck, you get a tax write-off. The amount of the write-off is the problem. According to the IRS, too many people have been claiming inflated deductions for their old cars. So, if you're thinking of donating a used car or truck, you might want to make that donation before the new rules kick in for 2005. See the related article in this issue on page 6.

**SUVs (also known as the anti-Hummer law).** The new law also changes the tax treatment of large SUVs. Because the vehicle caps on depreciation and first-year expensing have not applied to cars or trucks weighing more than 6,000 pounds, businesses could deduct up to the full cost of a large SUV. That tax break is over, but only in modified form. Effective immediately, vehicles weighing more than 6,000 pounds but less than 14,000 pounds are limited by a \$25,000 cap on the amount of "first-year expensing."

**Penalties.** Congress had to create a way to pay for all these tax cuts, and one way is to increase penalties for tax evasion. Individuals and businesses investing in tax shelters and other abusive transactions will be liable for much higher penalties. The companies that promote these transactions also will be hit with very high penalties. If you've invested in any kind of tax shelter or any transaction that seems too good to be true, now is the time to voluntarily disclose that transaction to the IRS. Congress gave the IRS discretion to waive the harsh penalties for taxpayers who cooperate. The penalties aren't only for tax shelters. Individuals and businesses that file bogus or frivolous returns will be slapped with higher penalties. Return preparers who help file these frivolous returns also will be liable for monetary sanctions.

This article has explored some of the highlights of the new law. There's much more, depending on your personal tax situation. If you own a small business, the manufacturing tax deduction is one of the most important tax breaks of the past 10 years. Even if you don't own a business, you'll want to make sure your personal tax planning, especially your charitable donations, don't run afoul of the new law.

Rae Jordan, CPA – Billings Office

*“Tax planning for 2004 and next year just got a little more complicated, but the news is very good for most people, especially businesses. Just weeks after passing one tax cut (Working Families Tax Relief Act of 2004), Congress has passed another (American Jobs Creation Act) and this tax law is one of the largest in years.”*

**For 2004 and 2005, the new law allows the option of deducting state and local sales taxes OR state and local income taxes.**

States with no income tax	States with no sales tax
Alaska	Alaska**
Florida	Delaware
Nevada	Montana
New Hampshire*	New Hampshire
South Dakota	Oregon
Tennessee*	
Texas	
Washington	
Wyoming	

\* Only interest and dividend income subject to state income tax.

\*\* Some local Alaska jurisdictions impose a sales tax.

Caution: You can elect to deduct state and local income taxes. You are not allowed to deduct **both** state income taxes and state sales tax.

# OVER-THE-COUNTER REIMBURSEMENT IN *FLEX PLANS*

Flexible spending accounts (FSA) allow workers to pay for certain medical costs with pre-tax dollars. In the past, most plans limited reimbursable expenses to items eligible for the medical expense deduction on an individual's tax return — which excluded non-prescription drugs. A recent ruling by the IRS has given individuals who have “cafeteria plans” at work and who elect to fund medical reimbursement accounts an opportunity to be reimbursed for a much wider range of health-related expenses.

The IRS ruling says reimbursements an employee receives from an employer-sponsored health FSA for over-the-counter

medications are excluded from his or her gross income. Up until the time of this ruling, most, if not all, FSA plans would reimburse only the amount of prescription medications (including copayments) not covered by other insurance.

Employees with access to an FSA should reconsider their decision not to participate or consider adjusting the amount they have deducted from their wages on a pretax basis. In turn, companies need to decide whether to expand their FSAs to cover these new over-the-counter medicines in the face of potentially higher administration costs and fewer employee forfeitures.

## OTC Medical Items: What Qualifies?

The following is a partial list\* of the over-the-counter items the IRS has determined to be primarily for medical care and that can be reimbursed when purchased in reasonable quantities without a medical practitioner's note.

- Allergy medicine
- Antacids
- Adhesive bandages
- Bug-bite medication
- Carpal-tunnel wrist supports
- Cold medicines
- Cold/hot packs for injuries
- Condoms
- Contact-lens cleaning solution
- Diaper rash ointments
- First aid kits
- Hemorrhoid medication
- Menstrual-cycle products for pain and cramp relief
- Motion sickness pills
- Nicotine gum or patches for stop-smoking purposes
- Pain relievers
- Electrolyte replacement for ill child's dehydration
- Products for muscle or joint pain
- Reading glasses
- Sleeping aids used to treat occasional insomnia
- Special ointment or cream for sunburn
- Thermometers (ear or mouth)
- Throat lozenges
- Wart removal treatments

**Ineligible expenses: Some OTC items will not be reimbursed under any circumstances since they are toiletries, cosmetics or items primarily used for general health and well-being.**

**Dual purpose: Some dual-purpose OTC items can be reimbursed if they are used for a medical purpose. They must be accompanied by a medical practitioner's note stating that the person has a specific medical condition, the doctor recommends the OTC drug to treat it, and the treatment is not a cosmetic procedure. These include:**

- Acne treatment (Retin A) — only to treat a specific medical condition such as acne vulgaris
- Dietary supplements or herbal medicines to treat a specific medical condition in narrow circumstances
- Orthopedic shoes and inserts (shoes are reimbursed only for the extra cost over buying nonorthopedic shoes)
- Prenatal vitamins
- St. John's Wort for depression

*\* This list does not include all over-the-counter items that are reimbursable.*

*Source: American Fidelity Assurance Company, Oklahoma City*

# Automobile Donations

The IRS has recently issued several publications regarding charitable donations of automobiles. Publication 4302 is a guide for charities who create automobile donation programs, and Publication 4303 is a guide for those who donate a car to charity. Some of the main topics discussed in the guide for those making car donations are discussed below. (More information can be found at [www.irs.gov/charities/](http://www.irs.gov/charities/).)

## A Donor's Guide to Car Donations

- *Check out the charity:* Make certain that the charity is a qualified organization.
- *See if you'll get a tax benefit:* You can deduct contributions to a charity only if you itemize on Schedule A of Form 1040.
- *Check the value of your car:* The IRS will only allow a deduction for the fair market value of the car, which may be substantially less than "blue book" value.

## American Jobs Creation Act of 2004

Effective for contributions made after 2004, a donor of a motor vehicle, the claimed value of which exceeds \$500, will be required to substantiate the contribution with a contemporaneous written acknowledgement from the donee. To be considered contemporaneous, the written acknowledgement must be provided to the donor by the donee organization within 30 days of:

- (1) the contribution of the qualified vehicle, or
- (2) the date of sale of the qualified vehicle by the donee organization if it sells the vehicle without any significant intervening use or material improvement.

The acknowledgement must contain the name and taxpayer identification number of the donor and the vehicle identification (or similar) number. It must also include:

- (1) if the donee organization sells the qualified vehicle without any significant intervening use or material improvement:
  - (a) a certification that the vehicle was sold in an arm's-length transaction between unrelated parties;
  - (b) the gross proceeds of the sale; and
  - (c) a statement that the deductible amount may not exceed the gross proceeds.
- or**
- (2) if the donee organization retains the qualified vehicle for its usage:
  - (a) a certification stating the intended use of the vehicle or any material improvement intended for the vehicle, and the intended duration of such use; and
  - (b) a certification that the vehicle will not be transferred in exchange for money, property or services prior to completion of the intended use or improvement. If the donee organization sells the qualified vehicle without any significant intervening use or material improvement, the maximum deduction the taxpayer will be allowed will be equal to the gross proceeds received by the donee organization from the sale of that qualified vehicle.

A penalty will be imposed for knowingly failing to furnish an acknowledgement or for knowingly furnishing a false or fraudulent acknowledgement.

Call us at GH&G to be sure that your automobile donation meets the latest requirements.

*Natasha Abdrasilova, CPA – Billings Office*

# States Limit Federal Tax Deduction

The Montana legislature has made one of the most comprehensive reforms of Montana's tax structure in recent memory. Beginning January 1, 2005, the individual income rates, which currently range from 2 percent to 11 percent, are reduced to a range of 1 percent to 6.9 percent.

In order to pay for these tax cuts and make this a revenue-neutral act, the legislature has also made significant changes to the federal tax deduction. This is the key issue for you. Prior to this act, taxpayers who itemized their deductions on the Montana return were allowed to deduct, in full, any federal income taxes paid during the year. Effective January 1, 2005, this deduction is limited to \$5,000; married couples who file a joint return will be allowed to deduct up to \$10,000 in federal income taxes paid. This deduction limitation is partially offset by the reduction in tax rates beginning in 2005.

We recommend you pay your fourth-quarter estimated taxes (due by January 15, 2005) on or before December 31, 2004, in order to receive the full tax benefit of the deduction.

Note: In Idaho, no deduction on state returns is allowed for federal income taxes paid. This type of deduction, if available in a state, varies from state to state as to what dollar amount or percentage can be deducted.

Please feel free to call your GH&G office with any questions or concerns.

*Leslie King – Billings Office*

# MONTANA

Department of Revenue

## — Personal Income Tax Relief —

Senate Bill 407 (SB407), enacted during the 2003 legislative session, represents one of the most comprehensive reforms of Montana's tax structure in recent memory. Beginning January 1, 2005, it reduces individual income tax liabilities in a manner that specifically addresses current features of the income tax believed to hinder economic development in the state.

Under SB407, the top rate of 6.9 percent applies to taxable income in excess of \$13,900 in tax year 2005, and \$14,300 in tax year 2006. As with current law, the SB407 tax bracket boundaries will continue to be indexed annually for inflation.

Prior to SB407, taxpayers who itemized their deductions were allowed to deduct in full any federal income taxes paid during the tax year. Under SB407, this deduction is limited to \$5,000; married couples who file a joint income tax return will be allowed to deduct up to \$10,000 in federal income taxes paid.

SB407 modifies the current credit allowed residents for income taxes paid to other states or countries by allowing in the credit the resident's distributive share of any income tax paid to another state or country by a partnership of which the resident is a partner.

Finally, SB407 institutes a new capital gains tax credit. Beginning with tax year 2005, taxpayers will be allowed a credit against their individual income tax liability equal to 1 percent of any capital gains reported for federal income tax purposes. Beginning with tax year 2007, this credit is increased to 2 percent of reported capital gains.

Currently, the highest state marginal rate of tax applied to capital gains income is 11 percent. After SB407 is fully phased in (tax year 2007), the highest effective marginal rate of taxation on capital gains income will be 4.9 percent (the top marginal rate of 6.9 percent less the 2 percent tax credit applied to capital gains income).

### Effective Dates

Most changes to the individual income tax are effective January 1, 2005 (tax year 2005), but the credit allowed resident taxpayers for income taxes imposed by foreign states or countries on the resident's distributive share of any income from partnerships applies retroactively to tax years beginning after December 31, 2002 (tax year 2003).

*Source: Montana Department of Revenue*

[www.discoveringmontana.com](http://www.discoveringmontana.com)

### Individual Income Tax

SB407 changes many aspects of Montana's individual income tax structure.

First, individual income tax rates, which currently range from 2 percent to 11 percent are reduced to range from 1 percent to 6.9 percent. The number of tax brackets is reduced from ten to seven. The following chart shows the change in tax rates and taxable income brackets for tax years 2005 and 2006.

#### SB407 – TY 2005

Individual Income Tax  
**Current Law**  
Tax Rate Table

\$0	\$2,200	2%	
\$2,300	\$4,600	3%	-23
\$4,600	\$9,200	4%	-69
\$9,200	\$13,800	5%	-161
\$13,800	\$18,400	6%	-299
\$18,400	\$23,000	7%	-483
\$23,000	\$32,300	8%	-713
\$32,300	\$46,100	9%	-1,036
\$46,100	\$80,700	10%	-1,497
\$80,700		11%	-2,304

Individual Income Tax  
**2005 Law**  
Tax Rate Table

\$0	\$2,300	1%	
\$2,300	\$4,100	2%	-23
\$4,100	\$6,200	3%	-64
\$6,200	\$8,400	4%	-126
\$8,400	\$10,800	5%	-210
\$10,800	\$13,900	6%	-318
\$13,900		6.9%	-443

#### SB407 – TY 2006

Individual Income Tax  
**Current Law**  
Tax Rate Table

\$0	\$2,400	2%	
\$2,400	\$4,700	3%	-24
\$4,700	\$9,500	4%	-74
\$9,500	\$14,200	5%	-166
\$14,200	\$19,000	6%	-308
\$19,000	\$23,700	7%	-498
\$23,700	\$33,200	8%	-735
\$33,200	\$47,400	9%	-1,067
\$47,400	\$83,000	10%	-1,541
\$83,000		11%	-2,371

Individual Income Tax  
**2006 Law**  
Tax Rate Table

\$0	\$2,400	1%	
\$2,400	\$4,200	2%	-24
\$4,200	\$6,400	3%	-66
\$6,400	\$8,600	4%	-130
\$8,600	\$11,100	5%	-216
\$11,100	\$14,300	6%	-327
\$14,300		6.9%	-456



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# COMPARISON OF RETIREMENT PLAN LIMITS

	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Qualified Plan Limits</b>			
401(k), 401(b) and SARSEP maximum deferral	\$14,000	\$13,000	\$12,000
457 maximum deferral	\$14,000	\$13,000	\$12,000
SIMPLE election maximum deferral	\$10,000	\$9,000	\$8,000
Catch-up for 401(k), 403(b), SARSEP and 457	\$4,000	\$3,000	\$2,000
Catch-up for SIMPLE	\$2,000	\$1,500	\$1,000
Defined Benefit - annual benefit	\$170,000	\$165,000	\$160,000
Defined Contribution - annual contributions	\$42,000	\$41,000	\$40,000
<b>Compensation Limits</b>			
Maximum compensation	\$210,000	\$205,000	\$200,000
SEP annual compensation floor	\$450	\$450	\$450
<b>Highly Compensated Employees</b>			
Any employee compensation	\$95,000	\$90,000	\$90,000
<b>Key Employees</b>			
Officer compensation	\$135,000	\$130,000	\$130,000

*Happy Holidays*  
*from Galusha Higgins & Galusha, PC*



Visit the GH&G Web site at [www.ghg-cpa.com](http://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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