

The Galusha Report

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Think You Know All the Year-End Tax Tips? Think Again.

Some seasonal tax advantages never go out of style. Others won't last long.

Wayne Iwen, CPA and Nicole L. Larson — Bozeman office

In the midst of holiday planning and gatherings, income taxes just might be the last thing on your mind. And yet there's no better time than now to take stock of recent tax changes that can save you money come tax season. Congress has been busy rewriting tax laws in recent years, some of which are going into effect now and others that expire soon. To help streamline your tax planning during this busy time of year, we've recapped many of the changes that could better your bottom line.

What's the Alternative Minimum Tax? AMT was designed to ensure that wealthy taxpayers could not escape taxation by exploiting deductions. The problem with AMT is that it's not indexed for inflation, which means that a growing number of taxpayers are hit by it

Congress has been busy rewriting tax laws. Many provisions will expire in the next two years, while others are just taking effect.

every year. Congress has passed a few legislative "patches" to keep it from affecting too many people, but unfortunately, one of those fixes — an increased AMT exemption — is set

to expire at the end of 2005.

What that means for you is that shifting some of your income and deductions into 2006 might make sense, since AMT disallows certain deductions. Your GH&G advisor can help determine if it would be advantageous to shift any of the following items:

- State and local taxes.
- Home equity loans and other mortgage interest not incurred in buying, building or improving your principal residence.
- Incentive stock options, which may generate AMT income even when sold at a loss.
- Private activity bonds.
- Other itemized deductions, such as medical expenses.

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Look Back. Think Ahead.

— Tom Copley, President

Any good accountant or financial planner does more than look back on the year. We think ahead. We look back at what has transpired and how it has affected our clients' businesses and personal finances. But we do it with the purpose of planning for the future. How can we improve our clients' finances? How can we better position a company financially? What new legislation can be used to our clients' benefit?

That, in brief, is what this *Galusha Report* is about. Wayne Iwen and Nicole Larson shed light on tax law changes and how they could affect your future — positively and negatively. Gayle Hokanson shows us how the Katrina Emergency Tax Relief Act of 2005 can have implications for charitable contributions and estate planning unrelated to the hurricane itself. You'll also find information on healthcare plans for small businesses and tax issues surrounding the sale of a home. And, in our *Industry Focus*, you'll learn about the "Production Deduction," a must read for building contractors and ranchers.

Please enjoy your copy of the *Galusha Report*. If you have questions about the articles or topics covered, call one of our offices listed on the back. And remember, as the year comes to an end, look back. So you can think ahead.

A Sea of Tax Implications in the Wake of Katrina

New Emergency Tax Relief Act of 2005 benefits those affected by natural disaster, and has provisions that apply to all taxpayers.

Gayle Hokanson, CPA — Bozeman Office

President Bush signed the Katrina Emergency Tax Relief Act of 2005 on September 23, 2005. While most of the provisions benefit those directly affected by the hurricane, there are a few that apply to taxpayers here in the West as well.

Charitable Contributions. In general, individuals can deduct cash contributions to public charities up to 50 percent of their adjusted gross income for the tax year, with excess amounts carried forward for up to five years. Under the Relief Act, the 50-percent limit increases to 100 percent for cash donations to qualified public charities between August 28 and December 31, 2005. Contributions in excess of adjusted gross income can be carried forward for the five-year period. In addition, donations are not subject to the three-percent phase-out of itemized deductions for high-income taxpayers.

Charitable contributions by a corporation are usually limited to 10 percent of its taxable income for the year, with the five-year carryover provision. The Relief Act allows a corporation to deduct cash charitable contributions up to 100 percent of its taxable income. Like individuals, the provision applies to cash donations made between August 28 and December 31, 2005. However, *unlike* individuals, the corporation's



As of December 2005, less than 20 percent of New Orleans' residents have returned to their homes and businesses.

contribution must be made for relief efforts related to Hurricane Katrina and the corporation must elect to have the provisions apply.

Estate Planning. The Relief Act allows an individual over age 59½ to withdraw funds from an IRA or other qualified retirement plan and donate the funds to charity, creating a full offset. (Be sure to check with your GH&G advisor about the broader ramifications of early retirement plan withdrawals.) Since it takes two to three weeks to process withdrawal requests, it's important to make your request soon in order to meet the December 31 deadline.

Other Provisions. The Relief Act also provides deductions to individuals who give shelter to evacuees, and enhanced deductions for gifts of food and book inventories. The mileage rate for charitable work related to Katrina relief was also increased. If you have questions regarding the Relief Act, or the enhanced charitable contribution deductions, contact your advisor at GH&G.

Charity Check-Up

The Federal Trade Commission encourages you to check out a charity thoroughly before you open your checkbook. These Web sites can help:

BBB WISE GIVING ALLIANCE
4200 Wilson Boulevard, Suite 800
Arlington, VA 22203
(703) 276-0100
www.give.org

AMERICAN INSTITUTE OF PHILANTHROPY
3450 Lake Shore Dr., Suite 2802 E
Chicago, IL 60657
(773) 529-2300
www.charitywatch.org

GUIDESTAR
427 Scotland Street
Williamsburg, VA 23185
(757) 229-4631
www.guidestar.org

MONTANA FOCUS:

The Small Business Healthcare Affordability Act

Starting January 1, offering health benefits will be easier than ever.

Jayne Schlepp, CPA – Bozeman Office

If you're a small business in Montana providing health insurance for your employees — or if you'd like to provide insurance but can't afford to — the new Small Business Healthcare Affordability Act is meant for you. The new legislation was created to help the state's many small businesses with the cost of health insurance. It works through a combination of tax credits and assistance with premium payments.

For small businesses already providing health insurance, the act offers refundable annual tax credits. To qualify, a business must meet these criteria:

1. The employer already pays for some or all health insurance premiums for employees.
2. The number of eligible employees is between two and five (including owners).
3. No employee is paid more than \$75,000 annually. This applies solely to employees, not owners.
4. The credit cannot be more than 50 percent of the premiums paid.

Additional tax credits are available if the employer also pays premiums for spouses and/or dependents of employees, and the credit amount increases by \$25 if the average age of the employees is 45 or older.

Businesses that do not currently offer health insurance may qualify for premium assistance and incentive payments by joining the newly formed State Health Insurance Purchasing Pool. The assistance covers both the employer and employee's portion of the insurance premium. To qualify, both employers and employees must meet the following criteria:

1. The employer currently does not provide health insurance.
2. The number of eligible employees is between two and five (including owners).
3. The employer begins to provide health insurance to eligible employees through the new State Health Insurance Purchasing Pool or another qualified Association Plan.
4. No employee is paid more than \$75,000 annually. This applies solely to employees, not owners.



A combination of tax credits is available when your business joins the Health Insurance Purchasing Pool.

5. Employees meet the income and other eligibility criteria.

Benefits will begin January 1, 2006. Applications are available by calling (800) 332-6148 or online at www.sao.mt.gov, and are being accepted by the State Auditor's office on a first-come, first-serve basis.



REAL ESTATE FOCUS:

You Sold Your Home. Can You Deduct \$250K from Your Income?

Only if you meet the requirements for exclusion of gain on the sale of your principal residence.

Valerie Hillman, CPA – Bozeman Office

If you sold a home in 2005, you might be able to exclude up to \$250,000 of gain (\$500,000 on a joint return) from income. It

all boils down to meeting "ownership" and "use" tests for your property. Additionally, the exclusion can be used only once every two years.

Ownership and Use. As a general rule, you can exclude gain if you owned and used the property two of the last five years. Ownership and use requirements can be met during nonconcurrent periods, provided

both tests are met during the five-year period ending on the date of sale.

Hardship Relief. If you don't meet the ownership and use requirements, or the minimum two-year time period for claiming the full exclusion, you may still be eligible for a partial exclusion if the sale of the home is due to: (1) a change in place of employment, (2) health reasons, or (3) unforeseen circumstances. According to the IRS, in order for an individual to be eligible for the partial exclusion, the individual's *primary reason* for the sale must be related to one of these three reasons.

How Can My Water Heater Affect My Taxes?

You can't afford NOT TO KNOW about these three federal tax credits resulting from recent energy legislation:

1. Homeowners will receive a tax credit of up to \$500 total (over the 2006 and 2007 tax years) for installing energy-efficient exterior doors and windows, insulation, heat pumps, central air conditioning, water heaters, or other nonbusiness property.

2. Solar water heaters and other solar equipment are eligible for a residential, alternative-energy credit of 30 percent of their cost. The maximum credit is \$2,000 per year for each type of solar equipment and \$500 for each .5 kw of capacity for fuel cell plants installed each year. These credits apply to property that is available for use only after 2005. If you were thinking of installing solar equipment sooner, consider delaying it.

3. The clean-fuel vehicle deduction for hybrid vehicles switches to a credit of about \$2,000, depending on fuel efficiency, beginning January 1, 2006, so you may want to wait on that hybrid purchase.

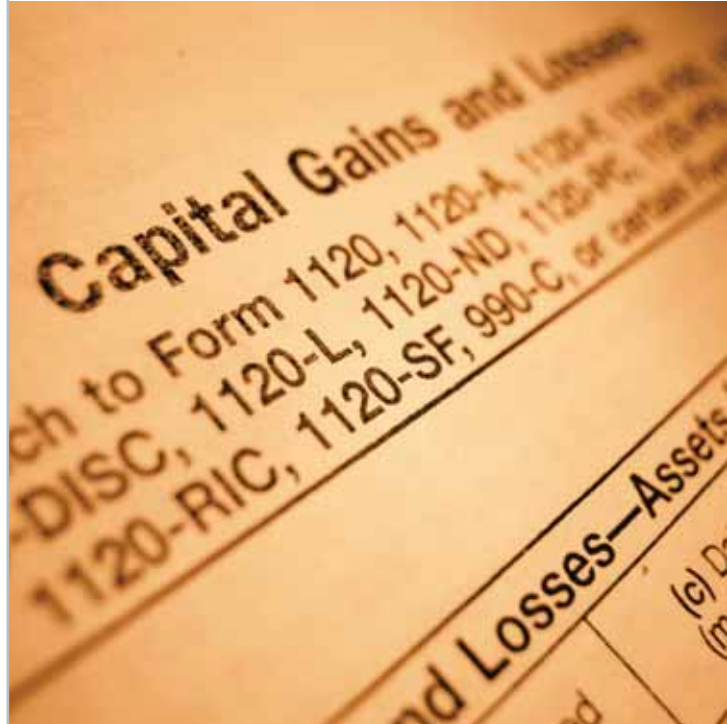
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Which Provisions Are Expiring This Year?

Some tax provisions were added as temporary economic stimuli and are set to expire at year's end. If you expect these expenses soon, it might be smart to take care of them now, while they're still deductible:

- State-sales-tax itemized deduction that provides an advantage for taxpayers in states with high sales taxes or no income taxes.
- Educators' deduction for school-related expenses.
- Tax credits for business activities in Puerto Rico and other U.S. possessions.
- Higher-education-expense deduction allows you to pay expenses for coursework starting in the first three months of 2006 before December 31, 2005.
- Tax relief provisions enacted as part of aid for Hurricane Katrina victims, including "unlimited" charitable contributions, expanded charitable contribution rules for donation of food inventory and a work opportunity credit for employers outside the Katrina disaster area that hire displaced workers.

The Perfect Time to Reevaluate Capital Gains?

December is also the right time to examine investments that minimize capital gain income. Losses on consistently underperforming investments can offset gains taken on winners, because it may be advisable to sell them to rebalance portfolios. Losses taken in excess of gains can offset ordinary income up to \$3,000 (\$1,500 for MFS). You might also consider donating appreciated stock to charitable organizations rather than selling it — these stocks can be deducted at fair market value. You could also shift capital gains to family members in lower tax brackets, through gifts of securities. The basis remains the same for donor and donee. Another recent tax change allows you to treat capital gains and qualified dividends as investment income, taxed at ordinary income tax rates, if you have deductible investment interest that offsets it.

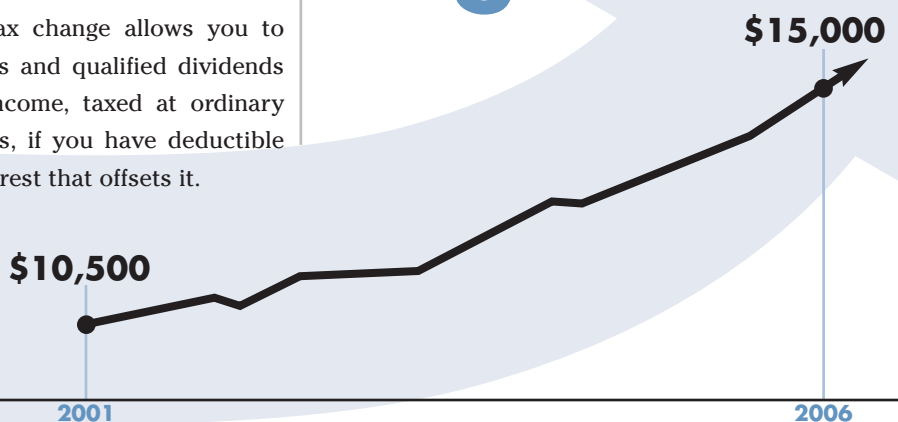


What About Retirement? Although you can contribute to an IRA for 2005 after the new year, the window on other retirement plans closes at the end of December. Take time now to:

- Maximize contributions to your 401(k) or other qualified retirement plan.
- Take advantage of your catch-up contribution limits (if you or your spouse is over 50).
- Convert from traditional to Roth IRAs.
- Find out if your employer plans to offer the new Roth 401(k) or 403(b) plan, and whether it is right for you (see page 6 for more details).
- Determine distributions from retirement accounts correctly, particularly with early distributions and required minimum distributions for those over age 70½.

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Federal limits on 401(k) contributions continue to grow



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Why Is December So Important for Small Businesses? As a small business owner, you have several immediate opportunities for tax savings, beginning with a review of how your business is organized. While S Corps and Limited Liability Corporations have typically offered tax advantages over C Corps in the past, a new tax rate for qualified dividends lessens the disadvantage of double taxation. Among other items, the Section 179 deduction for capital purchases that would otherwise have to be depreciated stands at \$105,000, and can be applied to purchases of

up to \$420,000. This limitation drops back to \$25,000 after 2007, making *now* the right time for these purchases.

Establishing employee benefit plans, qualified retirement plans, and medical or health reimbursement plans can also provide your business with significant tax savings. Manufacturers (and many other business) should look at lightening their tax load with the domestic production activities deduction. (Read more about it on the back cover.) In addition, it makes sense for some sole proprietorships to put family members on the payroll. Children, for example, can earn

up to \$5,000 tax free — and invest their funds in a Roth IRA — while your business is not subject to FICA on wages paid to children under age 18. If your business operates out of your home, talk to your GH&G advisor about how to maximize the home office deduction, as well as deductions for travel costs between home and clients.

By evaluating how the latest round of tax law changes impacts you, you'll be sure to begin the new year in the best possible financial shape. Your GH&G advisor is ready to answer any questions. ☑



Thirteen Steps Toward a Well-Planned Retirement

Ready or not, here it comes.

As millions of baby boomers approach retirement, we are reminded of the classic Aesop fable about the carefree, live-for-the-moment grasshopper versus the industrious, plan-ahead ant.

Life is all about balance. You want to have some fun along the way, but it's also vital to set aside time and resources for days that lie ahead. As you will see, there are many challenges to developing a well-planned

retirement. Mistakes made as you near retirement can be particularly damaging, in that you may not have the necessary time horizon to correct them. With so much to gain — or lose — your fee-only investment advisor can be a powerful ally in your efforts.

Below is a baker's dozen of tips to help maximize the efficiency of your retirement planning.

Faulty planning as you near retirement can be particularly damaging. You might not have the necessary time horizon to correct it.

1. Start saving early.
2. Develop a plan.
3. Assume modest rates of return.
4. Be extra cautious during the first few years of retirement.
5. Carefully assess your spending and tax requirements.
6. Plan to live long.
7. Assess your risk tolerance — and build your portfolio accordingly.
8. Plan for potential early retirement.
9. Be aware of the risks of inflation and other cost of living increases.
10. Remember that retirement is a family affair.
11. Minimize your risk with the right tools.
12. Maximize your Social Security benefits.
13. Consider setting up your IRA to benefit your beneficiaries.

The above information is a summary of an article that appeared in the summer 2005 issue of the *Educated Investor*. The *Educated Investor* is a quarterly newsletter available from Credo Investment Advisors, LLC, a fee-only registered investment advisory firm managed by Tom Shea, CPA/PFS, in our Bozeman office. For a full copy of this article or to learn more about Credo, please contact Tom at 406-586-2386 or tom@ghg-cpa.com.

COMPARE YOUR PLAN CHOICES.



Adding Roth Features to Your 401(k)

Trad 401(k) vs. Roth 401(k)

#1 Same tax rate today vs. retirement; no effect

Compensation to save
4,000 vs. 4,000

Less Taxes @ 25%
0 vs. -1,000

Amount invested
4,000 vs. 3,000

Investment earnings*
14,644 vs. 10,983

Value accumulated
18,644 vs. 13,983

Less Taxes @ 25%
-4,661 vs. 0

TOTAL
13,983 vs. 13,983

#2 Lower tax rate today vs. retirement; Roth is better

Compensation to save
4,000 vs. 4,000

Less Taxes @ 20%
0 vs. -800

Amount invested
4,000 vs. 3,200

Investment earnings*
14,644 vs. 11,715

Value accumulated
18,644 vs. 14,915

Less Taxes @ 25%
-4,661 vs. 0

TOTAL
13,983 vs. 14,915

#3 Higher tax rate today vs. retirement; traditional 401(k) is better

Compensation to save
4,000 vs. 4,000

Less Taxes @ 25%
0 vs. -1,000

Amount invested
4,000 vs. 3,000

Investment earnings*
14,644 vs. 10,983

Value Accumulated
18,644 vs. 13,983

Less Taxes @ 20%
-3,729 vs. 0

TOTAL
14,915 vs. 13,983

*20 years at 8%

Are Roth contributions the right choice? The answer to this depends upon your specific situation.

Steven A. Blom, CPC, QPA – Retirement Planning

Many people will soon have the choice between traditional 401(k)s and Roth 401(k)s through their workplace, thanks to a provision of the Economic Growth & Tax Relief Reconciliation Act (EGTRRA) of 2001 that takes effect January 1, 2006.

Roth or Traditional 401(k) Features. Will Roth 401(k) contributions be the right choice for you? The answer to this depends upon your specific situation. Traditional 401(k) accounts offer more immediate savings, since you don't pay state or federal income tax on contributions. The entire amount grows, tax-deferred, and is then subject to ordinary income tax upon withdrawal in retirement. A Roth 401(k), on the other hand, does not provide any immediate tax savings. Instead, earnings are withdrawn tax-free in retirement for qualified distributions. (Qualified distributions are those made after age 59½ or upon disability or death, *and* after you've had the Roth 401(k) account for at least five years.)

But there are other considerations as well. A Roth 401(k) might help you avoid income tax on Social Security benefits in retirement. Social Security benefits become taxable if taxable income plus half of your Social Security exceeds \$25,000 for a single taxpayer (or \$32,000 for married taxpayers filing jointly). Traditional 401(k) withdrawals are added to the taxable income tally, while Roth 401(k) withdrawals are not.

Traditional and Roth 401(k) plans share some features: Both prohibit withdrawals prior to age 59½ for active employees, except for financial hardships or certain types of loans. Minimum distribution

rules also apply to both, meaning that you generally have to begin withdrawing the funds after you turn age 70½. However, Roth 401(k) contributions can eventually be rolled into a Roth IRA, which does not have minimum distribution rules. Assets can then be preserved with no income tax liability for beneficiaries.

Weighing the Options. If your tax rate is the same now as it will be in retirement, the choice is probably equal. However, if your tax rate is lower now than it will be, a Roth 401(k) is the best choice. Conversely, if your tax rate is higher now than in retirement, a traditional 401(k) is a better fit. Whichever plan you choose, bear in mind that the annual limit has been upped to \$15,000 for 2006. Catch-up contributions are also available for anyone age 50 or over (the catch-up limit for 2006 is \$5,000).

To take advantage of this new provision, employers

Generally, if your tax rate is lower now than it will be, a Roth 401(k) is the best choice. Conversely, if your tax rate is higher now than in retirement, a traditional 401(k) is a better fit.

must amend their existing plans no later than the last day of the first plan year for which Roth 401(k) contributions are made available. The IRS is expected to finalize regulations on the new Roth 401(k)s soon (this article is based on proposed regulations as they exist today). As with the other provisions of EGTRRA, this provision will expire after 2010 unless further legislation makes it permanent. If you have questions, please contact the retirement plan services team at GH&G.



Sound estate tax planning starts with knowing overall family goals.

Pat Ellis, CPA – Bozeman Office

Recently I met with a married couple to discuss estate planning. I opened our discussion with a basic but important question: “What objectives do you hope to accomplish with an estate plan?” Their answer didn’t surprise me, because I’ve heard it from other families before: “We want to make sure the government doesn’t take too much of our estate for taxes when we die.” While avoiding or minimizing estate tax is certainly an important objective, I sensed that it only scratched at the surface of the couple’s deeper concerns.

So my next question was: “Pretend that we live in a world without estate taxes. What, then, would your objectives be?” And not surprisingly, the couple began describing their other goals, which really had nothing to do with taxes and everything to do with making tough decisions easier for their family.

In short, they wanted to lighten the burden that would be placed on family members if either of them died or became incapacitated. I told them about several important documents that could assist them in achieving these goals. These three documents — regardless of a person’s age or size of estate — can help enormously with planning for the future.

Minimizing Estate Taxes?

Think Bigger.



The Living Will Document. This document lets you specify what life-saving measures you wish to receive (or not) in the event of your incapacity. A Living Will only takes effect if you become incapacitated *and* have a terminal condition. A physician must determine that your condition is terminal and irreversible, generally meaning that without life support, death would occur in a short time period. A Living Will gives your family clarity in making otherwise difficult decisions about your medical care.

needs are met and their emotional burden is lessened.

Who Do I Choose? This is a question only you can answer. Many people look to a spouse first, then to one of their children. My advice is to choose a family member who is most likely to know what *you* would do — and be capable of doing it. Only you can decide who can best “walk” in your shoes. It’s not an honorarium; it’s an assignment.

In the case of the couple that came to me about avoiding estate taxes, we determined that their estate was below the level where estate taxes were of concern. For them, as for many clients, estate planning meant planning for uncertainties and eventualities so that their family wouldn’t have to later. Together, we worked with a lawyer to prepare documents that gave them full control over who would make important decisions when they were no longer able to. While GH&G does not prepare these documents, we hope you’ll involve us in this important stage of your estate planning.

If you think about it, your financial goals don’t have much to do with taxes. They have everything to do with your family.

The Durable Power of Attorney Document. The Durable Power of Attorney document ensures that your family can carry on your personal and financial affairs in the event that you cannot. It empowers another person to conduct your personal and financial affairs. The term “durable” is important because it means these powers continue in the event of your incapacitation.

The Health Care Power of Attorney Document. While the Durable Power of Attorney grants someone the power to govern your financial affairs, a Health Care Power of Attorney allows you to appoint a person to direct your medical care. In conjunction with a Living Will, the Health Care Power of Attorney provides your family with guidelines and limitations so that *your* desired medical

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INDUSTRY FOCUS: Builders, Manufacturers, Other “Producers” Get Ready for a New Deduction

What’s the Production Deduction? Answer: Great news for builders, ranchers, engineers and more.

Garry Spitzer – Bozeman Office

What do architects and grain growers have in common? The new “production deduction,” which kicks in this year. This deduction applies to construction activities in the U.S.; engineering and architectural services for projects in the U.S.; and any sale or lease of property manufactured, produced, grown or extracted within the U.S. The deduction amounts to three percent of net income for years 2005 and 2006; six percent for 2007, 2008 and 2009; and nine percent after 2009.

For many of our clients, the deduction will be a straightforward calculation. For businesses involved in *both* a qualifying activity and a non-qualifying activity, the computation becomes more difficult. For example, if you are growing grain and also have a grain-hauling business, the hauling is a nonqualifying activity, and

expenses must be allocated between the two activities, with the profit from each determined. For businesses with both qualifying and nonqualifying activities, it’s never been more critical to maintain records that differentiate the sources of net income.



The deduction is limited to 50 percent of the business’ qualifying wages for the year, making it a bit harder for sole proprietors and partnerships with little or no wages to qualify. In some cases, paying small wages to family members merits your consideration. Talk to your GH&G advisor about how the new production deduction can work for your business.

IRS Circular 230 Disclosure Statement

In accordance with Internal Revenue Service Circular 230, any advice contained in this correspondence is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed upon the taxpayer by the Internal Revenue Service. If you wish to rely on our advice to avoid the imposition of IRS penalties, we would be pleased to discuss expanding the scope of our correspondence. Please contact your tax advisor for more information.

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