

Barto, Hoss & Company, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

Dear Client:

As the end of the year approaches, it is a good time for you to engage in tax planning. You know your tax picture from earlier in the year and you have a pretty good idea of what it will be for the rest of the year. With that knowledge in hand, you are now in a position to take various actions that may save taxes for this year, next year, or both years.

Please note the optional financial planning survey provided on the insert panel.

A recent flurry of tax legislation may have an impact on your year-end tax planning for 2005. For example, the Energy Tax Incentives Act of 2005 provides a new tax credit for making certain energy-saving improvements around the house. But the new credit is not available until 2006, so you may want to hold off on the improvements if possible.

The Katrina Emergency Tax Relief Act of 2005 (KETRA) was signed into law on Sept. 23, 2005. KETRA is the first of two planned legislative initiatives dealing with the aftermath of Katrina. The second initiative will include stimulus provisions, such as accelerated depreciation and enhanced expensing, to encourage rebuilding of the vast area decimated by Katrina. KETRA, however, is designed to provide more immediate tax relief to help families recover from Katrina and to encourage Gulf Coast businesses to reopen their doors and keep employees on the payroll. An individual's Katrina casualty losses are deductible without regard to the \$100-per-casualty and 10%-of-adjusted-gross-income floors.

Despite its title, the Katrina Emergency Tax Relief Act of 2005 (KETRA) does not afford relief to just taxpayers in those parishes and counties designated as disaster areas by the President. Some of KETRA's relief provisions apply to taxpayers whether or not they are located in the Katrina disaster area, including, for example, allowing taxpayers to claim bigger charitable deductions than in the past because the Act lifts restrictions that limited the deductions. But it's only a temporary reprieve; the restrictions return after December 31, 2005. So you may want to consider accelerating your charitable donations from 2006 to 2005.

KETRA contains several expanded tax breaks to encourage charitable giving:

- *Increased charitable deduction limits.* An individual's cash donations whether Katrina related or not to charities made between Aug. 28, 2005 and Dec. 31, 2005, are exempt from the 50% of adjusted gross income (AGI) limit and the AGI-based phase-out of itemized deductions.

Corporate cash donations related to Hurricane Katrina and made between Aug. 28, 2005 and Dec. 31, 2005, aren't subject to the 10% of taxable income limit.

- *New limited exemption for housing Katrina victims.* Individuals may claim a \$500 exemption deduction for providing at least 60 days of temporary rent-free housing to a person dislocated by Katrina. The deduction can be claimed in 2005 and 2006, but cannot be claimed in both years with respect to the same person, and is capped at \$2,000.
- *Charitable standard mileage rate for Katrina relief increased to 70% of business mileage rate.* Effective during the period of Aug. 25, 2005 to Dec. 31, 2006, the mileage rate for charitable use of a vehicle increases from 14¢ per mile to 70% of the standard business mileage rate (currently 48.5¢ for the last four months of 2005). Thus, from Sept. through Dec. of 2005, the charitable standard mileage rate for Katrina relief is 34¢ ($48.5¢ \times .7 = 33.55¢$, rounded to 34¢).
- *Volunteers for charities may exclude from income mileage reimbursements for operating a passenger car for the charity's benefit.* Effective for tax years ending after Aug. 24, 2005, reimbursements by a charity for charitable use of an automobile in connection with providing donated services for Hurricane Katrina relief during the period of Aug. 25, 2005 to Dec. 31, 2006 are tax-free. However, the reimbursement can't exceed the business standard mileage rate, and the substantiation requirements applicable to business expenses deducted by employees must be satisfied.

There are other tax law changes taking effect at the beginning of 2006 that you should take into account in your end-of-2005 planning. For example, a deduction for college tuition is scheduled to go off the books unless Congress extends it. You may want to prepay in 2005 tuition not due until early 2006 if that lets you increase your tax savings from the expiring deduction.

Also, on January 1, 2006, the deduction for buying a hybrid automobile converts to a tax credit that's probably more valuable to auto buyers than the deduction. So if you are thinking about buying a hybrid, you may want to delay your purchase until 2006. Also, whether you are buying a hybrid or a regular car, you should think about the sales tax deduction.

For 2005, you can deduct state and local sales taxes in lieu of state and local income taxes. Unless the law is changed, for 2006, you won't have the choice; you'll only be able to deduct income taxes. So if you are deducting sales taxes this year and are planning to buy a car soon, you may want to push the purchase into 2005 to increase your sales tax deduction. This works because the deductible sales tax amount from the IRS's optional sales tax table is increased by the sales tax paid on a purchased or leased motor vehicle (which not only includes cars, but also motorcycles, motor homes, recreational vehicles, SUVs, trucks, vans, and off-road vehicles). Also, you may add to the table amount, sales tax paid on an aircraft, boat, home (including mobile or prefabricated), or home building materials. So these items also may be suitable for purchase this year.

We have compiled a checklist of actions that may help you to save taxes if you act before year-end. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

- Increase the amount you set aside for next year in your employer's health flexible spending account if you set aside too little for this year. Don't forget you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids. Also, new rules allow your plan to permit a grace period after year-end for using remaining amounts.
- If you have any capital gains or losses from sales of stock or other capital assets or you have stock or other capital assets that are ripe for sale, it may be advisable for us to meet to discuss how you can best coordinate timing your gains and losses to minimize tax on your gains and maximize the tax benefit from your losses.
- It may be advantageous to try to arrange with your employer to defer your bonus until 2006.
- If you own an interest in a partnership or S corporation you may need to increase your basis in the entity so you can deduct a loss from it for this year.
- Consider using a credit card to prepay expenses that can generate deductions for this year.
- You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.
- Business clients also should consider making expenditures that qualify for the \$105,000 business property expensing option.
- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.
- You may be able to save taxes this year and next year by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.
- Those facing a penalty for underpayment of estimated tax may be able to eliminate or reduce it by increasing their withholding.
- Self-employed individuals should consider setting up a self-employed retirement plan.
- You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give \$11,000 in 2005 to an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. Note that the annual exclusion amount increases to \$12,000 for 2006.
- If you're thinking of donating a used auto to charity, you may want to inquire whether the charity plans to sell the car or use it in its charitable activities; the latter may yield a bigger deduction for you.
- If you are contemplating marriage or divorce consider how marriage penalties could affect you. Marriage penalty relief has been extended for the 15% tax bracket and the standard deduction but other marriage penalties remain.

- Consider extending your subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job-related courses, etc., to bunch into 2005 miscellaneous itemized deductions subject to the 2%-of-AGI floor.
- Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2006, electing to deduct investment interest against capital gains, and disposing of a passive activity to allow you to deduct suspended losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

IRS Circular 230 requires us to inform you that any statements contained in this letter are not intended or written to be used, and cannot be used, by you or any other taxpayer, for the purpose of avoiding any penalties that may be imposed by federal tax law.