



SENGER
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To Our Clients and Friends:

With 2006 just around the corner, it's time to get your year-end planning and tax preparation in gear. This newsletter provides year-end tax strategies that can help you minimize your tax liability.

It's hard to believe that 2005 is winding down. From myself and the staff at Senger & Associates, P.C. we would like to wish all of you a happy upcoming holiday season. We appreciate having you as our client and look forward to continued service to you. We also appreciate the confidence you have placed in our Firm by referring your business associates, family and friends.

Senger & Associates, P.C. continues to offer individual, corporate, partnership, and estate tax return services as well as tax and retirement planning. We also offer payroll and computerized bookkeeping services for business as well as audit and review services for both business and not-for-profit clients. For clients who keep their financial statement records internally, we offer software support for QuickBooks.

The following is a checklist that might help you save taxes if you act before the year's end. Not all strategies will apply to everyone, but many clients will benefit from more than one item. Not all strategies are listed either. Don't miss the opportunity to reduce your tax burden by not planning ahead. We offer year-round tax planning services and can help you make the most of available strategies.

We would also like to remind you about our website www.sengercpa.com. This site has individual and business tax tips as well as IRS forms and other tax information. It also has calculators from mortgage payments to retirement plans. Please check it out.

TAX TIPS FOR INDIVIDUALS

1) **Remember**, if you do not have enough deductions to **itemize**, consider bunching your deductions every other year. The standard deduction for joint filers has increased from \$9,700 to \$10,000, and single filers from \$4,850 to \$5,000, which will make it harder to itemize.

2) **The best income tax tip for most people** is to **maximize your 401(k) deductions**. The deductions lower your taxable income and all earnings are tax-deferred until distributions are received after your retirement. If your employer offers a matching contribution, you have an immediate tax-deferred return on investment as well as a reduction of your wages on your

W-2. Another benefit to consider is that any money in your 401(k) account is protected by law against creditors. So if you are ever hit by a lawsuit or have to file bankruptcy, your 401(k) money is safe. **CAUTION:** IRAs do not have the same protection against creditors that 401(k) plans have.

3) **The maximum contributions to regular and Roth IRAs** will increase over four years to \$5,000 in 2008. The limit will be \$4,000 in 2005 through 2007, and \$5,000 in 2008 and later, with inflation adjustments after 2008. If you are over the age of 50, an extra \$500 can be added on.

4) Take advantage of your company's cafeteria plan and other tax-free benefits. The dependent care credit only gives you a tax credit of 20% of your child-care expenses, but through your company's cafeteria plan you will be getting a tax benefit equal to the federal tax bracket you are in as well as a reduction of your state income tax and your portion of social security and Medicare tax of 7.65%. Another example is medical expenses. Medical expenses can rarely be taken on Schedule A due to the 7.5% of AGI limitation, but through your company's cafeteria plan, you can fully deduct your medical expenses from your W-2 wages. The only catch is that if your unreimbursed medical expenses for the year are less than what you set aside from your wages, the difference is forfeited. The definition of what constitutes as qualified medical expenses is very broad so make sure to visit your dentist, optometrist, acupuncturist, chiropractor, etc. in December if you haven't used all of your current medical expense contributions.

5) The child ("kiddie") credit for children under age 17 is \$1,000 per child. This phase out begins when modified AGI reaches \$75,000 for singles, or \$110,000 for couples.

6) Don't overlook minimum distributions at age 70 1/2 and rack up a 50% penalty. Minimum distributions from qualified retirement plans and IRAs must begin by April 1 of the year after the year in which you reach age 70 1/2. The amount of the minimum distribution is calculated, based on your life expectancy or the joint and last survivor life expectancy of you and your designated beneficiary. If the amount distributed is less than the minimum required amount, an excise tax equal to 50% of the amount of the shortfall is imposed.

7) The official per-mile rate for business use of a car rises to 40.5 cents for January-August, and 48.5 cents for September-December. Charitable mileage rate is 14 cents, and the rate for medical and moving is 15 cents for January-August, and 22 cents for September-December.

8) The health-insurance deduction for the self-employed is 100% in 2005. Employees who pay for their own health coverage still get only an itemized deduction subject to 7.5% of AGI.

9) Planning for your Investments. For 2005, long-term capital gains and qualifying dividend income are subject to a tax rate of only 15% for taxpayers in a regular tax bracket of 25% or higher and 5% for taxpayers in the lower regular tax brackets. Given tax rates as high as 35% for other types of income, this is quite a break. Here are some ways to capitalize on it.

Lower Tax Rates on Dividends. The favorable tax rates (15% or 5%) might make dividend-paying stocks more attractive than they were in the past when dividends were taxed at ordinary income rates. This may cause you to reconsider the make-up of your investment portfolio. While dividends paid by domestic corporation generally qualify for the lower rate, not all foreign corporation dividends do.

Lower Tax Rates on Capital Gains. To be eligible for the lower 15% (or 5%) capital gain rate, a capital asset must be held for more than a year. So, when disposing of your appreciated stocks, bonds, investment real estate, and other capital assets, pay close attention to the holding period.

Harvesting Capital Losses. It's always a good idea to periodically review your investment portfolio to see if there are any losers you should sell. This is especially true as year-end approaches, since it's the last chance to offset capital gains recognized during the year or to take advantage of the \$3,000 (\$1,500 for married separate filers) limit on deductible net capital losses. But, don't forget the wash-sale rule. This rule defers your loss if you purchase a substantially identical security within the period beginning 30 days before and ending 30 days after the date of sale.

10) Strategies for Education Expenses. There are many tax breaks for education related expenses. If you or members of your family are incurring these types of expenses, now or in the near future, it's worth examining them a bit more closely.

Tuition Deduction. In 2005, you can deduct up to \$4,000 of college tuition and related expenses, provided your adjusted gross income (AGI) is no more than \$130,000 (for joint filers) or \$65,000 (for single and head-of-household filers). If your AGI exceeds these limits, you can still deduct up to \$2,000 of such expenses as long as your AGI does not exceed \$160,000 (for joint

filers) or \$80,000 (for single and head of household filers).

Education Credit Planning. If you pay college or vocational school tuition and fees for yourself, your spouse, or your children, you might be eligible for either the Hope Scholarship Credit or the Lifetime Learning Credit. These credits reduce taxes dollar-for-dollar, but begin to phase out when 2005 AGI exceeds \$87,000 for married filers and \$43,000 for other taxpayers. The credits phase out completely when AGI exceeds \$107,000 and \$53,000, respectively.

The Hope credit is only available during a student's first two years of college and equals 100% of the first \$1,000 of tuition

and 50% of the next \$1,000, for a maximum annual credit of \$1,500 per student. The Lifetime Learning Credit, on the other hand, is available without regard to the year of study, but is a per return (rather than a per student) credit, computed at the rate of 20% on up to \$10,000 of qualifying expenses for a maximum annual credit of \$2,000.

II) Gifts. To avoid capital gains, you may want to consider giving appreciated property to children or grandchildren if they are in a lower tax bracket than your own. For 2005, each person is entitled each year to give gifts of \$11,000 to an unlimited number of donees without incurring any gift tax.

YEAR-END PLANNING FOR YOUR BUSINESS

Expense the Cost of More than \$105,000 of Business Property. The Section 179 deduction allows business owners to deduct up to \$102,000 of the cost of qualifying depreciable property placed in service for 2004. Property eligible for the immediate tax write-off can be new or used and included "off-the-shelf" computer software. Even property purchased on the last day of the year qualifies. However, the allowable deduction cannot exceed your business' net income and is reduced dollar-for-dollar to the extent the amount of qualifying property placed in service during the year exceeds \$410,000. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property, you might consider doing so before year-end to maximize your 2004 deduction.

Equipment Purchases. A popular strategy in recent years is to purchase a vehicle (usually an SUV) for business purposes that exceeds the depreciation limits set by statute (i.e., a vehicle rated over 6,000 pounds). Doing so would not subject the purchase to the statutory dollar limit, \$2,960 for 2005; \$3,260 in the case of vans and trucks. Therefore, the vehicle would qualify for the full equipment expensing dollar amount. However, for SUVs (rated between 6,000 and 14,000 pounds gross vehicle weight) placed in service in 2005, the expensing amount is limited to \$25,000.

Employ Your Child or Grandchild. Employing your children or grandchildren shifts income from you to them, which typically subjects the income to the child's lower tax bracket and may actually avoid tax entirely (due to the child's standard deduction). There are also payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA.

When employing your child or grandchild, keep in mind that the wages paid must be reasonable given the child's age and work skills. Also, if the child is in college or entering soon, excessive earned income may have a detrimental impact on the student's eligibility for financial aid.

Accelerate Deductions and Defer Income. Virtually any taxpayer, in any year, can benefit from strategies that accelerate deductions or defer income based on the premise that it's generally better to pay taxes later than sooner. For example, cash-basis sole proprietors might delay year-end billings so that they fall in the following year or accelerate business expenditures to the current year. On the investment side, income from short-term CDs is not recognized until maturity. Income from those straddling year-end is deferred to the following year.

Roth 401(k)s. In 2006 employers can offer a great new benefit; Roth 401(k)s funded by payroll deductions. Roth pay-ins are non-deductible and must be segregated from deductible pay-ins to other accounts. There also will be no income limits on pay-ins to Roth 401(k)s like those on regular Roths.

1099's. Form 1099 must be filed by January 31, 2006 and sent to those to whom your business paid out more than \$600 for rent, interest, or services. Should you get audited, this is one of the first areas in which they will check.

CONCLUSION

Taking the time now to review your 2005 tax situation gives you a chance to take advantage of many year-end tax saving opportunities. This letter highlights selected strategies, but there are many others that might also apply to your particular situation. We are here to help. If you would like to discuss the strategies mentioned here or other ideas for reducing your 2005 tax liability, please don't hesitate to call us. We would be pleased to set up a meeting within the next few weeks while there's still time to implement tax strategies before year-end. For your convenience, worksheets are enclosed to help gather necessary tax preparation information. The use of these worksheets generally allows us to speed up the processing of your return. Please remember to call us early to set up an appointment and to give you time to collect additional information if required.

Sincerely,

Senger & Associates, P.C.