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We are pleased to provide you our online informational newsletter which we believe you will find of interest. Each month brief articles on relevant topics will be included, along with a tax calendar for the current and following months.

STAFF HIGHLIGHT

As part of our bulletin, we are continuing to highlight a couple of our team members. This month, we would like to introduce you to Sandra King and Sandy Care both of whom have been with our firm for over four years.

Sandra King is a Level III staff accountant with over 25 years experience in the accounting field. Her present duties consist of compiling financial statements and preparing payroll tax returns for a variety of business clients. As part of business accounting services, Sandra also prepares individual income tax returns and assists on special projects.

Prior to joining Cohen, Smith & Company, CPAs, Sandra was a partner in an accounting firm in Deltona for over eleven years and performed many of the same services. Sandra resides in Deltona with her significant other, Dale. Her personal interest include traveling, camping, riding her "Harley," white-water rafting, bird watching and canoeing.

Sandy Care is a member of our administrative team. She performs various administrative functions including scheduling, word processing, preparing tax returns for delivery, processing payroll and check writing. Her previous employment included customer service, computer system management and data entry in the printing industry.

Sandy has been married to Scott for 22 years and they reside in Deltona. In her spare time, she enjoys spending time with her husband, working outdoors, reading and walking.

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Reminder: The Importance of Long-Term Savings

With the Social Security debate in full swing, now is a good time to rethink the power of long-term savings strategies.

Although Social Security benefits currently provide the average retired worker with approximately 39% of pre-retirement income, it is impossible to know what the future will bring. No matter when or how Social Security is changed, you can count on some basic savings tips to help prepare for a comfortable retirement.

Even with interest rates at historic lows, some experts are starting to notice an inch-by-inch upward trend. The time value of money may not have seemed important to your overall savings plan recently, but it remains critical to consider the value of compounding interest as an integral part of your long-term savings plan.

The power of compounded interest

Nothing lowers your chances of building a solid savings base than tapping into your reserves too soon. If you follow a strict policy of making periodic investments, you will eventually see your interest earning interest. When interest earned is reinvested into the account instead of being paid out to you, the interest itself earns interest during the next interval for computing interest.

The earlier you start, the further your savings go

Sometimes examples speak louder than explanations. Consider the following comparison of what you'd have now if you had put \$100 a month away for the past 15 years versus the past 30 years:

	Save for 15 Years	Save for 30 Years
Savings per month	\$100	\$100
Number of months	180	360
Years saved	1990-2005	1975-2005
Interest Rate	7%	7%
Value of savings in 2005	\$18,000 grew into \$31,696	\$36,000 grew into \$121,997

The lesson here is obvious: Start seeding your savings, or that of your younger family members, as soon as possible.

Stay motivated: The "Rule of 72"

You can use a different method to estimate how long it will take your investment to double; by using the "Rule of 72." Simply divide the number 72 by the percentage of interest you earn, or plan to earn, on your investment. The result is the number of years it will take to double your initial investment:

$$\frac{72}{\text{Your interest rate}} = \text{Years it will take to double your investment}$$

What greater motivation could you need than visualizing a 100% return on your investment?

Please note: The "Rule of 72" is a tool, not an exact measure, because investment returns fluctuate.

Deductions for HSA Contributions Increased for 2005

If you have high annual deductibles on your health insurance, opening a health savings account (HSA) may be the best way to cover those costs while gaining tax benefits. You can receive an "above-the-line" deduction for contributions made to your HSA, and the deduction rates have risen slightly from 2004. HSAs are a relatively new health savings vehicle; they have only been available since January 1, 2004, as a result of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

HSA eligibility

HSAs are available to anyone who is not eligible for Medicare and is covered by a "high deductible" health insurance policy with an annual deductible of at least \$1,000 for individual coverage or \$2,000 for family coverage. To be eligible to open an HSA, you must not be eligible for Medicare. Additionally, the high-deductible policy must be your only health insurance, with limited exceptions for (1) individuals who participate in certain flexible or reimbursement arrangements; and (2) those who have a qualifying separate plan for prescription drug benefits. There are no income limits that affect your HSA eligibility, but you may not receive all the tax benefits HSAs offer if you do not file a federal income tax return. Finally, you cannot be claimed as a dependent on someone else's tax return.

Benefits of opening an HSA

Your HSA contributions are deductible "above the line," meaning you can reduce your taxable income without itemizing. Unlike other tax-favored health plans, you are not required to spend all of the money in your HSA by the end of the year. Better still, the interest and investment earnings in the HSA are not taxable, allowing unused contributions to grow tax-free. Employer contributions to your HSA through a cafeteria plan are also excluded from income. You may take tax-free distributions from your HSA so long as you use the money to pay for "qualified" medical expenses.

Another benefit is that your HSA is portable, allowing you to take it with you to a new job. Contributions to an HSA must be made in cash (that is, not with stocks or other property) and can be made through April 15, 2006, for the 2005 tax year.

2005 HSA deduction rates

The maximum deduction for contributions to a health savings account has risen for tax year 2005 to the lower of your insurance policy's deductible or \$5,250 for a family plan and \$2,650 for an individual plan (up from \$5,150 and \$2,600 in 2004). Individuals aged 55 and older may deduct an additional \$600, bringing the total deduction to \$5,850 for family coverage and \$3,150 for individual coverage.

Poor Health and Your Home: The Tax Connection

If you own your own home, you're probably familiar with the special tax rule that lets you exclude the gain from the sale of your primary residence. To take advantage of this exclusion, the IRS requires you to have lived in your home for at least two years within the five years prior to the sale date. Married couples that file a joint return may exclude \$500,000, and individual taxpayers get a \$250,000 exclusion.

Another, lesser known, exclusion

There are other, lesser exclusions if you sell your house far "too soon" because of unforeseen circumstances, divorce, or financial hardships.

But a lesser-known exclusion-the health exclusion-may be one of your strongest cases for getting an "early" exclusion. The exclusion amount is computed as a percentage of the regular exclusion rate (either the \$500,000 or \$250,000 rates mentioned above), expressed as the number of months you owned your home as your primary residence divided by 24 months.

Example

Assume that a homeowner purchased his home January 30, 2005 for \$300,000. He sells his home on July 30, 2005. He owned the house and lived in it as his primary residence for six months. If the sale was precipitated by a bona fide health reason, he will be able to exclude up to \$125,000 in gain on a joint return (one-quarter of the \$500,000 exclusion). Note that an additional adjustment may have to be made if he sells another primary residence (with gain) within two years of this sale.

By IRS definition, your home is sold for "health" reasons if

. . . . Your primary reason for the sale is to obtain, provide, or facilitate the diagnosis, cure, mitigation, or treatment of disease, illness, or injury of a qualified individual (such as your child). Health is considered to be the reason you sold your home if a doctor recommends a change of residence.

It would be prudent to obtain a doctor's recommendation, in writing, to help substantiate that the sale was brought on by health reasons for you or for a member of your family.

Please consult our office to handle the intricacies involved with obtaining this exclusion, as well as for information on the other lesser-known exclusions on the gain of the sale of your home.

Bankruptcy Legislation: Change is in the Air

You cannot watch a TV newscast or read the papers these days without encountering a story on the federal bankruptcy legislation that's made its way through Washington. On April 14, 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (S.256), also known as the Bankruptcy Reform Act, which the President signed into law on April 20. While it's a challenge to keep up with all of the twists and turns in the news on bankruptcy, it's even tougher to know how this legislation will affect you.

One thing is for certain: Changes in federal bankruptcy law will have a major impact on both individuals and businesses. Most of its provisions will be effective 180 days from the day it was

signed into law.

Bankruptcy, defined, by chapter

Mark Twain filed for bankruptcy protection. So did Walt Disney, as did Milton Hershey, P.T. Barnum, Kim Bassinger, Burt Reynolds, and, yes, even Henry Ford. Approximately 1.6 million Americans did it just last year alone. Bankruptcy is a process that takes place in federal court. It was designed to help individuals and businesses eliminate or repay their debts under bankruptcy court protection. Generally, there are two types of bankruptcies-liquidation and reorganization-which are addressed in various chapters of the U.S. Bankruptcy Code. For liquidation style bankruptcies, property is sold to pay debts, whereas payment plans are created under reorganization bankruptcies. Chapter 7 covers liquidations for both personal and business bankruptcies, and Chapters 11, 12, and 13 cover reorganization bankruptcies.

While no two bankruptcy situations are exactly the same, individuals and businesses typically file under only certain chapters of the U.S. Bankruptcy Code, the names of which get tossed around a lot without too many people understanding the references. Following is a quick overview of some of the chapters:

U.S. Bankruptcy Code

Protection offered

Who it protects

Chapter 7

Liquidation-a bankruptcy estate is formed from your personal property, except for certain types that are exempt from the bankruptcy estate, the proceeds of which are used to pay creditors. Most types of debts are then cancelled.

Chapter 11

Reorganization of debts to keep a business in business. Debtors may retain income earned after filing for bankruptcy while using only assets held at the time of filing to pay past debts. Covers corporations and certain individuals (those with debts greater than those that would be covered by Chapter 13 or of over approximately \$1.2 million).

Chapter 12

Debt reorganization.

Covers farms (extended under the new law to include family commercial fishing operations and aquiculture).

Chapter 13

Debt reorganization.

Repayment plan is set up to pay a portion of the debt and individuals can be forced to allocate disposable income to the plan. The debtor usually keeps his or her personal property. Covers individuals only (including sole proprietors, but not partnerships or corporations) with regular

income.

Fewer Chapter 7's on the horizon

Filing under Chapter 7 has become more difficult. Currently, almost 70 percent of individuals who file for bankruptcy do so under Chapter 7, according to the American Bankruptcy Institute.

Generally, under the new law, a Chapter 7 case will be converted to Chapter 13 if the debtor can pay the lesser of (a) \$10,000 or (b) the greater of (1) 25 percent of unsecured, non-priority debt or (2) \$6,000. A debtor will be able to rebut the means test by demonstrating special circumstances and certain "safe harbor" exemptions may apply.

That means that even if a debtor is \$100,000 in debt and can only afford to pay \$100 a month, as determined by the court, the debtor probably will no longer be able to file Chapter 7. The repayment will be structured under a Chapter 13 plan that spans five years (debtors with income that is less than the state median will pay over a three-year period). A Chapter 13 debtor will be permitted to deduct from plan payments the costs of health insurance, domestic support obligations, expenses to operate a business, and charitable contributions of up to 15 percent of gross income.

Some tax-related information

Non-dischargeable debts now include state and local taxes. Federal taxes were non-dischargeable prior to the enactment of the new law. Along with other documents required under prior law, debtors must now submit copies of tax returns, payroll stubs, and other documents with the petition for bankruptcy.

Saving your home

Under federal bankruptcy law, debtors can shield a portion of the equity in their homes from unsecured creditors. And under the new legislation, debtors who can choose a state homestead exemption over the federal exemption will be bound by a prior state of residence for two years after moving to a more generous state. Under the new legislation, a debtor must have lived in the state for at least 40 months to qualify for the full state homestead exemption. If the debtor has not been in his or her home for the required number of months, the new bill limits the homestead exemption to \$125,000.

Saving your car

Debtors will now be required to pay the full amount owed on a car loan, regardless of the condition of the car. Previously, the debtor would only have to pay what the car was worth to keep it. For many drivers with unpaid auto loans, this means that its payoff amount may far exceed its current market value, introducing a major change in bankruptcy law.

Saving your business

Before these bankruptcy changes, small businesses with a lot of debt could have filed under Chapter 7, giving them a chance to begin anew in about four months. Because the new law makes filing a Chapter 7 much more difficult, many businesses will have to file under Chapter 13, repaying their

debts over five years.

A lot could happen to you in five years-you may close shop, your spouse may become unemployed, or some other unforeseen event could affect your business. However, no matter what contingency occurs or alters your future ability to pay, you must stick to the Chapter 13 repayment plan.

Under the new law, businesses with less than \$2 million in debts can file an expedited form of Chapter 11 reorganization. A Chapter 11 debtor has only 18 months to propose a reorganization plan before creditors are allowed to propose their own plans. Prior to the new law, creditors were barred from making proposals indefinitely due to the debtor's ability to obtain extensions.

Saving your IRAs

Up to \$1 million held in tax exempt retirement accounts (including IRAs) will be exempted. This cap may be increased if in the interests of justice so require. Prior to the Act, only ERISA-qualified pension plans were unreachable by creditors.

TAX CALENDAR

JUNE 2005

June 10

Employees who work for tips

If you received \$20 or more in tips during May, report them to your employer. You can use Form 4070.

June 15

Individuals

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due. If you want additional time to file your return, file Form 4868 to obtain two additional months to file. Then file Form 1040 by August 15.

If you are not paying your 2005 income tax through withholding (or will not pay in enough tax during the year that way), pay the second installment of your 2005 estimated tax. Use Form 1040-ES.

Corporations with calendar year ends

Deposit the second installment of estimated tax for 2005.

Employers

For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

JULY 2005

July 11

Employees who work for tips. If you received \$20 or more in tips during June, report them to your employer. You can use Form 4070.

July 15

Employers

For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

Partnerships

File a 2004 calendar year return (Form 1065). This due date applies only if you were given an automatic three-month extension. Provide each partner with a copy of Schedule K-1 or a substitute K-1. If you need an additional three-month extension, file Form 8800.

Electing large partnerships

File a 2004 calendar year return (Form 1065). This due date applies only if you were given an automatic three-month extension. If you need an additional three-month extension, file Form 8800.

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