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### **Countdown 2005 . . . Year-End Tax Planning Ideas for Businesses**

Regardless of the structure of your business—limited liability corporation (LLC), C or S corporation, sole proprietorship, or partnership—you need to plan carefully during the last two months of the year to minimize your 2005 tax bill. The steps you take now will directly affect your after-tax profit margin. Remember, each situation is unique, and these few tips are intended to give general information. A myriad of year-end planning choices and considerations is available.

#### **Section 179 expensing deduction**

The Tax Code allows you to expense up to \$105,000 of qualified fixed assets for 2005, rather than depreciating them over several years. However, you cannot expense more than the taxable income generated by your active trade or business activities. The expensing deduction is reduced dollar-for-dollar if your total qualifying business property purchases rise above \$420,000, and is eliminated if they reach \$525,000.

#### **Domestic production activities deduction**

Is your business involved in domestic manufacturing, engineering, construction, eligible production activities, or architectural services that are related to construction? Regardless of whether your business is incorporated, you may be eligible for a 2005 deduction of 3% of the lesser of your (1) “qualified production activities” income; or (2) taxable income.

The rules surrounding this deduction are as intricate as they are complex. We will need to consider your eligibility, deduction limits, and other factors affecting this new deduction's impact on your business tax liability for 2005.

**Self-employed health insurance deduction**

For 2005, self-employed individuals may deduct all of their health insurance premiums as an “above the line” deduction on Form 1040. Qualified individuals include sole proprietors, more-than-2%-shareholder-employees of S corporations, and those partners and LLC members who perform services for the business.

You may deduct as a business expense 100% of health insurance premiums for yourself, your spouse, and your dependents, so long as the premiums do not exceed the net profit from the business from which your self-employed health insurance premiums are paid, minus certain deductions. Note that you are not entitled to the 100% tax deduction for any month that you are eligible to participate in a subsidized health plan maintained by either your employer or your spouse's employer.

You may also include the tax-deductible portion of self-employed health insurance premiums you paid for a tax-qualified long-term care policy, paying special attention to the amount of the premium that qualifies (based on a formula that includes age and type of coverage).

**Countdown 2005 . . . Year-End Tax Planning Ideas for Individuals**

Through careful planning, your tax liability can be reduced and your overall financial position improved. Here are a few additional ideas to start thinking about as December 31 draws ever closer.

**Withholding taxes**

Check your pay stubs or with your employer to see that you have paid enough in estimated taxes this year—either through withholding or estimated tax payments—to avoid penalties for underpayment. You can make up for any anticipated shortfalls before December 31 by increasing the amount withheld from your paycheck or by making an additional estimated payment. With good planning, you can avoid penalties for underpayment of estimated taxes.

**Make charitable donations**

As you may know, various rules apply to the limits and reporting requirements for donations to charities, depending on the type and value of donation made. To be deductible, contributions must be made to qualified organizations. You may not deduct contributions made to specific individuals, political organizations, and candidates, nor the value of your time or services or the cost of raffles, bingo, or other games of chance.

But you can lower your tax bill by donating to charities, so long as you itemize your deductions. Only contributions actually made during the tax year are deductible. Credit card charges and payments by check are deducted in the year they are given to the charity, even though you may not pay the credit card bill or have your bank account debited until the next year. You may also be able to get a bigger “bang for your buck” by donating appreciated stock you have held for more than a year. You may deduct the full market value of the stock and avoid paying tax on the capital gains.

For cash charitable deductions made between August 28, 2005 and December 31, 2005, special provisions have been passed under the Katrina Energy Tax Relief Act of 2005 (KETRA). For example, cash deductions (appreciated stock gifts do not qualify) made to qualified charities, will not be subject to the adjusted gross income phase-out rules. As a result, these contributions will be fully deductible, even for high-income taxpayers. As a result, high-income individuals may want to accelerate their normal charitable giving into 2005, since this special provision expires December 31.

In addition to the charitable deduction relief for individuals, C corporations are exempt from the normal 10% of taxable income limitation during this same period. However, there is one very important difference between corporate and individual donations. While individuals may give cash to any qualified charity, corporate contributions must be made to hurricane Katrina relief efforts.

The IRS has added a link on its site to the Federal Emergency Management Agency (FEMA) since Katrina and Rita wreaked their havoc. If you have a specific charity in mind, you can make sure it is a qualified charity by searching the IRS-approved list available on the site. Note that some organizations, such as churches and governments, may be qualified even though they are not listed.

**Offset your gains and losses**

Now is a good time to examine your portfolio for offsetting losses. It's also an excellent time to review the holding periods of your investments and determine which investments to sell. You may be able to rebalance your portfolio without tax consequences by redirecting future investing activity. For example, you can invest dividends and new investment funds in asset categories that are currently underweighted in your portfolio.

### **IRS Increases Business Mileage Gasoline Rates Through December 31, 2005**

Announced on the heels of Hurricane Katrina, the IRS raised the business mileage reimbursement rate from 40.5 cents per mile to 48.5 cents per mile, in effect from September 1 through the end of 2005.

The new four-month rate for computing deductible medical or moving expenses will be 22 cents a mile, up from 15 cents for the first eight months of 2005. The rate for providing services for charitable organizations is set by statute, not the IRS, and remains 14 cents a mile.

This temporary measure is the largest increase ever within a one-year period. (The previous record was the 3-cent increase from 2004 to 2005.) In recognition of recent gasoline price increases, the IRS made this special adjustment for the final months of 2005. Ordinarily, the IRS updates the rates only once per year, usually in the fall, to cover the following calendar year. This year, the IRS will not announce the 2006 rate until closer to the New Year.

### **Two New Laws Give Tax and Added Benefits for Buying Hybrid/Other Energy Vehicles**

#### **Tax credits**

The new energy bill revises existing federal tax incentives for purchasing hybrid vehicles. One important revision is that the current tax deductions will be replaced with dollar-for-dollar tax credits, directly reducing your tax bill. There are two credits available to purchasers of new hybrid or other type of lean-burn vehicles.

*The first credit for hybrids.* Under the new law, a complex formula uses both the rated fuel economy and weight class of the vehicle to calculate your tax credit. This credit rewards purchases of vehicles that achieve substantially more miles per gallon than a similarly situated traditionally fueled vehicle.

If your new hybrid is this percentage more fuel-efficient than a vehicle that uses only traditional fuel . . .	then you may qualify for this amount of dollar-for-dollar tax credit:
25%	\$400
50%	\$800
250%	\$2,400

*The “conservation credit” for hybrids.* This second credit is calculated using a formula based on the vehicle’s total estimated lifetime fuel savings and determines how much of a \$250 to \$1,000 credit you can get.

With the two credits combined, your new vehicle could bring you a maximum credit of \$3,400 (\$1,000 + \$2,400) to apply against your federal income tax. As an example of one vehicle’s credit: According to calculations by the American Council for an Energy-Efficient Economy, the highest credit available is \$3,150 for the Toyota Prius.

*Lean-burn technology vehicles.* These vehicles—including, but not limited to, certain new diesel models, will qualify for the same credits available to hybrids.

*Electric and battery-operated cars.* The energy bill extends an already existing tax credit of up to \$4,000 if you purchase an electric vehicle or one that is powered by rechargeable batteries.

*Fuel-cell-powered vehicles.* Fuel-cell-powered vehicles (such as a car that is powered by hydrogen cells) that weigh under 8,500 pounds get a base credit of up to \$8,000, with larger credits going to heavier fuel-cell-powered vehicles. Another credit of up to \$4,000 is given on a sliding scale, based on fuel-efficiency developments when compared to 2002 models of the same vehicle. The combined maximum credit would be \$12,000 (\$8,000 plus \$4,000).

*Natural gas and other “alternative” fuel vehicles.* If you purchase a vehicle powered by natural gas, liquefied natural gas, coal-derived liquid fuel, any liquid fuel composed of at least 85% methanol, or certain other alternative fuels, your tax credit—which is a maximum of \$4,000—will be determined by an intricate calculation based on, but not limited to, weight, cost, emissions, and fuel efficiency.

For all of these calculations, the IRS, car and truck manufacturers, and the Environmental Protection Agency may provide details in the coming weeks on which vehicles receive which particular tax breaks.

### **Act quickly**

The new credit applies to vehicles placed in service from 2006 and with termination dates that vary with the type of vehicle. If you are planning to purchase a hybrid vehicle soon, it might be best to wait just a little longer—to take advantage of the tax credits that become available in 2006. But be careful, especially if you plan to buy a popular model.

The new law sets a ceiling on how many tax credits it allows per manufacturer before the credit is phased out over a 15-month period. It limits the credit to the buyers or leaseholders of 60,000 hybrid vehicles per manufacturer from 2006 through 2010. Once a particular manufacturer has sold the allotted 60,000 vehicles, the law provides for a one-year “phase out” period that commences with the next completed calendar quarter. At that point, 50% of the credit will be available for that manufacturer’s hybrids in the first two quarters of the phase-out period and 25% in the final two quarters. So if you want to purchase a particularly popular model, do so before 60,000 of them are bought or, to be safe, within a year or so.

## **TAX CALENDAR**

### **NOVEMBER 2005**

#### **November 10**

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

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2005. This due date applies only if you deposited the tax for the quarter in full and on time.

#### **November 15**

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

### **DECEMBER 2005**

#### **December 12**

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

#### **December 15**

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

**Corporations.** Deposit the fourth installment of estimated income tax for 2005.

In accordance with IRS Circular 230, this newsletter is not to be considered a “covered opinion” or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.

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