

# THE LEDGER

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## TAX CREDITS: TAKE ADVANTAGE OF THEIR TAX-CUTTING POWER

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Tracking deductible expenses that reduce your personal and business income tax bills is smart. Even better, the same record-keeping may help you claim a valuable break – tax credits.

Tax credits are typically based on specific expenditures, and they work much like tax payments; that is, they directly offset your tax liability.

*Here's an illustration:* Suppose you owe \$750 in federal income tax. If you're eligible for a \$500 credit, you'd subtract that from the \$750 to arrive at a final tax bill of \$250.

Some credits are nonrefundable; that is, they're limited to the amount of tax you owe. Say the credit in the above example falls into this category. If the eligible credit is \$800, you could claim \$750 on your return, reducing your bill to zero. The \$50 excess credit would not be refunded to you. However, depending upon the credit, you might be able to carry the excess \$50 back to a prior year or forward to future years.

Other credits are refundable, which means that when the credit is larger than the tax you owe, you can receive a refund. Another benefit: You may be able to use certain nonrefundable personal credits to offset alternative minimum taxes. What's more, credits are available even if you're unable to itemize deductions on your personal return.

Here's a quick look at some of the tax credits for individuals and businesses.

#### Tax Credits

**Education tax credits.** You probably know these as the Hope

scholarship and lifetime learning credits. They're nonrefundable and subject to income limitations. You may be able to claim them when you pay tuition and fees for post-secondary education to an accredited school for yourself, your spouse, or your dependents.

**Child and dependent care credit.** Did you hire someone to care for your pre-teen child,

handicapped spouse, or other dependent so you can work? You may qualify for a credit of up to 35% of eligible employment-related expenses.

**Child tax credit.** A credit of up to \$1,000 is available for each dependent child under 17.

**Adoption credit.** The law provides a credit of up to

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## WHAT'S NEW FOR 2006?

Every new year brings tax changes. Here is a sampling of the 2006 changes that could affect you.

**You can contribute more to certain retirement accounts.** If you're under age 50, you can contribute \$4,000 to an IRA, \$10,000 to a SIMPLE, or \$15,000 to a 401(k) plan. Catch-up amounts for those 50 and older are \$1,000 for an IRA, \$2,500 for a SIMPLE, and \$5,000 for a 401(k).

**The first-year business equipment expensing limit** increases to \$108,000, with the phase-out starting when purchases for 2006 exceed \$430,000.

**The top estate tax rate decreases to 46% this year;** and the estate tax exemption increases to \$2 million. The annual gift tax exclusion increases to \$12,000.

**New tax credits are available this year** for making energy-saving home improvements, improvements to commercial buildings, building energy-efficient homes, and manufacturing energy-saving appliances.

**The Gulf Opportunity Zone Act of 2005,** signed into law last December, provides 50% bonus depreciation and double the first-year expensing allowance for qualified investments in the area devastated by last year's hurricanes. The law doubles the HOPE and lifetime learning credits for individuals who attend eligible schools in the disaster area. The law contains a number of other tax breaks designed to encourage rebuilding in the Gulf region.

For more information on these and other 2006 changes, give us a call at 630-953-4900.



## NEW RETIREMENT OPTION COMBINES ROTH AND 401(K)

Good news! This year employers can offer both a traditional 401(k) plan and a new Roth 401(k), thanks to a provision in

**“The Roth 401(k) offers some distinct advantages over the Roth individual retirement account (IRA).”**

the *Economic Growth and Tax Relief Reconciliation Act of 2001*. Though strictly voluntary, many companies are expected to offer

their employees this new Roth 401(k) option in 2006.

The Roth 401(k) offers some distinct advantages over the Roth individual retirement account (IRA). The Roth 401(k), for example, is available to all 401(k) participants. On the other hand, if your income is above a certain limit (generally \$110,000 to \$160,000, depending on your tax filing status), you can't contribute to a Roth IRA. In addition, the most you can contribute annually to a Roth IRA is \$4,000 (\$5,000 if you're 50 or older). But contributions to a Roth 401(k) have

higher limits: \$15,000 a year plus an extra \$5,000 “catch-up” amount for those aged 50 and older. So depending on your age, you could contribute up to \$20,000 a year to a Roth 401(k).

In some ways, the Roth 401(k) is similar to the Roth IRA. Both are funded with after-tax contributions; both allow tax-free withdrawals after age 59 1/2 (assuming the account is at least five years old). One difference: You have to start taking withdrawals at age 70 1/2 from the Roth 401(k).

On the downside, employer matching

is not available for the Roth 401(k). So it may make sense to contribute to your traditional 401(k) at least up to your company's matching amount. Also, if you expect your tax rate to drop in retirement, you may want to contribute at least a portion of your income to a traditional 401(k). Another consideration: The law authorizing the Roth 401(k) is scheduled to expire at the end of 2010. Unless the law is extended, new contributions to the Roth 401(k) couldn't be made after that date.

Need help planning for this new retirement option? Give us a call at 630-953-4900.



## TAX PLANNING

### TAKE ADVANTAGE OF TAX-CUTTING POWER

*Continued from page one*

\$10,960 for the eligible expenses related to adopting a child.

**Earned income credit.** This is a refundable credit for low-income individuals and families.

**Foreign tax credit.** Generally, you can claim this credit on your personal or corporate income tax return when you pay income taxes to a foreign country or U.S. possession.

**Research credit.** Is your business developing or improving a

product? Research and development activities that you carry on in-house or contract to others to perform, including the rental or lease of off-premises computers, may qualify for a credit.

The expenses must be paid in connection with your trade or business, and can include such items as the costs of obtaining patents. Overhead, general, and administrative expenses are usually not eligible. But wages

and supplies, as well as costs paid for the development of certain internal use software, may be considered qualified expenses if they satisfy specific requirements.

**Credit for pension plan start-up costs.** Establish a retirement plan for your employees, such as a 401(k) or a SIMPLE, and you may be able to claim a credit of up to \$500 for each of the plan's first three years. The credit is based on expenses paid to

establish and administer the plan.

There are many more credits available in the tax law. Some are subject to income limits, and many apply only in very limited situations. Some have expiration dates (such as the research credit), with a history of being extended again and again, usually retroactively. Don't overlook tax credits in your 2006 tax planning; find out which ones could reduce your tax bill.

## KEEP AN EYE ON YOUR COMPANY'S CASH FLOW

Do you regularly monitor your company's cash accounts? You should. Even if you leave the job to your bookkeeper or accountant, you should stay aware of where the cash is going and how the spending is approved. Along with inventory "shrinkage," theft or improper expenditures of cash are among the chief sources of loss for small companies.

Periodically, you hear about a huge loss caused by an employee who's been quietly embezzling cash for years. But many smaller cases are never noticed. And it's not always employees at fault. In fact, the vast majority of employees are scrupulously honest and loyal. Outsiders can be stealing your cash too, by submitting false or inflated invoices that are paid without proper review.

### Reducing Risk of Loss

What can you do to reduce the risk of losses? The textbook

answer is "internal controls." This refers to things such as standard procedures for approving and paying bills. It includes segregation of duties – having more than one person involved in preparing, signing, and reconciling checks. Unfortunately many small companies don't implement proper controls – either because there's not enough staff or because they think it's too much trouble.

Regardless of the size of your business, here are some steps you can take to control cash.

**Maintain a strict rule** that all invoices must have an approval signature before being paid. Nothing focuses a person's mind like having to sign his or her name on something.

**Have a policy** that all employee expense reports must be signed off by a higher-level employee.

**Make it a rule** that the person who prepares a company check can't sign that check.

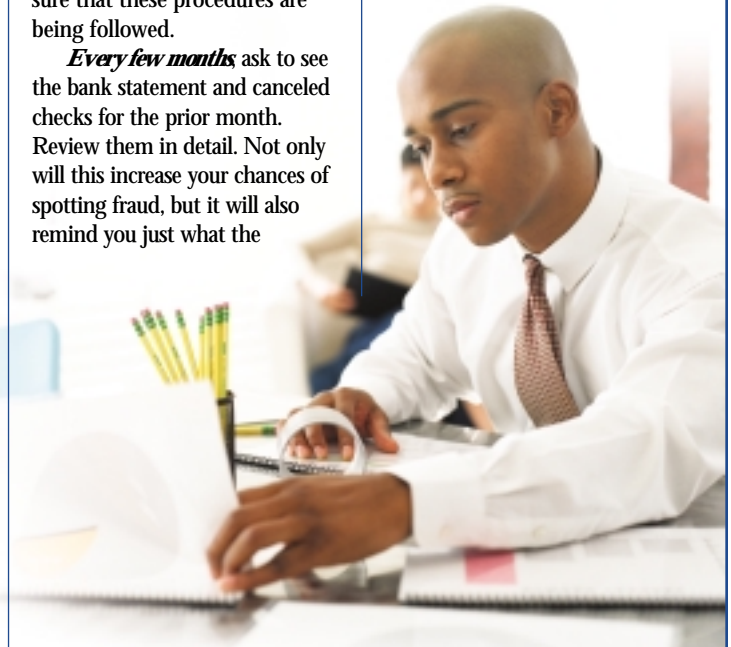
**Ask your bookkeeper** or accountant to give you a signed note each month affirming that the bank statement has been reviewed and balanced.

**Follow up personally** to make sure that these procedures are being followed.

**Every few months** ask to see the bank statement and canceled checks for the prior month. Review them in detail. Not only will this increase your chances of spotting fraud, but it will also remind you just what the

company's cash is being spent on.

Please contact our office for details or for assistance in improving controls over your company's cash.



## TAX PLANNING

### ESTIMATED TAXES: WHO OWES THEM?

During the year, you must prepay a substantial amount of the taxes you'll owe for that year, or you risk being hit with an underpayment penalty. If you're an employee, that's usually not a problem. Your employer will withhold taxes from each paycheck. You can

adjust the amount withheld so that it covers your total tax bill, even if you have extra income from moonlighting or investments. But if you're self-

employed or retired, you might need to make estimated tax payments.

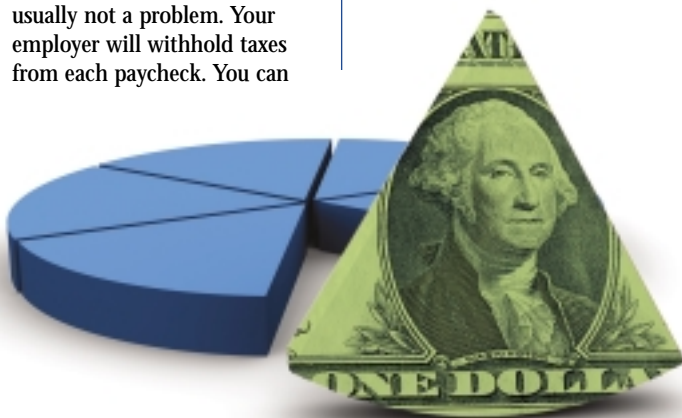
To avoid a penalty, the total of your withholding and estimated tax payments must generally be at least 90% of your tax liability for the year, or 100% of your last year's tax liability. There's no penalty if your underpayment is less than \$1,000. Special rules apply to farmers, fishermen, and higher-income taxpayers.

#### Quarterly Payments

You pay your estimated taxes by making four payments. The quarterly payments for 2006 are due on April 17, June 15, and

September 15. The final 2006 payment is due on January 16, 2007. You can't just wait until the last date to pay what you owe. You must start paying estimated taxes as you earn taxable income. You can either pay all the tax you owe on each quarter's earnings, or you can pay it in installments over the remaining periods. But you must be sure to pay enough to avoid an underpayment penalty for each period. Again, special rules apply to farmers and fishermen.

Please contact our office if you think you might need to make estimated tax payments. We can help you figure out how much you need to pay at each date.



## IRS ACTIVITY

### IRS Simplifies Filings

The IRS has issued regulations that will allow some small businesses to file tax withholding forms annually instead of quarterly. Called the Form 944 program, the rules will let employers file Form 944 once a year instead of filing Form 941 four times a year if they expect to owe annual employment taxes of \$1,000 or less.

During February, the IRS mailed notification letters to eligible small employers for calendar-year 2006. Employers who didn't receive a letter but who believe they are eligible for this filing simplification can call the IRS at 800-829-0115 by April 1, 2006.

### 2006 Mileage Rates

The standard mileage rates have changed again. The IRS increased rates for the final four months of 2005, but lowered them for 2006.

The rate for business driving is 44.5¢ per mile, and the rate for medical and moving expenses is 18¢ a mile. The rate for charitable driving remains at 14¢ a mile

except for driving related to hurricane recovery work. The 2006 mileage rate for charitable driving related to the 2005 hurricanes is 32¢ a mile for deduction purposes and 44.5¢ a mile for reimbursement purposes.

### New 6-mo. Extensions

The IRS is eliminating some paperwork for taxpayers who need more time to file their 2005 tax returns. New regulations allow taxpayers to request an automatic six-month extension for most individual and business tax returns. The six-month extension replaces the prior two-step process that required taxpayers to obtain first a four-month automatic filing extension. If additional time was needed, a second request explaining the need for more time had to be sent to the IRS.

The IRS estimates that the new rule will not only eliminate paperwork but also save taxpayers between \$73 million and \$94 million annually.

## BY THE NUMBERS

### IMPORTANT DATES FOR SPRING 2006

#### March

**March 15** – 2005 income tax returns are due for calendar-year corporations.

**March 15** – Deadline for calendar-year corporations to elect S corporation status for 2006.

#### April

**April 3** – If you turned 70 1/2 last year, this is the deadline for taking your first required distribution from regular IRAs and, unless you're still working, from other retirement accounts. Distributions are not required for Roth IRAs.

**April 17** – 2005 individual income tax returns are due.

**April 17** – 2005 partnership returns are due.

**April 17** – 2005 annual gift tax returns are due.

**April 17** – Deadline for making 2005 IRA contributions.

**April 17** – Due date for first installment of 2006 individual estimated tax.

#### June

**June 15** – Due date for second installment of 2006 individual estimated tax.

Any tax advice contained in this newsletter is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code or applicable state or local tax law provisions.



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