



4-Serenity, Inc.
P.O. Box 390428
Snellville, GA 30039

Larry M. Walker, Jr., EA
Enrolled Agent

Office (770) 465-8861
Fax (404) 795-0467

lwalker@4-serenity.com

Hours: 9:00 am to 6:00 pm
Monday thru Friday

Tax News 2nd Quarter 2006

****Update 2006****

We are moving

Our office will be relocating to Snellville, GA in early July. Please call for the new physical address for overnight mail, and deliveries. Please use the P.O. Box for all other correspondence.

2nd Quarter Schedule

Avoid IRS penalties by being on time

July 1 – 15: We need to receive all 2nd Quarter Accounting work on or before July 15th.

July 31: Quarterly Payroll Tax Returns must be in the mail.

September 15: Due date for Corporate income tax returns (extensions were filed on March 15th). There are no further extensions available.

October 15: Due date for Individual income tax returns (extensions were filed on April 15th). Returns received an automatic 6 month extension.

Life-Changing Events

Ten reasons for a mid-year review

1. Things happen throughout the year that may affect your finances and your tax situation. In most cases, it's better to visit your tax preparer as soon as possible so you can discuss taking action to prevent any unpleasant tax consequences. Here are ten good reasons to schedule a mid-year review:
2. A change in your marital status. A marriage or divorce can have a direct impact on the amount of exemptions you can claim and can alter the amount of your refund or balance due.
3. The birth of a child. You cannot claim a child as a dependent unless you have a social security number for that child.
4. The death of a spouse or other family member. If you inherit income, such as an IRA or pension plan, you have options for taking distributions.

5. The sale or purchase of a home.
6. The decision to retire or continue working. Depending on your age and other income, your social security benefits may be taxed or reduced.
7. The sale of investments. Timing a sale to reap the most tax benefit should be decided before taking action.
8. Contributions to a traditional IRA or Roth IRA. There are tax consequences to both options.
9. Charitable contributions. Whether or not you can itemize deductions may determine when it's best to make contributions.
10. Changing jobs. In some cases, your moving expenses are deductible if a new job takes you to a new location.
11. Planning for your child's college education. There are several tax-favored options available for college savings.

Buy a Hybrid Car

Save gas and tax dollars

With the price of gasoline reaching epic amounts, you may be contemplating your transportation alternatives. Purchasing a new hybrid vehicle may be the answer. But which one? Various makes and models are available and each carries a different credit amount.

The tax credit for hybrid vehicles applies to vehicles purchased on or after January 1, 2006, and may be as much as \$3,400 for those who purchase the most fuel-efficient vehicles. The hybrid vehicle certifications* and their credit amounts are:

- 2005 Toyota Prius – \$3,150
- 2006 Toyota Highlander 2WD Hybrid – \$2,600
- 2006 Toyota Prius – \$3,150
- 2006 Lexus RX400h 2WD – \$2,200
- 2006 Ford Escape Hybrid Front WD – \$2,600
- 2006 Lexus RX400h 4WD – \$2,200
- 2006 Ford Escape Hybrid 4WD – \$1,950
- 2007 Toyota Camry Hybrid – \$2,600
- 2006 Mercury Mariner Hybrid 4WD – \$1,950
- 2007 Lexus GS 450h – \$1,550
- 2006 Toyota Highlander 4WD Hybrid – \$2,600

The maximum credits are only available for a limited time. You may claim 100 percent of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records its sale of the 60,000th vehicle. For the second and third quarters, the credit is reduced by 50 percent and in the fourth and fifth calendar quarters, the credit drops to 25 percent. No credit is allowed after the fifth quarter. Be sure to ask the dealer whether the manufacturer has sold 60,000 vehicles.

*More makes and models may become certified for tax credits in the future.

Stock Options

Know when to hold 'em

If you were granted nonqualified stock options (NSO) from your employer, consider your other income before you exercise the options. Try to exercise them during a year when your income keeps you in the lower tax brackets. Why? Once you exercise the options, the difference between the fair market value of the stock on the date of exercise and the amount you paid for the option is included as additional compensation on your W-2. A later sale of the stock is reported as long-term capital gain income provided you held the stock for more than one year.

If you were granted an incentive stock option (ISO), the tax consequences are a bit different. The character of the income depends on when the stock is sold. If the ISO stock is held for at least one year and the ISO was granted at least two years before the sale, the gain upon sale is treated as long-term capital gain. However, a disqualifying disposition occurs if the stock is sold within two years of the grant date or within one year of the exercise date. In this case, the difference between the fair market value of the stock and the option price on the date of exercise is treated as ordinary income and is

included in taxable wages on your Form W-2 in the year the stock is sold. The remainder of the gain would be ordinary income or capital gain, depending on how long you held the stock.

ISOs are also subject to an alternative minimum tax (AMT) trap. If you exercise the ISO, but do not sell the underlying stock in the same tax year, the difference between the fair market value on the date of exercise and the option price are included in determining AMT.

If your income fluctuates from year to year, or you are considering retirement, exercising your stock options in a low-income year will save you tax dollars. Careful planning also will help you avoid AMT.

Did You Receive an E-mail From the IRS?

Hit the delete button

There were various e-mail scams circulating this past year that appeared as though they came from the IRS. The e-mails claim you may have a refund waiting for you and all you need to do is provide some information—like your name, address, social security number, and filing status. Some of the e-mails even went so far as to ask for your bank account information so they could credit your refund.

For starters, the IRS never corresponds with taxpayers via e-mail, nor asks you for your bank account information. The scam is a ruse to collect your personal information and steal your identity. Don't fall for it. Delete the e-mail and keep your personal information safe.

Health Savings Accounts

How they can help you

A Health Savings Account (HSA) is an account that you can put money into to save for future medical expenses. There are certain advantages to putting money into these accounts. Funds saved in an HSA and used for qualifying medical expenses are excluded from gross income and thus not subject to taxes.

You can contribute to an HSA if you meet the following requirements:

- Have coverage under an HSA-qualified “high deductible health plan” (HDHP).

- Have no other first-dollar medical coverage (other specific types of insurance like injury insurance or accident, disability, dental care, vision care, or long-term care insurance are permitted).
- Are not enrolled in Medicare.
- Cannot be claimed as a dependent on someone else's tax return.

An HSA-qualified "high deductible health plan" (HDHP) is health insurance where you pay all expenses until they reach a high deductible amount. The rules require that the health insurance deductible be a least \$1,050 for self-only coverage and \$2,100 for family coverage.

In addition, annual out-of-pocket expenses under the plan (including deductibles, co-pays, and co-insurance) cannot exceed \$5,250 for self-only coverage or \$10,500 for family coverage.

You, your employer, or both, can make contributions to your HSA each year that you are eligible. You can contribute up to the amount of your HDHP deductible but no more than \$2,700 for self-only coverage or \$5,450 for family coverage. Individuals age 55 and older can also make additional "catch-up" contributions of \$700 in 2006. An HSA is portable, meaning that it remains yours even if you change employers or leave the workforce. It can accumulate year-to-year if not used. If you make a contribution, you can deduct the contribution on your tax return whether or not you itemize deductions.

Distributions from your HSA are tax-free provided they are used to pay qualified medical expenses. If they are not used for qualified medical expenses, they are included in taxable income and are subject to an additional 10-percent penalty. Once you reach age 65, the 10-percent penalty no longer applies.

Save for Your Retirement

A seldom-used credit is about to expire

You may be eligible for the retirement savings contributions credit if you recently made retirement plan contributions of up to \$2,000. The credit is only available through 2006, unless Congress extends it. The credit amount is based on both your filing status and adjusted gross income (AGI). The most you can expect is 50 percent of your

contributed amount, up to \$1,000 per individual. See the following table:

Adjusted Gross Income (AGI) Amounts and Allowable Credit Percentage

Married Filing Jointly:

- Not over \$30,000 – 50 percent
- Over \$30,000 and not over \$32,500 – 20 percent
- Over \$32,500 and not over \$50,000 – 10 percent
- Over \$50,000 – no credit

Head of Household:

- Not over \$22,500 – 50 percent
- Over \$22,500 and not over \$24,375 – 20 percent
- Over \$24,375 and not over \$37,500 – 10 percent
- Over \$37,500 – no credit

All Other Taxpayers:

- Not over \$15,000 – 50 percent
- Over \$15,000 and not over \$16,250 – 20 percent
- Over \$16,250 and not over \$25,000 – 10 percent
- Over \$25,000 – no credit

Does Your Business Need a Retirement Plan for Employees?

A SIMPLE IRA plan may be an option for you

There are numerous retirement plans available for the small business owner. Some are more complicated to manage than others. If you want to start a retirement plan for your employees, a Savings Incentive Match Plan for Employees (SIMPLE) may be the answer.

As the name implies, a SIMPLE is relatively simple to set up and administer. A SIMPLE retirement plan is available to small businesses that employ no more than 100 employees. It makes no difference whether you are self-employed or whether your business is incorporated.

A SIMPLE plan allows your employees to make elective contributions to an individual retirement account (IRA). Employee contributions must be based on a percentage of their compensation and cannot exceed \$10,000 for 2006. Employees age 50 or older can elect to defer an additional \$2,500, not to exceed their compensation.

As an employer, you must satisfy one of two contribution formulas:

1. Under the matching contribution formula, your company generally would be required to match employee contributions dollar-for-dollar up to

three percent of each participating employee's compensation. If an employee chooses not to participate and does not make elective deferrals, you are not required to make a contribution on their behalf.

2. Instead of making matching contributions, you can elect to make a two-percent contribution for each eligible employee who earns at least \$5,000 in compensation during the year. Under this option, you must cover all eligible employees regardless if they are making elective deferrals.

A SIMPLE is appealing in the sense that the plan is somewhat flexible. The employee's elective deferrals are not limited to a percentage of their compensation, but to a dollar amount. In other words, if the employee only earns \$10,000, they can defer 100 percent of their compensation. From the employer's standpoint, SIMPLEs are appealing because they are not subject to the somewhat complex qualification rules. One word of caution, however: a SIMPLE must be established by October 1 of the year you wish to begin contributions.

Thinking of Selling Your Business?

Consider the tax implications before deciding

The first step you need to take is to find a reputable business appraiser. A business appraiser can guide you in placing a value on your assets, allowing you to command a fair selling price.

The sale of a business is not usually a sale of one asset. Instead, all of the assets of the business are sold. Generally, when this occurs, each asset is treated as being sold separately for determining the treatment of gain or loss. Assets are divided into two categories: *tangible assets* such as real estate, furniture, fixtures, equipment, and possibly inventory, and *intangible assets* such as goodwill and a customer list.

If you are incorporated, you can either sell your stock, or the corporation can sell the assets. If the assets are sold, the corporation pays the tax on any gain. You, as a shareholder of the corporation, do not have a tax consequence unless the corporation liquidates and distributes the proceeds

of the sale to you in exchange for your stock. Different rules apply if you are an S corporation. It is important to determine what the potential tax consequences are prior to signing the sales contract. If you want to defer the gain on the sale, an installment agreement might be the best option.

Your Home-Based Business

Is it *really* a business?

Have you ever listened to a seminar on how to earn extra money by starting a home-based business? Often the speaker will tout the tax benefits of such activities by claiming you are allowed to deduct all sorts of expenses related to your home that are normally considered personal expenses. If the idea seems too good to be true, it often is. In some cases, the IRS has determined that some of these purported income-producing activities are nothing more than a scheme designed to avoid paying tax, and they have shut them down.

In order to deduct expenses related to the business use of your home, you must operate a "bona fide" business, as well as meet other specific requirements. Even then, your deduction may be limited. To qualify to claim expenses for the business use of your home, you must meet the following requirements:

1. Your use of the business part of your home must be:
 - Exclusive;
 - Regular; and
 - For your trade or business.
2. In addition, the business part of your home must be *one* of the following:
 - Your principal place of business;
 - A place where you meet or deal with patients, clients, or customers in the normal course of your trade or business; or
 - A separate structure (not attached to your home) you use in connection with your trade or business.

The thing to keep in mind is that operating a home-based business cannot simply be a way to deduct otherwise nondeductible expenses. You must have a bona fide business purpose with the intention of making a profit. Don't fall prey to a con artist who promises huge profits and even bigger tax savings.