Komisar Brady & Co., LLP

TAX BEAT

November 2005

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Welcome to another issue of Tax Beat. As the year draws to a close, it is a good time to think and act upon tax planning for the current and upcoming year. In additional to the tax planning techniques and ideas mentioned in this and in past issues, here are a couple of things to think about as the end of the year approaches. If it makes sense from an investment perspective, you might want to consider selling securities with unrealized losses to offset gains realized during the year or if you have realized losses you could sell securities to trigger offsetting gains. If you are an employee with an unused flexible spending account balance, you should attempt to utilize it fully by the applicable deadline and/or reconsider the amount to withhold for 2006.

We provide tax planning and projecting for a number of our clients throughout the year. If you need some advice or assistance when it comes to short and long term tax planning, please let us know.

If you would rather receive further issues via email, or have any other comments about the newsletter, please let us know at taxbeat@komisarbrady.com.

Our Mission Statement

We are dedicated professionals working together to provide comprehensive quality services to satisfy the needs of clients, business advisors, and each other

College Financial Aid Planning

By Patrick Shanahan

A key component of family financial tax planning is shifting assets and income to your children to take advantage of lower tax rates. This technique works well in reducing the overall tax liability of the family, but is this planning technique right for every family? If you have children close to college age, the answer might be no. In fact if you have children in their senior year of high school and you are applying for financial aid, income and assets owned by your children can decrease the amount of financial aid you will be eligible for compared with the assets held and income earned by the parent.

The amount of financial aid that a student qualifies for is based on a Department of Education formula that takes into account the cost of the school attended and the family's financial position and circumstances. The formula is calculated on the Free Application for Federal Student Aid (FAFSA). The formula is:

Financial Need = Cost of Attendance (COA) – Expected Family Contribution (EFC).

The COA encompasses all of the costs of attending college including tuition, housing, books, supplies (including an allowance for a computer), transportation and other miscellaneous expenses. The EFC is comprised from a portion of both the student's and the parent's income and available assets. Planning for and managing the EFC portion of the formula can help the student qualify for a higher amount of aid and loans.

Separate calculations are done to derive the parent's and student's respective portions of the EFC. The starting point of the income component is the prior year's tax returns. That means you would use your 2005 tax returns when applying for financial aid for 2006. Using adjusted gross income (AGI) calculated on your tax return, several adjustments are made including adding back tax-exempt interest and retirement plan contributions as well as subtracting allowances for Federal, State, and Social Security taxes, income protection and employment expenses for single parent homes or two parent homes where both parents work. After the adjustments and allowances are made, the result is Available Income (AI). For purposes of calculating the EFC, 35% of the parent's AI and 50% of the student's AI is counted. Planning techniques include:

- Shifting income to years prior to filing for financial aid or after the need for financial aid has passed.
- Deferring recognition of capital gains until after filing years.
- Deferring the sale of your personal residence at a gain during filing years. Even though up to $500,000 of the gain is not taxable, it is an addition in the calculation of AI.
- Selling appreciated assets owned by the student prior to senior year of high school. The proceeds will still be an includable asset of the student, but you will not have to include the income.
- Limiting student's income to permissible allowances ($2,440 in 2005).

The asset portion of the EFC is calculated as of the date the financial aid form is prepared and is based on the eligible assets of the parents and student. Assets of other siblings or family members are not included in the calculation. Some assets are not included in the eligible asset calculation. These assets include: your personal residence, retirement accounts (even though contributions to retirement accounts are added back in the income calculation, the value of retirement accounts are not included as an eligible asset), cash surrender value of any life insurance policies and personal property such as automobiles, boats, furniture and appliances. The parents also receive an allowance for education savings and asset protection from tables provided by the Department of Education. Of the assessable assets, 35% of the student's assets and 12% of the parent's assets are included in the EFC calculation. Planning techniques for the asset portion of the EFC involve exempt assets, credit management and shifting assets between the parents and the student. They include:

- Paying down or paying off your mortgage with available cash.
- Paying down or paying off consumer debt such as credit cards, auto loans with available cash.
- Using a home equity line of credit instead of a cash-out refinancing for college expenses to minimize includable assets if little cash is available.
- Accelerating major cash purchases such as automobiles or computers prior to filing the FAFSA.

College Financial Aid Planning, continued

- Deferring gifts from family members until after the student graduates from college and applying the gifts toward student loans. If the gift cannot wait, give the money to the parents or determine if giving the money directly to the school impacts the student's eligibility for financial aid.
- Spending the student's assets before the parent's assets toward items such as private high school, SAT/ACT review courses, summer camps, computers or other educational expenses. Since you must reapply for financial aid every year, reducing the student's assets could increase the amount of financial aid available in future years.
- Owning a §529 college savings plan in the parent's name instead of the student's name. An even better idea is owning the §529 plan in the name of a grandparent or other relative which will have no impact on financial aid.
- Rolling over prepaid tuition plans into a §529 college savings plan. Prepaid tuition plans reduce need based financial aid eligibility dollar for dollar however §529 plans are only assessed at either 12% or 35% of their value.

Knowing the financial aid formula can allow your family to make financial decisions and understand the financial aid impact. This formula is used at almost every post-secondary school with modified versions of the formula being used at some private and elite universities. Planning and making the right decisions can increase the amount of financial aid students would be eligible for so the sooner you start planning the better. Please contact our office and we would be happy to discuss college planning and help you formulate a plan to meet your needs.

Year-End Capital Gain Distributions from Mutual Funds Expected to Increase

If you invest in mutual funds, be prepared to see capital gain distributions much larger than in years past. According to reports, T Rowe Price expects a 35% to 40% increase this year in the average capital gain distribution of its equity fund, and American Century Investments expect their capital gain distributions to increase 50% to 60% over last year.

The cause of these dramatic increases goes back 5 years to 2000, when the stock market experienced a dramatic decline. This decline produced capital losses for funds, which unlike capital gains, cannot be passed through to its investors. The funds are allowed to offset subsequent year's capital gains, and lower distributions to its investors. Most of these capital losses were used up in 2004, causing the dramatic projected increase in capital gain distributions.

Should you be Concerned?

If your mutual fund investments are held in tax-favored retirement accounts, the capital gain distributions or other income dividends will not affect your income tax this year, income is tax deferred until the time when distributions are taken, where distributions may or may not be taxed depending on the type of retirement account. If the mutual funds are held in regular accounts that are not tax deferred, you should consider altering any plans to invest additional funds until after the dividend distribution date of record to avoid additional income tax. In order to determine the distribution date of record, contact the mutual fund company, or check the mutual fund company's website. The mutual fund companies can also provide you with estimated income and capital gain distributions. These amounts can aid you in your year end tax planning, such as deciding whether or not to sell stocks at a loss, or determining whether or not you should make additional estimated tax payments before the end of the year. If you need any assistance with any of these planning ideas, please give us a call.

Tax Planning Tools: Charitable Remainder Trusts

By Jennifer Medley

Are you charitable in nature and looking for a different way to give to charity? Do you have highly appreciated assets you have put off selling because of the potential tax liability? Are you looking to receive some current income tax benefits and to potentially reduce future estate tax? If you answered "yes" then you should consider establishing a charitable remainder trust (CRT).

What is a charitable remainder trust? It is an irrevocable trust that makes periodic payments to you. Upon the trust's termination, the remaining assets are left to a qualified charity you designate.

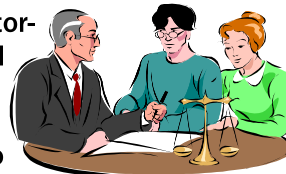
Charitable remainder trusts can take a couple of different forms. A CRT must be either a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT). The CRAT pays an annual fixed sum to you. On the other hand, a CRUT pays out to you a varying annual amount based upon a fixed percentage of the fair market value of the trust's assets as of the beginning of each year. Under both a CRAT and a CRUT, the term of the trust may be over either yours or your spouse's life, or a fixed term, up to 20 years.

There are several benefits to creating a CRT. The reason most often cited for creating this type of trust is the ability to defer gain on highly appreciated assets. Although the highest long-term capital gains tax rate is generally only 15%, the potential to defer and/or avoid capital gains tax on appreciated assets can result in a large reduction in your current tax liability. If you sold the asset you would pay the resulting capital gains tax. If, instead, you gifted the asset to the CRT and the CRT sold the asset, there would generally be no immediate tax consequence because your taxable income is limited to the distribution you receive from the CRT.

In the year of the funding of the trust you are able to take a charitable deduction on your personal income tax return. The amount of the deduction equals the fair market value of the gifted assets less the present value of the distributions to be made to you.

Another possible benefit for creating a CRT is the potential for eliminating and/or reducing estate tax. If the sole income beneficiaries are you and/or your spouse, then the CRT assets will not be subject to estate tax.

There are drawbacks, however, in creating a CRT. Administrative costs are a factor. Because of the complexity of this type of trust you will want to consult with an attorney well versed in this area in order to draft the appropriate documents to meet your needs. Also, on an annual basis, the CRT is required to file two tax returns with the IRS. Although there is no tax due with the returns, balance sheets and proper reporting of income, expenses, and distributions to beneficiaries are required. In addition to administrative costs, you need to realize that a CRT is irrevocable and you only retain an interest in annual distributions. You cannot terminate the trust or change the distribution formula provided in the trust document. Thus, CRTs generally reduce the assets available for children and other heirs. In certain circumstances, you could purchase life insurance to replace those assets.



The charitable remainder trust is a very good planning technique given the proper set of facts and circumstances. If you are interested in more information regarding charitable remainder trusts please contact our office as we can provide you with more specific details and/or determine whether or not there may be other charitable giving methods more suitable for you.

Converting a Regular IRA to a Roth IRA

By Bill Wright

In 1997, Congress created Roth IRAs as an alternative to traditional IRAs. Although you can not deduct Roth IRA contributions, you do not have to pay tax on future Roth IRA distributions. Also, taxpayers can convert traditional IRAs to Roth IRAs but you must pay all the income tax in the year of conversion. Even with incurring the tax hit, converting some or all of your traditional IRA still might be an attractive option.

In order to qualify for a conversion, your modified adjusted gross income (MAGI), exclusive of the sum being converted, must be $100,000 or less. This limitation is not indexed for inflation, and applies to both “single” and “married filing joint” taxpayers (taxpayers filing “married filing separate” are not allowed to convert traditional IRAs to Roth IRAs). If you qualify, you have the opportunity to convert part or all of the balance of your traditional IRA account, but remember that whatever is converted will be subject to tax (except for nondeductible IRA contributions). Since the conversion must be completed by the end of the year, now is a good time to analyze whether you will fall under the MAGI limit, and if so, the benefits and downfalls of making this conversion.

Deciding on whether it makes sense to convert part or all of your traditional IRA into a Roth IRA and incur the tax liability from doing so, depends on such factors as how long the taxpayer intends to leave the funds in the Roth IRA, what the taxpayer's tax rate is currently and what it will be when withdrawals are taken, the size of the taxpayer's estate and what the plans are for the estate, and whether the taxpayer has the funds to pay the tax due at conversion without using IRA funds (which generally will trigger a 10% Federal early withdrawal penalty and a possible state early withdrawal penalty if you are younger than age 59½).

What are some of the situations when a conversion might make sense?

- You are in a lower tax bracket in the year of conversion than you will be when withdrawals are taken.
- You fall under the MAGI limitation currently, but do not expect to in future years.
- You do not expect to tap into your IRA funds during your lifetime. Roth IRA funds are not subject to the required minimum distribution (RMD) rules imposed upon reaching the age of 70½. These funds can continue growing until they are passed on to your beneficiary, who must take distributions, but withdraws them tax-free.

When might a conversion not make sense?

- Any conversion will increase your current year income. This can negatively affect tax credits and deductions on your tax return that phase-out when your income rises. It could also expose a greater portion of your social security benefits to taxation (however taking a hit in one year by converting all of your traditional IRAs could decrease income in future years (due to no RMDs), thereby lessening exposure to phase-outs and taxability of Social Security benefits in the future).
- You must use part of the traditional IRA money to pay the income tax incurred upon conversion. Not only does this reduce the amount converted into a Roth IRA, but the amount used to pay the tax will generally be subject to an early withdrawal penalty if the taxpayer is younger than age 59½.
- You are applying for financial aid for yourself or for your child; the additional income reported due to the conversion may limit or disqualify you from receiving financial aid.
- You think Congress will change the rules regarding the taxability of Roth IRAs. There is no guarantee that tax laws will not be changed, and doing so might wipe out any advantage in making this conversion.

After considering the pros and cons, you can see that a Roth conversion isn’t for everyone. On the other hand, if you think you might benefit from a conversion or have further questions based upon your personal circumstances, please contact us. Unlike IRA and Roth IRA contributions, Roth IRA conversions must be completed by the end of the calendar year in order to be included in that year’s income.

MEDICARE PART D IS APPROACHING FAST

By Brian Thiel

Starting January 1, 2006 for the first time ever, everyone eligible for Medicare, regardless of health status, other drug coverage or income, will have access to prescription drug coverage. This means that everyone with Medicare can get coverage that may help lower prescription drug costs and help protect against higher costs in the future. If you or a family member is eligible for Medicare, it pays to research options now.

Cost

Similar to Medicare supplement insurance, Medicare Part D is insurance which is provided by private companies. Individuals choose the drug plan and pay the monthly premium.

Component of Coverage	Paid by You	Paid by Medicare Part D
Monthly premium	Amount will vary, but approximately $37 per month	N/A
First $250 of drug costs	Deductible, paid by beneficiary	Medicare does not pay
Next $2,000 of drug costs	You pay 25%	Medicare pays 75%
Next $2,750 of drug costs	You pay 100%	Medicare does not pay
All drug costs $5,000 and higher	You pay 5%	Medicare pays 95%

As you can see, the out-of-pocket costs can be significant, so it is important to look closely at your individual situation in making a decision on coverage.

Other Attributes

If you do not join when originally eligible, you will be penalized with a jump in your premium cost of at least 1% per month for every month that you wait to join, unless you are currently in a plan that is at least as good as the Medicare standard. Also, if you have limited income and resources, you may also be able to get financial assistance with drug plan costs. You have until May 15, 2006 to join for 2006.

Benefits to Employers and Employees

Employers and employees can benefit from Medicare Part D in that older employees now have an option for health insurance that provides drug coverage. If an employer's current plan costs more to the employee than a Medicare plan, it could benefit both to have Medicare-eligible employees switch to a Medicare plan. Employers would benefit from lower insurance costs, and employees would have much greater access to care and could have reduced premiums or out-of-pocket costs.

For employers who provide retiree prescription benefits, there are also ways to save 20% or more on the coverage. The government provides guidelines to your insurance company based on individual policy, and you should consult with your insurance agent regarding eligibility.

Because health insurance benefits fall under non-discrimination on other labor law guidelines, we recommend employers discuss Medicare Part D with their respective health insurance and legal advisors before addressing it with employees.

Conclusion

Medicare Part D is complicated and may not be right for everyone. Therefore, we encourage anyone eligible for Medicare to learn the specifics for his or her individual situation. If you or a family member is eligible for Medicare, we recommend contacting the many resources available to obtain more information on Medicare Part D. You can find actual costs and available plans for your area by visiting www.medicare.gov or by calling 1-800-MEDICARE (1-800-633-4227).

Playing it Safe With Employees in the Home

The general issue in the insurance industry for lawsuits is *negligence*. However, in reality, anyone can sue anybody, for anything, at anytime, regardless of negligence. Once you accept this, you can take appropriate protective measures.

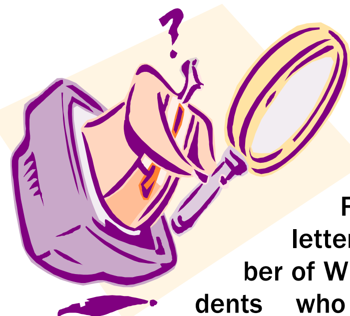
Beyond the above disclaimer, your responsibilities in the case of an in-home employee change very little from an insurance perspective. Insurance policies are meant to protect the named insured for property and liability loss. The named insured is defined in the insurance policy, and automatically includes all relatives and dependents that are a permanent part of the household. So, if your nanny is related, you are likely covered.

The personal belongings *of an employee* are not covered under your homeowner's policy. If this person has moved in with his/her belongings and a fire or theft occurs, there will be no financial settlement from the insurance company to offset the individual's losses.

As for liability coverage, a negligent act by your employee, such as being the accidental cause of a fire, could create an expensive and extensive subrogation process for the employee. If your employee causes an injury to another individual, they would likely have coverage as your employee. However, this interpretation poses a problem for a live-in employee, as coverage would not exist on "personal time". Insurance policies do allow for adding additional insured individuals. However, this is rarely a good option as you are allowing the person to affect your loss history. Signed waivers are an option to protect you, but are often not legally binding.

Renter's insurance for your employee is an inexpensive solution to the concerns of personal property and liability coverage. For less than $150 per year, your household employee will have their belongings and personal liability protected. You should ask every year for proof of insurance from their insurance carrier to make sure they are covered. We recommend you consult with your personal insurance advisor if you have any household employee to address potential liability concerns. We also recommend you contact us to discuss potential tax withholding issues for any household employee.

What's your Use Tax Obligation?



Back in July of this year, the Wisconsin Department of Revenue sent letters to a number of Wisconsin residents who purchased cigarettes from online retailers and asked them to pay use tax on their purchases, along with a cigarette excise tax, interest and penalties. The Department of Revenue acquired the customer list during the online retailer's bankruptcy proceedings and the Department has said that they have acquired customer lists from other internet retailers as well. Even though ultimately the state backed off from the collection of use tax in this instance, there is no guarantee that the state will not pursue this avenue or others in the collection of use tax.

The Wisconsin use tax is a tax imposed on the buyer. It has the same requirements for taxability and exemptions that apply to the Wisconsin sales tax. It is imposed when sales tax is not charged on an otherwise taxable transaction. The most frequent imposition applies to mail order or internet purchases from out-of-state sellers who are not required to collect Wisconsin sales tax on the transaction. Businesses are required to remit use tax with their sales tax return. If those sales tax returns were ever selected for audit, it is very likely that the auditor will audit the business' use tax obligation along with the sales tax.

Individuals have the same use tax reporting requirement as businesses. Because individuals do not fill out sales and use tax returns, they must report out-of-state purchases on which no sales tax was collected on their Wisconsin individual tax return. The risk of not reporting your use tax obligation may be increasing in future years as more and more purchases, including large ticket items, are being made over the internet, and budgetary issues keeps the state looking for new revenue sources.

Sales and use tax issues can be complicated and complex, depending on all the variables involved. If you have sales or use tax questions regarding you or your business, please give us a call. Also if you are worried that your business lacks the correct procedures, or your documentation and record keeping may be lacking if an audit were to come up, please give us a call as well. With penalties and interest being charged in addition to the tax owed, audit assessments are usually larger than expected.

Komisar Brady & Co., LLP

633 West Wisconsin Avenue #900
Milwaukee, WI 53203

Phone: 414-271-3966
Fax: 414-271-3502
Email: kbco@komisarbrady.com

Past Issues of Tax Beat can be found at www.komisarbrady.com

Increased Charitable Contributions this Year

Under the Katrina Emergency Tax Relief Act of 2005, both individual and corporate taxpayers are permitted, in certain situations, to take a larger than normal charitable contribution deduction, but only for a limited time. For corporate taxpayers, the general rule is that charitable contributions are limited to 10% of the corporation's taxable income, with the excess carried over for 5 years. The new law waives the 10% limitation for cash contributions made between August 28 and December 31 to charitable organizations that aid in the relief efforts related to Hurricane Katrina. The Act also allows an increased charitable contribution to businesses that donate food and books out of inventory.

Individual taxpayers can deduct cash contributions without regard to the 50% of adjusted gross income (AGI) limitation when made between August 28, 2005 and the end of the year. The law also exempts these donations from the application of the phase-out of itemized deductions for high- income taxpayers. In order to deduct charitable contributions which exceed 50% of your AGI, the contributions must be made in cash or check, contributions of appreciated securities or other non-cash items are not eligible. The recipient just needs to be an otherwise qualified charitable organization and does not need to engage in Katrina relief efforts. For both corporations and individuals, an election needs to be filed with the tax return indicating that the taxpayer is taking advantage of the new law.

Komisar Brady & Co., LLP offers much more than high quality tax, accounting and auditing services. We offer many types of consulting services to businesses, including business succession planning, sale or acquisition of a business, long range forecasts and budgeting, and valuation services. We also offer estate and retirement planning and aid in the choice and implementation of qualified retirement plans for business owners and sole proprietors. If you have any questions in regards to your individual or business financial matters, please give us a call and see what we can do to help, or if we can direct you to someone who can.

This document provides information of a general nature. None of the information contained herein is intended or written as a tax opinion relative to specific issues addressed in this document.