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Client Information Bulletin

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Ten Top Tax Tactics at Year-end

How to reduce your 2005 tax liability

With the holidays fast approaching, things can become quite hectic at home and work. Nevertheless, it is important for both individual and business taxpayers to carve out some time for year-end tax planning. The tax-planning strategies you use -- or the ones you fail to use -- can have a significant impact on your 2005 tax bill.

Although everyone's situation is different, here are ten top year-end strategies for you to consider.

1. Estimated tax penalties: Even if you do not have enough federal income tax withheld during the year, you can avoid an estimated tax penalty by meeting one

of two "safe harbor" exceptions. No penalty is imposed if annual tax payments for 2005 equal 90% of the current year's liability or 100% of the prior year's tax liability. The percentage for the 100% safe harbor is increased to 110% if your adjusted gross income (AGI) for the prior year exceeded \$150,000.

2. Charitable donations: As a general rule, the full amount of a cash donation is deductible on the donor's personal tax return. If a donation is made by credit card at year-end, the gift is deductible in 2005, even if the charge is not actually paid until next year. **Added tax break:** For donations of property, the full fair-

market value is generally deductible if the property has been held for more than one year.

3. AMT liability: The alternative minimum tax (AMT) can sneak up on unsuspecting taxpayers. It applies if your AMT liability, based on a special tax computation involving “tax preference” items, exceeds your regular tax liability. Individual taxpayers should have their AMT liability calculated before year-end. Depending on the result, it may be advisable to shift tax preferences to next year to avoid or reduce AMT liability. Alternatively, you might accelerate income into 2005 if the AMT rate is lower than your top marginal tax rate.

4. Section 179 allowance: Under Section 179 of the tax code, you can elect to currently deduct some or all of the cost of business assets placed in service anytime this year. For 2005, the maximum Section 179 allowance, which was just \$25,000 before the law was changed a few years back, has been increased to \$105,000.

5. Medical and dental expenses: You may deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your AGI. Try to bunch nonemergency expenses (e.g., new eyeglasses or dental cleanings) in the tax year that provides the best opportunity for a deduction. **Note:** Do not forget to include co-payments required under a company health insurance plan.

6. Business travel expenses: The travel expenses of your employees -- including airfare, lodging and 50% of meals -- are deductible if the trips are business-related. When it is appropriate, you can move up business trips planned for January into December. This allows you to write off the travel expenses on your 2005 return instead of waiting until 2006. Note that unreimbursed travel ex-

penses must be deducted as miscellaneous expenses subject to the 2%-of-AGI limit.

7. Income-shifting: You can reduce the overall family tax bill by shifting taxable income from your high tax bracket to other family members in lower tax brackets. For instance, you might transfer income-producing property to custodial accounts for your minor children. Caution: Be aware of the “kiddie tax.” To the extent that the unearned income of a child under age 14 exceeds an annual limit (\$1,600 for 2005), the excess is taxed at the top marginal tax rate of the child’s parents.

8. Mutual fund sales: If you own mutual fund shares you want to sell, it often makes sense to sell the shares before the date when the fund will declare taxable dividends for 2005. Otherwise, you will be taxed on the dividends even if you sell shortly thereafter. On the other hand, it makes good tax sense to buy mutual fund shares after a fund has declared its annual dividends. You can find out the expected ex-dividend date by contacting the fund.

9. Business debts: In these uncertain economic times, a business may have difficulty collecting debts from various accounts. As a general rule, the bad debts of a business can be deducted from gross income when they become worthless. Business owners should keep records of all collection efforts such as letters, phone calls, e-mail communications and collection agency activities. This documentation can support deductions based on the worthlessness of the debts.

10. Tax-free gifts: If estate taxes are a concern, you can reduce the size of your taxable estate through a series of lifetime gifts. For 2005, you can give away up to \$11,000 a year to each recipient without any gift tax; \$22,000 if a spouse joins in

the gift. (The \$11,000 gift-tax exclusion is expected to increase to \$12,000 for 2006.) An affluent couple may give a family member the maximum in both December and January, free of gift tax.

Reminder: You may be able to use one or more of these techniques to reduce your 2005 tax bill. However, tax planning cannot be done in a vacuum. With the help of a tax-planning professional, you can develop a year-end plan customized to fit your specific needs.

Shoring Up Deductions for Conservation Easements

New case points out tax law requirements

The IRS has been taking a tough stance on charitable deductions for **conservation easements**. However, a new case shows that you can still qualify for a current deduction if you meet the tax law requirements.

To qualify, the donation of an easement must be made exclusively for conservation purposes. For instance, a contribution may be made to protect a relatively natural habitat in which a fish, wildlife or plant community, or similar ecosystem, normally lives. With this type of conservation easement, public access to the area may be restricted.

Facts of the new case: Over a two-year period, the taxpayers donated conservation easements for undeveloped land along the shore of Lake Michigan. The donation was made to a qualified tax-exempt organization, which preserves

land and wilderness for the recreation and education of the residents of Michigan.

The couple maintained a log cabin, guesthouse and garage on the property. The easements did not interfere with their enjoyment of the property -- first as a vacation home and subsequently as their principal residence -- but did restrict development along the lakefront.

Was the contribution made exclusively for conservation purposes? To answer this question, the Tax Court relied heavily on the testimony of the taxpayers and the representatives of the tax-exempt organization.

Result: The Court determined that the easements donated protected a natural habitat for wildlife and plants, so the deductions were allowed.

Warning: Computer Hackers Sow “Pharming” Seeds

Take precautions against personal computer-based identity theft

Don't think you are safe if a “**phishing**” line has not hooked you yet. An even more insidious computer-based attack is making the rounds. This version is called “**pharming**” and it can lead to a financial disaster if you are not careful.

First, let's explain how phishing works. Typically, you receive an e-mail appearing to come from a financial services company or other firm. The e-mail asks you to update your account information or verify existing records by providing credit card numbers, user names, passwords and the like. Not only does the e-mail look identical to comparable messages from the actual source, the web site it links to is an exact replication. After the crooks obtain the information through this fraud, they sell it or use it for criminal purposes.

Pharming is a more sophisticated version of this scam. With pharming, the Domain Name Servers -- the giant machines that turn Internet names into real addresses -- allow a hacker to acquire the domain name for a web site and redirect that site's traffic to a different web site. If the web site receiving the traffic is a fake web site, such as a copy of a bank's web site, it can be used to “phish” or steal the personal computer (PC) user's information.

In other words, you will not even be aware that your information has been lifted. As far as your computer is concerned, everything is working fine and you really are talking to the web site you

thought you had accessed. Even worse, the pharming attack can redirect all of your traffic to this site -- your e-mail, transactions, etc. -- to the criminal's computer.

What can you do against pharming attacks? In addition to running an up-to-date antivirus program and maintaining a firewall, a little knowledge can go a long way.

For instance, most financial sites run on secure servers (i.e., there is a closed lock icon on the bottom of your Internet browser). The “https” indicates a secure server. By keying it in, you force the browser to go only to an SSL (Secure Sockets Layer)-enabled version of the web site.

If the site has been hijacked, your browser should issue a pop-up box alerting you that the site SSL certificate does not match the URL you typed. At that point, log off and abort your attempt to visit the hijacked site. Use the telephone to call and alert the financial company.

Secure sites must have a digital certificate issued by a trusted third party source such as VeriSign or Thawte. Your web browser can be set to properly validate SSL certificates.

By taking these precautions and using some common sense, you can ward off pharming attacks. It is recommended that you consult with a PC expert for more details.

IRS Rules on Cleaning Up Hazardous Materials

In a new Revenue Ruling, the IRS has clarified the tax rules for costs relating to the cleanup of hazardous waste materials.

Details: The new ruling covers five situations in which land and groundwater were contaminated with hazardous waste from manufacturing activities. Since the costs do not materially add to the value of land, appreciably prolong its life or adapt it to a new or different use, they are more in the nature of repairs than capital improvements. Therefore, they must be treated as indirect costs that are included in inventory costs to the extent they are allocable to inventory.

Although the ruling does not allow a current tax deduction for expenses, the news is not all bad. **Silver tax lining:** The costs can be recouped when the inventory is sold. In contrast, no recovery would be allowed if the costs were required to be capitalized.

It is recommended that you consult with a professional tax adviser concerning the impact of this new ruling on your production activities.

Take a Long Look at Long-term Care

Considering the well-being of family members

Due to recent medical advances, people are living longer these days. Of course, that's a good thing, but consider a potential downside to this benefit: Your family may face devastating consequences -- both financial and emotional -- relating to the long-term care of elderly relatives. Since the risk of needing long-term care increases with age, it is important to plan for your **care needs** now, while you are younger and healthier.

Background: Long-term care is the type of help people need when they are unable to perform activities of daily living such as eating, bathing and dressing. Typically, it is not provided by doctors or by skilled nursing professionals. Long-term care does not try to cure an illness.

Frequently, it is assumed that long-term care means care in a nursing home. While some people do require such specialized care, most long-term care takes place in the home and community. Family members, adult day-care centers and assisted living facilities are among the most common care providers. Long-term care is not defined by the setting in which it takes place, but by the **type of care** that is needed.

The family dynamic today little resembles that of even a generation ago. Children may live half a world away, single-parent homes are more common and more women are finding success and financial rewards in their careers. The safety nets that many relied upon in the past -- such as family caregivers -- may no longer be realistically available to those requiring care.

Important: Long-term care impacts the entire family, not just the person who needs care. A family member -- usually, a middle-aged adult with children of his or her own -- often takes on the role as unpaid caregiver for an aging parent or spouse. These caregivers typically must make adjustments at work and in their careers, such as taking leaves of absence or turning down promotions, in order to provide the needed care for an ailing relative. If you are a caregiver, this may also have an impact on your own family life and overall personal health.

Practical approach: Address these issues while you still have the opportunity. If you act expeditiously, you may be able to preserve the dignity and savings of a loved one who will need long-term care in the future.

Facts and Figures

Timely points of particular interest

➔ **Loyalty Oath** -- How can you gain the loyalty of your customers and employees? One prominent executive advises entrepreneurs to “be yourself” and make sure your employees follow suit. Displaying the genuine article -- no phoniness or pretenses -- can foster a high level of commitment within the organization and help distinguish your operation from the competition. All too often, customers will see through any bluster and go elsewhere.

➔ **Tools of the Trade** -- Generally, reimbursements for a worker’s tools are tax-free to the workers. However, a new IRS ruling draws an important distinction: The reimbursements are taxable unless the employees are required to substantiate expenses and return any excess amounts. This is true even if the employees have to provide their own tools and the employer bases the reimbursements on national industry surveys.