



## DYER & ASSOCIATES, P.C.

Certified Public Accountants

10415 Armory Avenue

Kensington, MD 20895

(301) 654-6200 FAX: (301) 692-1990

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## How to Cope with an IRS Audit

### *Surviving the ordeal with professional assistance*

Naturally, being subject to an IRS audit can be a nerve-racking experience, but it doesn't have to turn into life-or-death. If you stay calm, you may emerge from the ordeal relatively unscathed. In some cases, you might even be due a tax refund.

**First step:** Consult with a professional tax adviser for anything other than a simple "correspondence audit" about a math error or a comparable mistake. Your adviser can assess the potential damages, if any, you may incur and suggest the course of action to be followed. Depending on the circumstances, the ad-

viser may be used to spearhead your defense.

If you are tempted to handle things on your own, be forewarned: Simple matters can lead to complications down the road. Don't wait until it is too late to salvage the situation. In any event, you will need to supply the records needed during the audit. Usually, the better shape your records are in, the better off you will be.

There are three basic types of audits. They are:

**1. Correspondence audits:** This audit is generally handled through the mail, so

you never see an IRS agent face-to-face. Typically, a correspondence audit is limited to a few items on your return that can be cleared up by responding with the required documentation.

**2. Office audits:** As the name implies, this type of audit takes place at an IRS office. This type of audit generally requires that additional information be provided to determine if tax is due or to close the file.

**3. Field audits:** A field audit takes place at the taxpayer's home or place of business. The IRS auditor may ask for extensive proof of various deductions. However, a field audit usually does not turn into a comprehensive audit where the auditor questions every deduction. In

most cases, a field audit is targeted at businesses (especially large corporations) and high-income taxpayers.

It is important to provide the auditor with all the relevant information that he or she requests. However, no matter what type of audit is involved, there is no need for you (or an employee if your business is being audited) to volunteer information to an IRS auditor. The best thing to do is to comply properly with each request made by the auditor -- no more, no less.

***Final point:** There is no foolproof way to avoid an audit, but completing your return in a timely, orderly and accurate fashion reduces the odds of being tapped for an audit in the first place.*

# Roundup of New Energy Tax Law Provisions

## *New tax breaks available to individuals and businesses*

The recently enacted Energy Tax Incentives Act of 2005 provides a wide array of tax-saving opportunities for individuals and businesses. This new law generally takes effect in 2006. Here is a brief summary of the key provisions.

**Homeowner credits:** There are two types of credits available to homeowners under the new law.

**1. Solar and fuel-cell property:** Beginning in 2006, you can claim a personal tax credit each year for qualifying property. The credit is equal to 30% of the cost of

- ❖ Equipment that uses solar energy to generate electricity up to a maximum credit of \$2,000;
- ❖ A maximum credit of \$2,000 for solar water heating equipment; and
- ❖ Fuel-cell power plant technology that converts fuel into electricity (if certain other requirements are met) up to a maximum credit of \$500 for each 0.5 kilowatt of capacity purchased.

For this purpose, cost includes expenses for installation as well as hardware. The tax credits for solar and fuel-cell property are available only for equipment placed in service in 2006 and 2007.

**2. Residential energy property:** Homeowners can claim a 10% credit for energy-efficient building components, including insulation materials or systems that reduce heat loss and/or gain; exterior windows (including skylights); exterior doors; and certain metal roofs with special coatings designed to reduce heat gain. To qualify, the taxpayer must be the initial user of the equipment, and the

equipment must be expected to last at least five years.

In addition to the 10% credit, homeowners can claim a credit equal to 100% of the cost of

- ❖ Energy-efficient building property such as electric heat-pump water heaters; electric heat pumps; geothermal heat pumps; central air conditioning; and natural gas, propane or oil water heaters meeting certain energy efficiency standards. The maximum credit is \$300.
- ❖ Natural gas, propane or oil furnace or hot water boilers. The maximum credit is \$150.
- ❖ Advanced main air circulating fans. The maximum credit is \$50.

The overall lifetime credit for these improvements is limited to \$500, but only \$200 of the credit may be attributed to buying and installing energy-saving windows. These credits are also restricted to property placed in service in 2006 and 2007.

**Energy-efficient vehicles:** The new energy tax law effectively repeals the tax deduction for clean-air vehicles and replaces it with the following tax credits for vehicles placed in service after 2005.

- ❖ **Hybrid vehicle credit:** This type of vehicle combines an internal combustion engine with another system relying on an onboard rechargeable energy source (e.g., electric batteries).
- ❖ **Advanced lean-burn technology vehicle credit:** This refers to passenger autos and trucks with an in-

ternal combustion engine that uses lean-burn technology.

- ❖ **Fuel-cell vehicle credits:** This category includes automobiles that run on hydrogen cells.
- ❖ **Alternative-fuel vehicle credit:** The credit is available for vehicles capable of running solely on compressed or liquefied natural gas, liquefied petroleum gas, hydrogen or any liquid that is a minimum of 85% methanol, ethanol or any other alcohol.

**Note:** The actual calculations for these credits are complex and require professional assistance.

**Energy-efficient buildings:** Owners of commercial buildings may benefit from tax breaks for upgrading existing energy systems and constructing new ones in an energy-efficient manner. For qualifying property, the deduction is generally equal to \$1.80 per building square foot less any aggregate deductions claimed in prior years. This new deduction is available for property placed in service after 2005.

*Naturally, this is just an overview of the key provisions in the new energy tax law. Consult with a professional tax adviser for more details.*

## Six Steps for Cultivating Business Contacts

### *Traditional networking requires advance planning*

The business environment has changed dramatically since the onset of the electronic age, but networking is still often essential for continued success. This is the old-fashioned method of establishing contacts with influential people who can provide benefits to your business.

Successful networking is usually the result of diligent groundwork. Although there is a chance you might bump into someone at the airport or in town, most professionals will tell you that the best contacts are the ones planned in advance. While “accidents” may happen, it is better to be proactive than reactive.

With that in mind, here are six steps for networking your way to profitability.

**1. Develop a networking calendar.** At the beginning of each month, write down all the professional and social events you have been invited to attend. Examine each one closely and decide which offers the best chance for generating new busi-

ness. Make it a point to attend those meetings.

**2. Get the jump on the competition.** For each meeting you plan to attend, call beforehand and obtain a list of the scheduled attendees (if this is possible). Go down the list and check off the names of the people with whom you would most like to make contact. It’s a good idea to keep this “who’s who” list with you at the meeting as a handy reference tool.

**3. Study the meeting’s agenda.** What are the important issues that the attendees will most likely be talking about? Once you zero in on the “hot topics,” arm yourself with as much information as possible so you can carry on thoughtful, informative conversations with the contacts that you have targeted.

**4. Make a good first impression.** When you introduce yourself to a prospective client, be sure to say your name and the

name of your company clearly and with conviction. Don't get lost in the crowd. By the same token, listen closely to introductions. The surest way to lose a contact is to forget how to pronounce someone's last name or the location of his or her business.

**5. Collect cards.** At the very least be sure to get a business card from everyone on your "must meet" list. You might obtain other business cards from contacts you make. On each card, make a note of your conversation with that person and any ways in which you can help their business.

**6. Follow up.** Your networking attempts should not end when you leave a meeting or social event. When you get back to your office or home, make a list of the things you said you would do for the

people you met. It is important to fulfill the obligations that you have promised. Frequently, your credibility is at stake.

*When you are compiling your list of important contacts, do not forget to use your business advisers and other associates as sources.*

### **Need More Time to File? It's Automatic**

The deadline for filing your 2005 personal tax return will be here sooner than you think. Due to circumstances out of your control, you might not be able to wrap it up on time. In that case, you can request a filing extension. The IRS will grant an automatic extension for requests made before the tax return due date -- no questions asked and no late fees attached.

**Good news:** The automatic extension for 2005 returns is now six months. In the past, the IRS only provided four additional months to complete your return. If you needed more time, you were required to request another extension, subject to IRS approval.

Be aware that you still must provide an estimate of your tax liability based on the information available to you. Furthermore, you must pay at least 90% of your tax liability, through income tax withholding or estimated tax payments, by the original tax return due date. Otherwise, a late payment penalty will be assessed for each month dating from the original due date to the date of payment as well as interest figured on the regular interest rate for underpayments.

**Note:** Special rules apply to individuals who are out of the country or serving in a combat zone. Contact your professional tax adviser concerning these circumstances.

## Going Up: New 2006 Retirement Plan Limits

*Cost-of-living adjustments higher than usual*

The IRS has announced its annual cost-of-living **adjustments (COLAs)** for certain retirement plan thresholds. Due to relatively low inflation rates, the adjustments have been minor the last few years. However, the increases for 2006 are much larger than usual.

In addition, other qualified plan increases are mandated by law. For instance, the dollar limit for 401(k) plan deferrals jumps from \$14,000 to \$15,000 under a provision in the **Economic**

### **Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).**

The table below is a summary of the most important retirement plan changes taking effect in 2006.

***Caveat:** The annual limit for contributions to IRAs (individual retirement accounts; both traditional and Roth IRAs) remains at \$4,000 for 2006. The next scheduled increase to \$5,000 occurs in 2008.*

|   | <b>2005 Limit</b> | <b>2006 Limit</b> |
|---|-------------------|-------------------|
| Maximum annual dollar benefit for a defined benefit plan  | \$170,000         | \$175,000         |
| Maximum dollar limit on contributions to a defined contribution plan  | \$42,000          | \$44,000          |
| Maximum amount of compensation taken into account for qualified retirement plans  | \$210,000         | \$220,000         |
| Dollar limit for definition of "key employee" in top-heavy retirement plan  | \$135,000         | \$140,000         |
| Dollar limit for definition of highly compensated employee in qualified plan  | \$95,000          | \$100,000         |
| Dollar limit for elective deferrals to a 401(k) plan  | \$14,000          | \$15,000          |
| Dollar limit for contributions to a SIMPLE (Savings Incentive Match Plan for Employees) plan                                    | \$10,000          | \$10,000          |
| Dollar limit for elective deferrals to deferred compensation plans of state and local governments, and tax-exempt organizations | \$14,000          | \$15,000          |
| Dollar limit for catch-up contributions to 401(k) plan*   | \$4,000           | \$5,000           |
| Dollar limit for catch-up contributions to a SIMPLE plan*   | \$2,000           | \$2,500           |

*\*Catch-up contributions only permitted for individuals age 50 years or over.*

## Facts and Figures

### *Timely points of particular interest*

- Rotten Decision -- To qualify for a deductible casualty loss, the loss must be caused by a “sudden, unexpected or unusual” event. Damage that occurs progressively generally will not qualify. In a new case, a couple’s deck collapsed during a graduation party. It was determined that the damage was due to wet or dry rot, experienced over a long time. Result: Because the cause was not sudden, unexpected or unusual, no casualty loss deduction was allowed.
- S Corporation Alert -- The IRS recently announced that it plans to randomly select 5,000 S corporations for “research audit” purposes this year. The objective of the audits is to increase IRS understanding of S corporation practices. Since the last time this type of program was undertaken -- more than 20 years ago -- the number of S corporations in the country has quadrupled.