CPA

ClientBulletin

JANUARY 2006

BUSINESS & TAX PLANNING IDEAS *for* OUR CLIENTS *and* FRIENDS

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Get Tax Breaks for Helping Mom, Dad, or Other Aging Relatives

Do you feel the pressure that comes from financially supporting and caring for your children and your parents at the same time—like you're caught in the middle of two very demanding family roles, while managing a career and your own personal life? If so, you are one of the many thousands of Baby Boomers that comprise the Sandwich Generation.

These roles, when played altogether, can cause quite a strain on your finances. Before you forgo seeding your retirement account (which is one of the many ways you care for *yourself* financially), why not try to do all you can for yourself by reaping some of the tax advantages associated with caring for your aging relatives?

Dependency exemption and filing status

Your mother may live at home and your father may live in an assisted living facility, but if you provide their financial support, you are entitled to claim the appropriate number of exemptions and the head of household filing status.

A bit of information that often surprises people: Your parents do not have to live with you for you to claim them as your dependents, nor does where they live impact your filing status. The right to claim the "head of household" status can be beneficial to single filers.

The test is simply whether you supply more than half of the cost for your parents' support in a given year. But there is at least one exception to this rule: If you and your siblings, or other family members, all contribute roughly equally to your aging relatives' care, then you cannot claim the exemption or filing status. What you can do is bargain each year with all of your relative-caregivers for the exemption. So long as you provide more than 10% of the support, you can receive the entire dependency exemption providing that your relatives agree to that designation. Each of you can take turns claiming it each year, making it a fair deal for everyone.

The dependency exemption is worth $3,300 for 2006, and it is available for each qualified dependent. Thus, if you are caring for both your mother and your father, you may be entitled to a $6,600 exemption.

Deductible medical expenses

You might just be able to deduct the payments you make for medical expenses for your aging parent. To get this benefit, usually your relative must be your dependent. But if he or she does not pass the gross income or joint return test for dependency, you may still be able to claim these deductions. Our office can assess your situation to determine whether these are available to you.

Eligible medical expenses include those associated with nursing home or certain other long-term care costs, along with other types of services.

continued on page 3

IN THIS ISSUE

Did You Know?

An interesting financial planning incentive: First-born daughters are three times more likely to survive to age 100 compared to later-born daughters. And, overall, people living to age 100 and beyond represent one of the fastest-growing age groups of the American population, increasing at a rate of about 4.1% each year.

Source: The Society of Actuaries at www.soa.org

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Develop Better Financial Habits in 2006

Did you know that, on average, you can develop a new habit by repeating or avoiding a behavior for 21 days? If, for example, you'd like to give up chocolate, you could mindfully abstain from it for 21 days and ultimately you will have developed a new habit (for example, not eating chocolate).

Smart savings tips

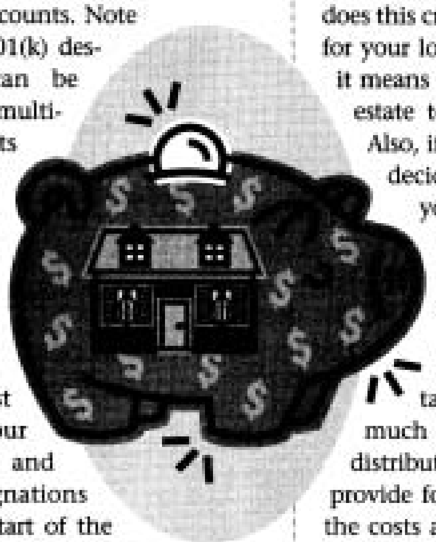
The same is true for repeated financial behavior. If you are accustomed to stopping by your local designer coffee depot before going to the office and dropping $4.25 plus a toss of coins into the ubiquitous tip jar, you can replace that behavior with something more financially desirable. For example, you can switch to a gas station or donut shop cup of $1.75 coffee, forgo the tip, and toss the remaining $2.50 per day in your own "tip jar." This would result in amassing at least $7.50 extra per week or at least $375.00 per year, even with a two-week vacation.

Your retirement savings

How about the funds you designate for contributions to 401(k)s, FSAs, HSAs, and IRAs? Could you develop a new habit to make the maximum allowed contributions to each, thereby cutting your net paycheck and probably your discretionary spending?

For 2006, taxpayers who are eligible to make IRA contributions can make a contribution of up to $4,000 to a traditional IRA (which is the same amount as 2005). If you are 50 or over, you can make an additional contribution of up to $1,000 for 2006, up from $500 in 2005.

In 2006, the maximum amount you can contribute to your 401(k) plan has increased to $15,000 (up from $14,000 in 2005). This $15,000 limit also applies to 403(b), 457, and SARSEP plans, as well as the new Roth 401(k), if your employer offers it. Under the catch-up contribution rules, taxpayers who will turn age 50 any time during 2006 and anyone older can contribute up to $5,000 extra to these salary reduction accounts. Note that Roth 401(k) designations can be partial, so multiple accounts are possible using the same total limit.



Although you must make your 2006 FSA and HSA designations before the start of the year, you can increase your retirement savings plan contributions throughout the year. The sooner you start thinking about your financial planning for 2006, the greater your chance to improve your financial and tax performance.

Your home

Regardless of whether the housing bubble continues to swell or is punctured sometime in the future, it's always best to maintain your investment at the highest standard possible. Keep up with repairs as needed to keep your home—likely your biggest investment—in peak condition.

In addition to keeping up with repairs, you should make certain to have adequate homeowner's insurance in the event of unforeseen and accidental misfortune.

The will to make a will

Some people's bad habits have to do with the avoidance of difficult subjects. Across the U.S., for example, some 50% of all adults are without wills. Not only does this create problems down the line for your loved ones or favorite charity, it means that you are subjecting your estate to needless federal taxation. Also, if you don't want the state to decide how best to distribute your assets, making a will is the best way to be certain that your wishes are carried out.

You should have a will to (1) reduce your potentially taxable estate; (2) gain as much control as possible over the distribution of your assets; and (3) provide for "freed up" assets to cover the costs associated with settling your estate.

Once you have made a will that conforms to the laws of the state in which you reside, make sure that you keep it updated and in a safe place. This means that if you marry, divorce, or remarry; adopt or have a child; move to another state or out of the country; experience a substantial increase or decrease in your net worth; or a host of other factors, you will want your will to reflect your most current set of circumstances.

Your properly signed and witnessed will should be kept in as safe a place as possible, such as with a county registrar of wills, if one is available. You may also want to tell your executors where it is kept.

continued on page 3

continued from page 3 — **Develop Better Financial Habits in 2006**

Plant "savings seeds" in children's heads

The best habits are born young and last a lifetime. A new year is also an excellent time to teach your children good financial habits, starting at as early an age as possible. One popular tip is to teach your children to put 15% of every paycheck, allowance, and gift into savings. By taking this simple step, your children can pave the road to financial security in their adult lives. Habits born young become the "little voice" inside that will stop them from spending an entire year-end bonus on a fancy new sports car when they are 28 years old.

Also, take a close look at your own money habits when setting an example for your children. Regardless of the influences exerted on your children by their peers, school, television, music, and the Internet, children tend to carry the lessons of how their parents handled money with them throughout their lives. Your children learn how to save—and how to spend—based on the patterns they see in their own home. Set good examples by, for example, talking about luxury items you will forgo buying to better save for their college education, and comparison shopping with them for the best rate on their savings accounts or the best price for toys.

Pay special attention to teaching your high school senior or junior about credit cards—before the aggressive credit card pushers on college campuses do it for you. Credit card representatives will offer free gifts for filling out an application, and will open credit lines to college students that enable them to spend without thinking about the consequences.

Social Security Changes for 2006

The Social Security Administration has announced increases in benefit amounts, cost of living adjustments, and maximum taxable earnings for 2006. Social Security and Supplemental Security Income (SSI) benefits increase automatically each year based on the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers.

Social Security payments

Monthly Social Security and SSI benefits have increased 4.1% for 2006—representing the largest increase in a decade. This means the average monthly Social Security benefit amount for all retired workers will rise from $963 to $1,002. The average amount for a retired couple, assuming both are receiving Social Security, will increase from $1,583 in 2005 to $1,648 in 2006. The maximum monthly benefit for a person retiring at "Full Retirement Age" (age 65 and 6 months for those born in 1940, age 65 and 8 months for those born in 1941) rises from $1,939 to $2,053 in 2006. The maximum federal SSI monthly payment to individuals has risen from $579 in 2005 to $603 and for couples from $869 in 2005 to $904 in 2006.

Social Security taxes

Based on the increase in average wages, the maximum amount of earnings subject to Social Security tax increases from $90,000 to $94,200 for 2006.

IRS Announces Various Inflation Adjustments for 2006

The IRS recently announced that personal exemptions and standard deductions will rise and individuals will be able to make larger tax-free gifts in 2006, thanks to inflation adjustments.

By law, a variety of tax provisions must be revised each year to keep pace with inflation. As a result, more than three dozen tax benefits are being modified for 2006. Key changes affecting 2006 returns include:

- The value of each personal and dependency exemption will be $3,300, up $100 from 2005.
- The new standard deduction will be $10,300 for married couples filing a joint return, $5,150 for singles and married filing separately, and $7,550 for heads of household. Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions, such as mortgage interest, charitable contributions, and state and local taxes.
- The annual gift tax exemption will be $12,000.

continued from page 1 — **Get Tax Breaks for Helping Mom, Dad, or Other Aging Relatives**

And did you know that the same dependency care savings plans available at your workplace are open to helping you fund care for your aging relatives? Many people believe that they can only designate funds from their workplace medical savings accounts to cover the costs of child care, but you can also direct these tax-favored funds to cover up to $5,000 (pre-tax) for your other dependents' care.

Projections indicate that by 2036, one out of every five Americans will be over the age of 65. Today, that number is somewhere around 36.3 million, or one out of every eight.

Tax Calendar

JANUARY 2006

January 10

Employees who work for tips. If you received $20 or more in tips during December, report them to your employer. You can use Form 4070.

January 17

Individuals. Make a payment of your estimated tax for 2005 if you did not pay your income tax for the year through withholding (or did not pay enough in tax that way). Use Form 1040-ES. This is the final installment date for 2005 estimated tax. However, you don't have to make this payment if you file your 2005 return and pay any tax due by January 31, 2006.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in December if the monthly rule applies.

January 31

All businesses. Give annual information statements (Forms 1099) to recipients of certain payments you made during 2005. Payments that are covered include: (1) compensation for workers who are not considered employees, (2) dividends and other corporate distributions, (3) interest, (4) amounts paid in real estate transactions, (5) rent, (6) royalties, (7) amounts paid in broker and barter exchange transactions, (8) payments to attorneys, (9) profit-sharing distributions, (10) retirement plan distributions, (11) original issue discounts, (12) prizes and awards, (13) medical and health care payments, (14) debt cancellations (treated as payment to debtor), and (15) cash payments over $10,000. There are different forms for different types of payments.

Employers. Give your employees their copies of Form W-2 for 2005.

For nonpayroll taxes, file Form 945 to report income tax withheld for 2005 on all nonpayroll items, such as backup withholding, and withholding on pensions, annuities, and IRAs.

For Social Security, Medicare, and withheld income tax, file Form 941 for the fourth quarter of 2005.

For all taxes, deposit any undeposited tax. If the total is less than $2,500 and not a shortfall, you can pay it with the return. If you deposited the tax for the year in full and on time, you have until February 10 to file the return.

For federal unemployment tax, file Form 940 (or 940-EZ) for 2005. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you already deposited the tax for the year in full and on time, you have until February 10 to file the return.

FEBRUARY 2006

February 10

Employees who work for tips. If you received $20 or more in tips during January, report them to your employer. You can use Form 4070.

February 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in January if the monthly rule applies. Begin withholding income tax from the pay of any employee who claimed exemption from withholding in 2005, but did not give you a new Form WS-4 to continue the exemption for 2006.

Individuals. If you claimed exemption from income tax withholding last year on the Form W-4 you gave your employer, you must file a new Form W-4 to continue your exemption for another year.

February 28

All businesses. File information returns (Form 1099) for certain payments you made during 2005. These payments are described under January 31. If you file Forms 1099 electronically (not by magnetic media), your due date for filing them with the IRS is March 31.

Employers. File Form W-3, along with Copy A of all the Forms W-2 you issued for 2005. If you file Forms W-2 electronically (not by magnetic media), your due date for filing them with the Social Security Administration (SSA) will be extended to March 31.

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