CERTIFIED PUBLIC ACCOUNTANTS

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CERTIFIED PUBLIC ACCOUNTANTS

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Dear Clients and Friends:

We hope that the New Year finds you all safe and healthy. Last year was a difficult year for most of us and many of us will still be coping for years to come. Here are our thoughts on some of the current issues that may affect you and your taxes for the 2005 and 2006 tax years.

Tax Changes. Again we have seen numerous changes to the tax code especially with the Katrina Emergency Tax Relief Act of 2005 ("KETRA") and the Gulf Opportunity Zone Act ("Go Zone"). Individual income tax rates for 2005 and 2006 remain unchanged with the brackets adjusted for inflation as in the past. For 2005 and 2006, both employer and employee will continue to pay 6.2% each for social security tax (old age, survivors, and disability insurance) and 1.45% each for Medicare tax (hospital insurance). The 2005 wage limit for social security tax is $90,000, while all covered wages are subject to Medicare tax. The social security wage limit will rise to $94,200 in 2006, a 4.7% increase.

Estate Taxes. The estate tax exemption increases to $2 million in 2006. The U.S. gift tax annual exclusion increases to $12,000 in 2006. The maximum estate and gift tax rate decreases to 46% in 2006. The lifetime gift tax exclusion remains at $1,000,000.

Extended Federal and State Tax Filing and Payment Deadlines for Those Affected by Katrina. The Internal Revenue Service and Louisiana have extended individual, corporate, franchise, payroll and estimated tax deadlines until February 28, 2006. Interest will be abated and underpayment penalties will not be charged for this period. Louisiana requires that all 2004 Amended Tax Returns for casualty losses be filed before February 28, 2006.

IRA Rules. The annual IRA contribution for both regular and Roth IRAs increased to $4,000 in 2005 and remains the same in 2006. Those 50 years and older can contribute $4,500 for 2005 and $5,000 in 2006; non-working spouses can contribute $4,500 for 2005 and $5,000 for 2006, as well. In 2005, if you are covered by a retirement plan at work, you can take an IRA deduction if your modified adjusted gross income is less than $80,000 (married filing joint) or $60,000 (single or head of household). In addition, it is a good idea to review your beneficiary forms to make sure that actual people, not a trust or your estate, are named as beneficiaries.

Retirement Plans. For 2005 the maximum individual salary deferral for a 401(k) is $14,000 and for individuals age 50 and over the catch- up limit is $4,000. The salary deferral increases to $15,000 with a catch-up limit of $5,000 in 2006. The maximum annual contribution to a retirement plan for a business owner in 2005 is $42,000 and in 2006 is $44,000, which does not include the $4,000/$5,000 catch-up provision. A discretionary employer profit sharing plan with a 401(k) option can allow business owners to increase their contributions above the $15,000 401(k) limit. For 2006 Roth IRAs are now allowed in your company's retirement plan. This may be of interest as Roth IRAs do not have required minimum distribution rules and distributions are tax-free. Be sure that your pension consultant or third party administrator reviews your retirement plan every year as changes in tax laws, employee ages, and owner's compensation can affect the type of plan that works best for your business.

Penalty-free Treatment for Qualified Katrina Retirement Account Distributions. The new law exempts up to $100,000 of "qualified Hurricane Katrina distributions" from the 10% premature withdrawal penalty tax that applies to most retirement account withdrawals taken before age 59½. Income tax is still due on the distribution. A qualified Hurricane Katrina distribution is any distribution from most types of tax-favored retirement plans and accounts (including IRAs) made on or after 8/25/05 and before 1/1/07 to an individual whose principal abode on 8/28/05 was in the Hurricane Katrina disaster area and who sustained economic loss due to Katrina. However, the aggregate amount you can treat as qualified Hurricane Katrina distributions in 2005 and/or 2006 cannot exceed $100,000. The new law permits qualified Hurricane Katrina distributions to be re-contributed to eligible retirement plans and IRAs to recover previous taxes paid. In addition, the new law says qualified Hurricane Katrina distributions that are not re-contributed (as defined earlier) can be spread out and taxed over three years.

*Larger Retirement Plan Loans for Katrina Victims***.** The new law generally increases the amount that can be taken out as a tax-free loan from a qualified retirement plan to the lesser $100,000 or your vested account balance. This special rule applies to plan loans made to any "qualified individual" after 9/23/05 and before 1/1/07. Under the normal rules, plan loans generally cannot exceed $50,000 or half of your vested account balance. Qualified individual means any person whose principal abode on 8/28/05 was in the Hurricane Katrina disaster area and who sustained economic loss due to Katrina. In general, retirement plan loans must be repaid within five years to be tax-free (home loans can have longer terms). The new law offers relief to any "qualified individual" who has a plan loan outstanding on or after 8/25/05 with repayment that is otherwise due between 8/25/05 and 12/31/06. The due date can be delayed for one year, and subsequent loan repayments will be adjusted to reflect the delay.

Standard Mileage Rates. If you haven't already done so, it is time to record your odometer reading. This will help document your total miles for 2005. The KETRA provides for changes in the allowable deduction for the standard mileage rates. See the chart below for 2005 and 2006 rates per mile:

	January 1- August 31, 2005	September 1- December 31, 2005	January 1- December 31, 2006
Business Miles	40.5	48.5	44.5
Charitable Miles	14.0	14.0	14.0
Charitable Services	*29.0	34.0	32.0
Medical Miles	15.0	22.0	18.0
Moving Miles	15.0	22.0	18.0

* Only applies to the period after August 24, 2005 and before September 1, 2005.

New Mini Personal Exemption for Housing Katrina Victims. For 2005 and 2006, the new law provides a $500 mini personal exemption (equivalent to a deduction) for each Hurricane Katrina displaced individual housed in your principal residence. There is a $2,000 cumulative cap on the exemptions, therefore, amounts claimed in both 2005 and 2006 must be added together. An exemption can only be claimed once for a particular person, and no payment can be received for housing that person. To qualify for this write-off, you must provide housing in your principal residence for a period of at least 60 consecutive days ending in the year for which you claim the exemption. You need not itemize to benefit.

No Limitations on Katrina-related Personal Casualty Losses. The new law provides that the normal $100 per incident floor for personal (non-business) casualty and theft losses and the separate 10% of Adjusted Gross Income floor are both waived for personal casualty and theft losses caused by Katrina on or after 8/28/05 in the Hurricane Katrina disaster area. This means that you can fully deduct such losses on your Form 1040 as an itemized deduction. The casualty loss calculation can be complex. We have included an example below for your reference. In addition, we will attach a schedule to your 2005 organizer that can assist you in preparing a list of the contents lost in your home. Properly completing this schedule will help minimize the fees to report the casualty loss. Fees for reporting casualty losses will be based on the organization of your records and the complexity of your individual situation. Casualty losses can be claimed on your 2004 or 2005 income tax returns. We will assist you in determining in which year to claim the loss. Again, Louisiana is requiring all 2004 Amended Tax Returns for casualty losses be filed before February 28, 2006, which is not a very practical limit.

Calculation of Casualty Losses. Casualty losses are calculated in a two-step process. The first step is to determine the lesser of your basis (what you paid for the property, plus improvements) or the decrease in fair market value as a result of the casualty. The second step is to add back any insurance proceeds that were received to compensate for the loss.

Example: You bought your home in Lakeview 10 years ago for $250,000 and spent an additional $50,000 in improvements since then. Hurricane Katrina flooded your home in August 2005. A competent appraisal valued the property as a whole at $650,000 before the storm but only $100,000 after the storm. Your insurance company paid you $250,000 for your loss. Your casualty loss is calculated as follows:

1. Adjusted Basis in the property	$ 300,000	(250,000+50,000)
2. FMV before the storm	650,000	
3. FMV after the storm	100,000	
4. Decrease in FMV (step 2 - step 3)	550,000	
5. Loss (smaller of step 1 or step 4)	300,000	
6. Subtract Insurance	(250,000)	
7. Casualty Loss	$ 50,000	

Extended Tax-free Replacement Period for Katrina-damaged Assets**.** The new law extends the normal period to replace assets in order to avoid being taxed on gains triggered by casualty insurance proceeds (or certain other payments) to five years for assets (whether business or non-business) damaged or destroyed by Katrina on or after 8/25/05 as long as you acquire replacement assets that are used within the Katrina disaster area.

Work Opportunity Tax Credit for "Katrina Employees". The new law provides that employers may take a credit up to $2,400 (maximum qualified wages for credit is $6,000) per employee who lived in the affected area and is hired within two years by an employer located in an affected area. (Special rules apply for rehires).

New Employee Retention Tax Credit for Small Companies Affected by Katrina. This new break is intended to encourage Katrina-affected small employers to retain and continue paying their employees until the end of this year. The maximum credit is $2,400 per employee whose employer is located in the affected area, but the benefit is mostly offset by the loss of deduction for those same wages.

Alternative Minimum Tax (AMT). Originally intended to ensure that wealthy taxpayers paid a minimum amount of taxes, it is estimated that by 2010 32 million taxpayers will be affected by the AMT. The majority of these taxpayers will have incomes of less than $100,000. Taxpayers with large dividend or capital gains income are victims of this tax without ever engaging in any overt tax avoidance strategy. Approximately 15% of our clients were hit with this tax in 2004. The real grief from this tax arises when taxpayers learn many of their itemized deductions are essentially disallowed when the AMT takes effect. State income taxes are not deductible for taxpayers in AMT, which is another reason to purchase Louisiana movie credits (see below).

Movie Tax Credits. In 2002, the Louisiana legislature enacted the Louisiana Motion Picture Tax Incentive Act (the "Act") in order to induce production companies to base their film and video productions (i.e., movies, television shows, commercials, music videos, etc.) in Louisiana. The Act provides a tax credit incentive for qualified, Louisiana-based productions. The state of Louisiana issues tax credits to producers who film motion pictures in our state. However, these producers are usually not residents of Louisiana and can't take advantage of the tax credits. As a result, they are selling the credits to Louisiana residents at a discount to be used against Louisiana state income tax. Individuals claim their share of the credit on their individual tax returns. These credits can be purchased for 85 cents on the dollar and in lots beginning at $5,000. In the event the entire credit cannot be used in the year earned, the remaining credit may be carried forward and applied against income tax liabilities for the next ten years.

LA Sales Tax Refund on Uninsured Personal Property. Louisiana victims of Hurricane Katrina in parishes where disaster relief funds have been made available by President Bush may be eligible for a refund of state sales taxes paid on uninsured personally owned, non-business, movable property destroyed in the storm (not on acquisition of replacement property) and not reimbursed by insurance.

<u>*Immediate Expensing of Capital Assets.*</u> The Go Zone act provides up to $100,000 of immediate expensing of capital assets placed in service in the disaster area in addition to the $108,000 that was previously allowed bringing the total to $208,000. The Go Zone act also brings back 50% extra first year bonus depreciation. These changes are in effect for assets placed in service from August 28, 2005 – December 31, 2007. The 50% bonus depreciation is extended to December 31, 2008 for residential rental and non-residential real property, as long as the original use of the property begins with the taxpayer, essentially limiting it to new construction.

<u>*Net Operating Losses.*</u> The Go Zone act allows for a special five year carry back of net operating losses instead of the normal two year period for losses attributable to certain Katrina expenditures and losses.

<u>*Hope and Lifetime Education Credits.*</u> The Go Zone act doubles the Hope and Lifetime education tax credits for 2005 and 2006. The maximum Hope credit is $3,000 for 2005 and $3,300 for 2006, and the maximum Lifetime credit for 2005 and 2006 is $4,000.

<u>*Energy Tax Incentives Act of 2005.*</u> This act was passed in August and provides for a very small credit of up to $500 if you replace existing doors, windows, heat pumps, hot water heaters, central air conditioners, etc. with energy efficient models. Please keep receipts for these purchases and we will be able to take the credit on your 2006 tax returns. The act also provides for credits for hybrid vehicles. This credit can range from $400 to $2,400 depending on the vehicle.

<u>*E-filing*</u>. Last year approximately 30% of our clients successfully utilized the Authorized IRS e-file Program. The e-file program allows us to electronically file your federal and state individual income tax returns. We continue to peruse this avenue as a more convenient method of filing for our clients. Please let us know if you are interested in this "paperless" filing program.

<u>*Privacy Policy.*</u> We again wish to remind you the information you supply us to prepare your financial statements, income tax returns, and to provide various tax and financial planning services is held in the strictest confidence. We do not disclose personal information about our clients or former clients to anyone for any reason without specific authorization. We do not outsource any work overseas and have no plans to do so in the future.

<u>*Office Update.*</u> Our office suffered flood damage on the first floor, but we have been back in the office working upstairs since November 15th. Despite the hurricane, we do have good news. John is the proud new father of Caroline Kelly Falgoust, who was born July 29th. Annie, Janet, and Nicole are still with us and help us continue to provide you the high level of service you have come to expect.

We all wish you a happy, prosperous, and hurricane free 2006!

Dave John