RECAP OF SIGNIFICANT DEVELOPMENTS THAT OCCURRED IN THE FIRST QUARTER OF 2006

The following is a summary of the most important tax developments that have occurred in the first quarter of 2006 which may affect you, your family your investments and your livelihood. We've summarized the most important new developments below. Please call us for more information about any of these developments and what steps you should implement to take advantage of favorable developments and to minimize the impact of those that are unfavorable.

- **Chances of being audited**

  The IRS has issued its annual data book, which provides statistical data on its fiscal year 2005 activities, including how many tax returns it examines (audits), and what categories of returns it focuses its resources on. In general, audit rates have risen in all categories of nonbusiness individual returns except for those 1040A filers under $25,000. The audit rate for most corporations has declined, but it has increased for corporations with assets of $250 million or more.

- **Energy-efficient home improvements tax credit.**

  The IRS has issued guidance on the up-to-$500 tax credit available to homeowners for eligible energy-efficient home improvements placed in service after 2005 and before 2008. A 10% credit is allowed for the cost of certain improvements, e.g., insulation, exterior windows, skylights, exterior doors and pigmented coated metal roofs; and a specified amount is allowed for other items - e.g., advanced main air circulating fans ($50), natural gas, propane or oil furnaces or hot water boilers ($150), and heat pumps, water heaters, and central air conditioners ($300). Manufacturers of these energy-efficient items must provide consumers with a certification that they can rely on in claiming the credit.

- **Donations of cars, boats, and planes valued at more than $500**

  The IRS has revised the form which a charity must use for 2006 to report qualified vehicles donated to it - Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes. Under stringent new rules, a taxpayer's charitable deduction for these vehicles with a claimed value in excess of $500 can't, with a few narrow exceptions, exceed the charity's gross proceeds from its sale of the vehicle. The revised form clarifies that, for a donor to get his deduction, the charity's acknowledgement must include (along with other required information) whether the charity provided any goods or services in exchange for the vehicle, and a description and good faith estimate of the value of any such goods or services, or, if the goods or services consist solely of intangible religious benefits, a statement to that effect.

- **Phaseouts of 2006 itemized deductions and personal exemptions**

  Under liberalized tax law changes which apply for the first time in 2006, there's a smaller phaseout of a higher-income taxpayer's itemized deductions and personal exemptions. All things being equal, a smaller phaseout means a larger deduction and, as a result, less taxes due for 2006. This may be of particular importance to individuals who must pay quarterly estimated tax or face a penalty (i.e., most taxpayers who have income which is not subject to withholding). The smaller reductions in a taxpayer's itemized deductions and personal exemptions may result in smaller required estimated tax payments during the year. The IRS has provided official worksheets for calculating these reduced phaseout amounts.

- **Domestic production deduction**

  The IRS's instructions to new Form 8903, Domestic Production Activities Deduction, and revised instructions to S corporation Form 1120S and partnership Form 1065 carry additional guidance on some aspects of the new-for-2005 U.S. production activities deduction. Under this provision, taxpayers are allowed a deduction equal to a percentage (3% for 2006; 6% through 2009; and 9% thereafter) of the lesser of their qualified production activities income for the tax year (i.e., net income from U.S. manufacturing, production or extraction activities) or their taxable income, subject to a 50% of W-2-wages limitation. The various instructions shed some light on the often tortuous computations necessary to determine this credit. For example, they explain how disallowance rules under other deductions apply, and provide liberalized rules for computing qualified production activities income. They also explain special rules which apply to S corporations and partnerships.

- **Contractor's energy-efficient home credit**

  The IRS has explained how an eligible contractor can get the required certification for a dwelling (including a vacation home) which he's constructed in order to qualify for the $1,000 or $2,000 energy-efficient credit. This new credit applies to homes purchased after December 31, 2005, and before January 1, 2008. To get the credit, the home's construction (which can include substantial reconstruction and rehabilitation) must be substantially completed after August 8, 2005, and meet specific energy saving requirements. The IRS guidance carries a list of software programs which may be used in calculating energy consumption to obtain the certification.

- **Cost of removing building's mold is currently deductible**

  Generally, expenses must be capitalized if they're needed to place property in an ordinarily efficient operating condition (as in the case of expenses to remedy a condition that existed when the property was acquired), or if they add to a property's value, substantially prolong its useful life, or adapt it to a new or different use. The IRS and some courts have treated the costs of removing asbestos from a building as a capital expenditure because it results in an improvement in the property by reducing or eliminating human health risks. In welcome news for taxpayers affected by the sometimes devastating cost of a mold condition in a structure, the IRS has privately ruled unlike the costs of removing asbestos the cost a business incurs to remove mold from a building it owned and leased out is deductible as an ordinary and necessary expense.

- **Luxury auto depreciation limits for 2006**

  The IRS has released the inflation-adjusted depreciation limits for business autos, light trucks and vans, including minivans and sport-utility vehicles (SUVs), placed in service in 2006. It has also released the annual income inclusion amounts for such vehicles first leased in 2006. The "luxury passenger auto limits"cap the otherwise allowable depreciation which can be claimed in a year. In general, the limits are the same as for vehicles placed in service last year, except for a slight increase ($100) for business autos in some years after the car is first placed in service. The IRS guidance also carries the depreciation limits and lease inclusion amounts for electric autos.

- **Distributions from Roth 401(k)s**

  The IRS has issued proposed reliance regulations which provide comprehensive guidance on the taxation of distributions from Roth 401(k) accounts. For tax years beginning after 2005, an employer's Code Sec. 401(k) plan or Code Sec. 403(b) annuity can include a qualified Roth contribution program (i.e, a "Roth 401(k)") which allows participants to elect to have all or part of their elective deferrals treated as Roth contributions. These amounts are currently includible in income, but their distributions may be excluded from income. The complex rules which apply to Roth 401(k)s are different from those applicable to Roth IRAs. For example, the special ordering rule which treats the first distributions from a Roth IRA as a return of contributions (and thus not includible in income) until all contributions have been returned as basis doesn't apply to distributions from a Roth 401(k); instead the tax rules for annuities apply.

- **Hurricane relief**

  The IRS has approved an additional filing and payment extension to August 28, 2006, for some, but not all, of those treated as affected taxpayers because of Hurricane Katrina. It has also extended until October 16, 2006 the deadline for deducting in a prior year hurricane-related losses attributable to Hurricane Katrina, Rita, or Wilma.

- **Tobacco payment information reporting will reflect installment reporting option**

  The IRS says it will modify the information reporting requirements for payments made to owners of tobacco quotas in exchange for the termination of the quotas because it has learned that many quota owners were confused about how much to report on their tax returns. The confusion stems from the fact that installment reporting is allowed but the current information reports only show the gross proceeds to be paid over 10 years.

- **Toyota Prius Hybrid certified for the clean burning fuel deduction**

  The IRS has certified the 2006-model-year Toyota Prius Hybrid as being eligible for the clean-burning fuel deduction. The original owner of one of these vehicles may claim a deduction of $2,000 for vehicles placed in service in 2005, the last year this credit is available. (However, hybrid vehicles may qualify for the new Code Sec. 30B alternative motor vehicle credit.) Other 2006-model-year vehicles previously certified by the IRS are the Ford Escape Hybrid, the Mercury Mariner Hybrid, the Lexus RX 400h and the Toyota Highlander Hybrid.

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