RECAP OF SIGNIFICANT DEVELOPMENTS THAT OCCURRED IN THE SECOND QUARTER OF 2005

The following is a summary of the most important tax developments occurring in the past three months which may affect you, your family, your investments and your livelihood. Please call 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 which are unfavorable.

- **IRS explains new tougher rules for auto donations.**

  The IRS has issued guidance on the tougher charitable contribution rules which apply to autos (as well as boats and planes) donated after 2004. Under these rules, the deduction for qualified vehicles (motor vehicles, boats and planes which aren't inventory or held for sale in the ordinary course of business) contributed to a charity after 2004 for which the claimed value exceeds $500 is dependent on the charity's use of the donated property. If the charity sells the vehicle without any "significant intervening use" (i.e., the charity actually uses the vehicle to substantially further its regularly conducted activities, and the use is significant) or "material improvement" (i.e., a major repair or improvement), the donor's charitable deduction can't exceed the charity's gross proceeds from the sale. The guidance explains these new terms and creates a whole new exception for autos given (or sold at low price) by the charity to needy individuals. Here, the donor may deduct the auto's fair market value. The guidance also informs donors of what they must do to substantiate their contributions.

- **Flexible spending arrangements can have grace period.**

  Cafeteria plans (also known as flexible benefit plans or flexible benefit arrangements) allow employees to pay for health benefits and other qualified benefits with pre-tax dollars. The employee must determine how much he wants set aside from his salary before the beginning of the year. Any amounts not used for qualified benefits incurred before the end of the year are forfeited. Employees often try to avoid any forfeiture by incurring qualified expenses late in the year, such as ordering new eyeglasses or contact lenses in December. The IRS says companies can give employees an additional 2 ½ months after the close of the year to utilize unused amounts. However, there is a possible downside where a health savings account (HSA) is also involved. Because an individual can't contribute to an HSA while he's covered by an FSA (flexible spending arrangement), if the 2 ½ month grace period is treated as coverage under an FSA, an employee would be ineligible to make contributions to an HSA during the extension period.

- **Deduction limits on aircraft for employees' personal use.**

  An IRS notice explains the tough 2004 Jobs Act deduction restriction on aircraft provided for the personal use of officers, directors and more-than-10% owners. Although the notice's main focus is on deductions for aircraft use, its principles apply to other types of expenses for entertainment -, amusement - or recreation - related goods, services and facilities. For costs incurred after October 22, 2004, an employer's deduction is limited to the amount of the costs which are treated as wages (or nonemployee compensation) to the recipient on account of the personal use. In the notice, IRS clarifies that these rules don't affect deductions for supper money furnished to an employee working overtime, a hotel room maintained by an employer and furnished to employees while traveling on business or an auto used for business even though used for routine personal purposes such as commuting to and from work.

- **Gain from state disaster relief to business may be deferred by reinvesting.**

While a number of Code provisions may allow an individual to receive disaster relief without having to pay any tax, a new revenue ruling explains these aren't available to a corporate taxpayer. However, the rules on involuntary conversions and replacement property can allow a corporation to defer its tax on disaster relief payments. In the ruling, a business realizes taxable gain when it receives a grant under a state's program to reimburse business losses for disaster-related damages. But it then gets to defer this gain to the extent it buys qualifying property similar to that damaged or destroyed.

- **Flat-rate long-distance telephone service not subject to 3% excise tax.**

The Eleventh Circuit recently held, contrary to IRS's view, the 3% federal excise tax on long-distance telephone service doesn't apply to charges for calls which don't take into account the distance of the call, i.e., non-distance sensitive service. This decision reverses the one court decision which had agreed with the IRS. In addition, bills repealing this excise tax have been introduced in both Houses of Congress. Because of this, there's some speculation the IRS may soon abandon its position.

- **Disclaimer can be made after receipt of minimum distribution.**

A recipient can disclaim property without it being treated as having been transferred to him for gift or estate tax purposes only if he makes a "qualified disclaimer," i.e., one which meets various requirements. In particular, the one disclaiming can't have accepted the property or any of its benefits. A separate rule requires an IRA owner to begin taking required minimum distributions (RMDs) by April 1st of the year following the year in which he attains age 70 1/2. A new revenue ruling concludes a beneficiary of an IRA may make a qualified disclaimer of the IRA even after he has taken a RMD from the IRA. However, there can be no qualified disclaimer of the RMD amount itself and the income allocable to it since the beneficiary has already accepted the RMD amount.

- **Revised rules of conduct for tax practitioners.**

The IRS has revised its rules governing the rules of practice before IRS, commonly known as Circular 230, which are effective for written advice rendered after June 20, 2005. With the goal of improving ethical standards and curbing abusive transactions, these rules prescribe conduct for accountants and attorneys who prepare tax returns and give tax opinions. These rules affect what advice a preparer and tax advisor can give you and how he can do it. For example, strict and sometimes burdensome standards apply for "covered opinions," written advice (including electronic communications) dealing with certain tax shelters and plans for tax avoidance or evasion. The revised regulations exclude three types of advice from these burdensome standards: written advice solely for a taxpayer's use after he has filed a return reflecting the transaction referenced in the written advice; advice provided to an employer by a practitioner solely for purposes of determining the employer's tax liability; and written advice concluding a tax issue won't be resolved in the taxpayer's favor.

- **Two more hybrid vehicles certified for clean fuel deduction.**

  IRS has certified the 2006-model-year Lexus RX 400h and Toyota Highlander 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 the year the vehicle is first put into use. The IRS had earlier certified the following model-year 2005 hybrid gas-electric automobiles as being eligible for the clean-burning fuel deduction: the Ford Escape SUV, Toyota Prius, Honda Insight, Honda Civic Hybrid and Honda Accord Hybrid.