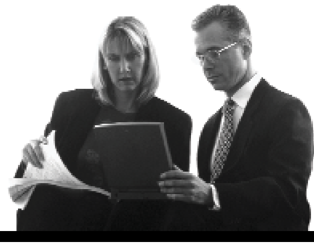
BKD

Advisor

Beyond Your Numbers

June
2006



Information to Help You Make Smart Business & Financial Decisions

IRS SIMPLE IRA plan compliance letters

In its audits of employers with Savings Incentive Match Plan for Employees (SIMPLE) individual retirement account (IRA) plans, the Internal Revenue Service (IRS) discovered significant noncompliance with amendments required by the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA).

Therefore, the EGTRRA relief initiative was launched to give SIMPLE plan sponsors more time to update their plans and retain the favorable tax benefits they afford. As part of this effort, the IRS is sending 190,000 small employers with SIMPLE plans a letter with tips to determine if plan documents are up to date:

- Only use IRS model forms with revision dates of March 2002 or August 2005.
- If you use a prototype issued by a financial or other institution, it *likely* complies if its issue date (or most recent revision date) is after April 2002.

What if your documents have not been updated? Current IRS model forms are available from the IRS web site: **http://www.irs.gov**. If you use prototype documents but your provider has not supplied the updated version, substitute an IRS model form that complies with the above. (Have your BKD advisor review both documents for any unintended consequences in making the switch.)

The relief initiative gives plan sponsors until December 31, 2006, to make the required amendments. Your plan could be disqualified if you fail to update your documents on or before the December deadline.

As we go to press, the President has signed the *Tax Increase Prevention and Reconciliation Act of 2005*. Most notably, the Act extends preferential rates for capital gains and dividends and provides alternative minimum tax (AMT) relief for 2006. Stay tuned for more information about this Act.

Miscellaneous business tax law changes for 2006

Electronic filing of returns - C and S corporations with assets of $50 million or more that file at least 250 returns annually must electronically file their 2005 federal income tax returns. For 2006 returns, the asset threshold drops to $10 million. Accordingly, many more corporations will be required to e-file their 2006 federal income tax returns.

Taxes paid by credit card - Beginning January 1, 2006, businesses filing Form 940, *Employer's Federal Unemployment Tax Return*, and Form 941, *Employer's Quarterly Federal Tax Return*, can pay any balance due using a credit card over the phone or Internet.

Credit card payments—which can be made through either of two authorized service providers that are permitted to charge a fee

Can you control your digital information?

by John Mallery, jmallery@bkd.com

Current advances in technology have made it extremely easy for individuals and businesses to store and transmit large amounts of data. Though distributing information with a mouse click has improved workplace efficiency, it's also created problems in that widely disseminated data is becoming more difficult to control.

Employees share information with colleagues and can easily share it with competitors simply by e-mailing proprietary information as an attachment or copying it to a portable data-storage device.

At one time, the most commonly used portable data-storage device was the venerable floppy disk. It had limited capacity but could easily store client lists, business plans and some financial records.

Then, new developments in technology made it possible to copy data to a CD (compact disk), which can store the equivalent of more than 450 "floppies." Today's most common portable data-storage devices are USB (Universal Serial Bus) flash drives.

Also called jump or thumb drives, these devices are about the size of a tube of lipstick and can store a huge amount of information. In fact, USB drives exist that can store 16GBs (gigabytes) of data—that's more than 10,000 floppies can store!

As technology advances, it's important to recognize that as the capacity of these devices increases, their physical size will decrease. USB drives now come in many forms, including pens, watches, pocket

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What's inside

based on the amount of the payment—can be made for the balance due on the current return.

In addition, Form 941 filers can make credit card payments for up to three prior quarters. Service providers give a confirmation number as proof of payment, effective on the date the charge is authorized. Note, tax deposits **cannot** be paid by credit card.

Withholding on nonresident alien employees - With certain exceptions, for wages paid on or after January 1, 2006, employers must calculate income tax withholding on wages of nonresident alien employees by adding an amount to their wages solely to calculate their income tax withholding for each payroll period. The specific amount depends on the payroll period.

Employers determine income tax withheld by applying **IRS Publication 15** tables to the sum of the wages paid for the payroll period plus the additional amount.

Credit and deduction expirations - Unless legislative action extends them, the following credits and deductions expired December 31, 2005:

- The research and experimentation tax credit
- The work opportunity tax credit (except for most Hurricane Katrina employees)
- The welfare-to-work tax credit
- The Indian employment tax credit
- Accelerated depreciation for business property on an Indian reservation
- The 15-year straight-line cost recovery for qualified leasehold and restaurant improvements
- Upfront expensing of "Brownfield" remediation costs (except for qualifying projects under the *Gulf Opportunity Zone Act of 2005* (GO Zone Act)
- Suspension of the 100%-of-net-income limitation on percentage depletion for oil and gas from marginal wells
- The deduction for corporate donations of computer technology

Uniform state sales-tax system launched

After about five years in the making, the *Streamlined Sales and Use Tax Agreement* (SSUTA) took effect October 1, 2005, launching a uniform state sales-tax system nationwide.

SSUTA has benefits *and* pitfalls for taxpayers. Initially, 19 states are participating in the system, but many more are expected to join. States generally believe billions of dollars in sales and use taxes go uncollected, and they hope SSUTA will help with collections, primarily through increased cooperation between member states and electing retailers.

Further, by signing on, many retailers will collect and remit taxes they are not legally obligated to, such as taxes on Internet or mail-order sales to customers in states where the retailer has no physical presence. This means purchasers will pay more sales and use taxes.

Retailers are not required to participate in SSUTA because it's strictly voluntary. So why would retailers volunteer to participate? SSUTA creates a system of simplified returns, uniform definitions and other paperwork reductions, saving big retailers money.

Another attractive benefit to electing retailers is an amnesty program. Retailers that volunteer during the amnesty period to collect taxes for all the participating states for a 36-month period will generally incur no audit risk for any past tax liabilities, including penalties and interest.

The amnesty program does not apply to retailers already registered in a state or those already contacted for audit.

Are you giving Uncle Sam an interest-free loan?

Receiving a refund check from the IRS is like getting money you didn't have to work for. The check just appears in your mailbox after you file your income tax return. Perhaps you've come to think of it as your annual bonus from the government.

Here's another way of looking at it: Receiving a refund means you overpaid your taxes and provided an interest-free loan to Uncle Sam. That money could have been invested throughout the year to generate income.

For example, suppose you've been receiving a $12,000 annual refund for the past 10 years. If you had invested that $1,000 a month in a fund earning 8% a year (compounded monthly), you would have about $183,000 after 10 years—$9,000 more than if you had invested your refund each year as a lump sum.

Remember, it's up to you to change your withholding allowances or estimated tax payments as your tax circumstances change. If you get married, have children or purchase a home, you may want to make an adjustment in your withholding to better reflect your particular situation.

Simply ask your employer to change the amount you have withheld from your paycheck. And, if you pay quarterly estimated taxes, review your income and deductions annually to determine the appropriate amounts to pay.

Should you yield to tax-exempt investments?

Should you put your money in an investment that pays 8% or one that pays 5%? Sounds like a no-brainer, doesn't it? But what if the interest you earn on the investment paying 8% is taxable, while the interest on the investment paying 5% isn't? Then which one should you choose?

Taxable investments typically pay higher rates of return than tax-exempt investments. But you'll want to know the after-tax yield before you decide. Do the math—you can't make an accurate comparison until you know how much tax you'll pay on the income from the taxable investment.

To find out, subtract your marginal tax rate from 100% and multiply the rate of return on the taxable investment by the result. For example, here's the calculation if your marginal rate is 35%: 100%–35% = 65% x 8% return = 5.2%.

Compare this with the rate of return on the tax-exempt investment. In this example, a tax-exempt investment would have to pay more than 5.2% to be a better deal than the 8% yield on the taxable investment.

Working from home? Keep door open to tax benefits

When your workplace is as close as your basement or spare room, the boundary between home and business probably gets blurry at times; however, if for no other reason than your taxes, it's important to separate the two.

What's deductible? - As the owner of a home-based business or professional practice, you may be able to deduct various expenses related to using your home for business purposes, potentially including:

- Heat, air conditioning, electricity
- Cleaning services
- Homeowners' insurance
- Trash removal
- Building depreciation

Because many expenses relate to your entire home, calculating the business portion is usually accomplished using square footage.

Example: The square footage of Meredith's home office is 10% of her home's total square footage. Last year, Meredith paid $1,200 to heat her home. She may deduct $120 (10%) as a business expense, provided she meets the tax law's requirements for a home office deduction.

Off limits - Deductions for a home office are generally available only if the space is used regularly and *exclusively* for business. The exclusive-use rule can be particularly difficult to follow.

Example: During business hours, Derek's home office is used strictly for business; however, Derek also uses it as a bedroom when his kids visit. Derek's office doesn't qualify as a home office, even though there is no personal use of the room during the workday.

Selling your home - Ordinarily, you may exclude up to $250,000 of capital gain ($500,000 if married) from your income when you sell your home, provided you have owned and used it as your principal residence for at least two of the five years before the sale.

However, when you have a home office, you have to pay tax (at a 25% rate) on capital gain up to the amount of prior depreciation on the home. Any *additional* gain can qualify for the $250,000/$500,000 exclusion.

Example: The Garcias, who previously deducted $15,000 of depreciation for their home office, made a $100,000 profit when they sold their principal residence. Although they meet the tax law's requirements for a capital gain exclusion of up to $500,000, they will have to pay tax on $15,000 of their profit, the amount previously deducted as home-office depreciation.

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Can you control your digital information. . .

continued from page 1

knives, credit cards, stuffed animals—even sushi!

Actually, you no longer need portable data-storage devices because free, online storage sites exist, such as Box.net (**www.box.net**) and ElephantDrive (**ww.elephantdrive.com**). These sites allow users to securely store information on a third-party server, accessible from anywhere using an Internet connection.

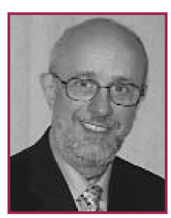
As easy as it is to distribute data with these tools and devices, it's surprising many businesses don't restrict or monitor their use. If you suspect an employee of inappropriate distribution of proprietary data, it's possible to accurately pinpoint his/her online activities using computer forensics.

Computer forensics can recover deleted files, Internet history and activity and a wide range of other information. Computers create so much residual data in the background during use, that incredible amounts of data can be recovered from a computer hard drive. This makes it difficult for users to completely cover their tracks if involved in inappropriate activities.

While computer forensics can help during investigations and litigation, it also can evaluate employee productivity. Even if employees aren't involved in illicit activities, it could be helpful to know if their time is spent surfing the Internet or engaging in activities like online trading, visiting adult-oriented web sites or participating in online auctions. ❖❖❖

BKD Kansas City opens computer forensics lab

Computer forensics is a powerful tool that can help you avoid risk and regain control of your digital data. BKD has high-tech computer forensics labs in two of its 27 locations and will soon open a third in its Kansas City office. Richard J. Marchewka, who recently joined BKD's Forensics & Dispute Consulting (FDC) division as a senior consultant in computer forensics, will perform investigations.



With more than 10 years of experience conducting examinations of digital media and more than 20 years of experience in law enforcement, Marchewka joins BKD after working two years in the High Tech Crime Bureau of the Illinois Attorney General's office.

Marchewka also helped develop the High Technology Crime Investigation Unit at the Kansas Bureau of Investigation, qualified as a computer forensics authority in both civil and criminal trials and built a computer forensics lab for a private investigation firm founded by a former director of the Federal Bureau of Investigation.

FDC utilizes a combination of state-of-the-art computer forensics tools for retrieving electronic information and documents. We have assisted the Federal Bureau of Investigation in one of its largest white-collar fraud investigations and provided other forensic services to state and city governmental entities.

For more information about FDC, visit **www.bkd.com**. ❖❖❖

Energy Tax Act affects both businesses & individuals

New nonbusiness energy credit for 2006

The nonbusiness energy credit generally allows you a lifetime credit of up to $500 for making qualifying energy-saving improvements to your home, of which $200 may be for qualifying windows.

Subject to these limits, the credit is summarized as a 10% credit for energy-efficiency improvements to the building envelope, such as insulation, exterior windows, skylights, exterior doors and pigmented coated metal roofs; and a credit for the following residential energy property expenses:

- $50 for each advanced main-air circulating fan
- $150 for each qualified natural gas, propane or oil furnace or hot-water boiler
- $300 for qualified energy-efficient property (heat pumps, water heaters and central air conditioners that meet certain requirements)

For example, if, in 2006, you install $2,000 of certified energy-saving insulation and $2,000 of certified energy-efficient windows in your home, you can claim a $400 credit ($4,000 × .10) on your 2006 tax return.

Energy Act's new deduction for commercial buildings

Instead of being expensed when incurred, building and improvement costs are generally depreciated over either 39 or 27.5 years. The *Energy Tax Act of 2005* (the Act) provides an exception to this general rule for a portion of qualifying energy-efficient commercial building property (eligible property) placed in service in 2006 and 2007.

With the increased demand for energy resources, the provision is a major incentive for building owners to upgrade systems and, for those building new structures, to design them in an energy-efficient manner.

The deduction is as much as $1.80 per building square foot. Eligible property must meet all of the following requirements:

- It must be otherwise depreciable or amortizable
- It must be located in the U.S.
- It must meet the requirements of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (ASHRAE/IESNA)

- It must be installed as part of the interior lighting systems, heating, cooling, ventilation and hot water systems or the building envelope
- It must be certified as having been installed as part of a plan to reduce the total annual energy/power costs of the building by 50% or more compared to a reference building that meets the minimum Standard 90.1-2001 requirements

A partial deduction may be available if a building does not meet the required 50% energy savings.

New energy-efficient home credit for contractors

A new federal income tax credit under the Act provides up to $2,000 for eligible contractors who build and sell qualified energy-efficient homes (or up to $1,000 for qualifying manufactured homes).

A home qualifies for the credit if:

- It is located in the U.S.
- Its construction was substantially completed after August 8, 2005
- It meets specified energy-saving requirements
- It sold in either 2006 or 2007 for use as a residence

To meet the energy-saving requirements, a home generally must be certified to provide a level of heating and cooling energy consumption at least 50% (30% for manufactured homes) below that of a comparable home constructed in accordance with the standards of the 2004 Supplement to the 2003 International Energy Conservation Code.

It also must have building envelope component improvements that provide a level of heating and cooling energy consumption at least 10% below that of a comparable home. In addition, manufactured homes can qualify for the credit by meeting Energy Star standards.

If you seek this credit, all construction must be performed in a manner consistent with the design specifications provided to the eligible certifier. The IRS has issued guidance about certification requirements, available at **www.irs.gov**.

Alternative motor vehicles & refueling property

The Act provides a new alternative motor vehicle credit for the purchase of qualifying vehicles placed in service in 2006 and subsequent years. The credit can be as much as $3,400 and covers certain vehicles with fuel cell, advanced lean burn, hybrid and/or alternative fuel technology. The credit can not be used against AMT.

And, to bar double tax benefits, the depreciable basis of the vehicle must be reduced by the amount of the credit allowed. This credit effectively replaces the deduction for clean-fuel vehicles which has expired.

Clean, renewable-energy bond credit

The Act provides a new credit based on the face amount of any clean, renewable-energy bond you hold during 2006 - 2008. The credit is nonrefundable and is included in taxable income as interest, but can be used against AMT. ❖❖❖

Boomers to transfer millions of companies

by Steve Blumreich, BKD Corporate Finance, sblumreich@bkd.com

If you're a baby boomer and own a company or are a Gen-Xer looking to buy one, the following facts should be of interest:

- There are approximately 12 million privately owned companies in the U.S.
- In the next 10 to 15 years, 8.4 million of them are expected to change hands
- Private equity groups raised $173.5 billion in 2005 to invest in private companies

This year, the first of approximately 76-million boomers began to enter their mature years (defined as 60+), including President Bush, former President Clinton and celebrities like Cher and Dolly Parton. The last members of their generational tsunami won't reach this milestone until 2023.

In the meantime, boomer-owned companies will begin to change hands in greater numbers and at an ever-faster pace, creating a massive ripple effect on merger and acquisition (M&A) activity, market pricing and capital resources.

> *With many more companies coming to the market in the next 10 years, it will be more important than ever to evaluate exit options, select the right timing of a sale and take steps to enhance the value of your company.*

Take M&A and market pricing, for example. The sellers' market the U.S. has experienced for the last three years will change when boomer-owned companies begin to hit the market in large numbers.

Within the next three years, we'll likely change from a sellers' to a buyers' market because of the number of companies for sale and because much of the private equity money available today comes from retirement accounts, which boomers will use for retirement.

Private equity groups & other sources of liquidity

There are approximately 2,500 to 3,000 private equity groups looking for companies to acquire. Private equity groups collectively raised $173.5 billion in 2005 compared to $42 billion in 2004, compared to $24 billion in 2003. **In addition to the current funds raised**, there's an estimated $100 billion surplus of private equity funds looking for acquisitions.

Along with private equity groups, S&P 500 companies had more than $600 billion in cash at the end of 2004, and approximately 9,000 hedge funds have $1 trillion under management. All of this money, combined with relatively low interest rates, has fueled the sellers' market of the last few years. **That could change**.

Much of the available investment money today is from pension funds. As more boomers retire, fewer pension dollars will be available, changing the market dichotomy. Interest rates also are a big part of the equation. With many more companies coming to market in the next 10 years, it will be more important than ever to evaluate exit options, select the right timing of a sale and take steps to enhance the value of your company.

Exit options, timing & planning

Every private company owner faces the challenge of transferring ownership at some time. The reasons for this transfer may be a sale to a third party, the transition of ownership to an employee stock ownership plan (ESOP), a management buyout, the decision to go public or a transfer to family members by sale or gift.

The 2003 MassMutual Financial Group/ Raymond Institute American Family Business Survey reports 42% of owners planning to retire in five years have not chosen a successor *or* an exit plan.

Of those surveyed who are age 61 or older, 55% have not chosen an exit plan. Yet we know a typical exit-planning timetable can take three to seven years: six months to a year to prepare a plan, a year or more to execute value enhancements and tax planning, another year to execute the plan and one to three years or more for the transition process.

Start building value now

To build your company's value *before* the market is overwhelmed with companies for sale and capital markets are less favorable, you need to act now by managing certain business fundamentals, understanding the impact of certain uncontrollable industry and market fundamentals and working with an experienced advisor.

Proper timing, planning and execution of these components are essential to increasing the value for your company and must be built into the sale process. For a more detailed look at understanding and effectively managing the array of value drivers, please see our article "Components to Build Value," available at **http://www.bkd.com/docs/about/componentstobuildvalue.pdf**.

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With more boomer-owned companies for sale, sellers who prepare in advance will achieve higher values. Stay focused on your business fundamentals, understand how favorable industry and market conditions can add value and work with an experienced advisor to add value to the transaction.

BKD Corporate Finance, LLC

If you follow these suggestions, you'll be among the boomers who realize their share of the trillions of dollars in wealth. ❖❖❖

Contact BKD Wealth Advisors for investment,

Market commentary: strong first quarter indicates gro

by Jeff Layman, BKD Wealth Advisors, jlayman@bkd.com

The fourth quarter of 2005 proved to be the one that broke the nearly three-year string of above-trend growth in the U.S. economy. Gross domestic product (GDP) growth slowed to 1.7% in the period, the result of some extraordinary factors, namely the spill-over effects of last September's hurricanes.

What early indicators suggest

Early indications are that growth in the first quarter of 2006 is back on track and may, in fact, prove to be the strongest quarter of GDP growth in more than two years. Many economists predict the economy grew more than 4.5% in the quarter just ended.

The strong showing in the first quarter is the result of a rebound from hurricane effects, the beginning of the rebuilding process in the Gulf and an exceptionally warm January, which led to strong housing and construction activity.

The Federal Open Market Committee continued to tighten during the period, lifting the Federal (Fed) Funds rate to 4.75% by the end of March. The Fed indicated additional firming may be necessary to keep sustainable economic growth and price stability in balance.

Another quarter-point rate hike at the May meeting is a near certainty, and the futures market currently implies a 50% probability of another quarter-point increase in June. Because of strong employment and wage growth, consumers continue to show resilience, allowing consumer spending to remain a significant contributor to economic growth despite high energy prices and rising borrowing rates.

These factors may cause consumer spending to slow somewhat in 2006, but increases in business spending should offer a partial offset. Our expectation is overall GDP growth will slow toward 3% as the year progresses.

Equity markets

In the first three months of 2006, stock market returns were the strongest they've been in any first quarter since 2000 during the height of technology stock mania. The S&P 500 index gained more than 4% during the quarter, nearly equal to the return for all of last year.

The commodity-dependent energy and materials sectors continued to be among the best performing areas of the market; however, telecommunications stocks posted the best results to start the year, as signs emerged the tremendous overcapacity created in the late 1990s in this industry is being absorbed.

Equity Index Returns	1Q 2006
S&P 500	4.21%
S&P Mid-Cap 400	7.63%
Russell 2000	13.94%
MSCI EAFE	9.40%

Other equity indices posted even more significant advances: Small-cap stocks rebounded from a lackluster 2005, registering an impressive 13.94% return in the first quarter. Small-cap companies significantly lagged behind large ones in the bull market of the late 1990s.

The last six years of relative out-performance has not only brought small companies back to more normal relative valuation but to even slightly over-valued status relative to large companies by some measures. As the current economic cycle continues to mature, investors will likely shift preference to companies with greater earnings predictability and above-average growth.

International stocks continued their string of above-average performance with the MSCI EAFE gaining more than 9% during the first quarter. Foreign markets are benefiting from a synchronized expansion in global economies, good corporate profitability and generally reasonable valuations.

The growth in China and the robust U.S. demand for foreign goods have been the major factors energizing global economies. Although currency, economic and political risks are still relevant considerations in international investing, the emergence in many countries of the consumer class, along with the stabilization of some emerging economies and markets, creates interesting investment opportunities.

Fixed income markets

The cumulative effect of 15 consecutive Fed rate hikes finally began to affect Treasury yields during the first quarter. The rate on the benchmark 10-year Treasury note rose from 4.39% to 4.85% during the first three months of the year.

The current yield on the 10-year note represents its highest level in nearly four years. This significant rise in interest rates during the quarter caused a challenging total return environment for bonds. The Lehman Aggregate taxable bond index posted a return of -.65%, while the Lehman Municipal index gained just .25%. Bond values declined in the

'Behavioral finance' p

by Jim Lincicome, BKD Wealth Advisors, jlincicome@bkd.com

When a stock declines in value, why do some investors fixate on breaking even or getting back to their purchase price instead of simply cutting their losses through a sale? And what causes people to treat a tax refund as a windfall even though it's essentially money they've overpaid to the IRS?

In a perfect world, the answers to these questions would be easy because people are expected to be inherently rational when it comes to their financial best interest. But, as the emerging field of behavioral finance asserts, this is not how human nature works.

Behavior can undermine success

Behavioral finance attempts to uncover repeated patterns of inconsistency in the way people make financial decisions. Sometimes, these irrational behaviors can undermine an investor's long-term success or, at the very least, arouse feelings of pain and anxiety, making investing an unpleasant experience.

Regardless of income level or net worth, three common tendencies can reduce your

owth back on track

face of rising interest rates, offsetting the quarter's income return.

Credit spreads between investment-grade bonds and lower-quality bonds have reached the lower end of the historical range in recent years as the appetite for risk has grown along with an improving economy. This means investors buying lower-quality, "high-yield" bonds today are accepting a lower-than-average return in exchange for the greater credit risk.

Outlook for 2006

Entering 2006, global equities represented good value relative to U.S. bonds and real estate. Despite very robust earnings' growth for U.S. companies in the past two years, stocks have been somewhat range bound, as is often the case in a period of Fed tightening.

The P/E multiple of the S&P 500 currently stands at 16 times 2006 expected earnings. These earnings have grown at a low-teens pace for several quarters and will likely continue this trend in the first quarter of 2006.

The strong equity returns posted in the first three months of this year may indicate investors are acknowledging the end of this tightening cycle is near, that the economy is still making good progress despite high energy prices and rising interest rates and that corporate profitability continues to be solid.

We still believe stocks represent good value relative to other investment alternatives, and there is an opportunity for modest price-to-earnings multiple expansion when it's clear the Fed's tightening cycle is over. Therefore, we remain optimistic about the prospects for stocks in the remainder of 2006.

Our expectation is the Fed is nearing the end of its tightening cycle. Having said that, total bond returns should improve as the year progresses. On the shorter end of the maturity spectrum, income yields have increased significantly over the past two years, improving return potential. ❖❖❖

provides insight into investors' decisions

chances of reaching your investment goals, including mental accounting, loss aversion and overconfidence. Following are behavioral finance's insights into each.

Mental accounting - Instead of looking at the big picture, people tend to mentally compartmentalize their assets into different "baskets," which they manage independently and treat differently. As a result, it's easy to lose sight of the fact each category of money, regardless of its source, contributes to overall wealth. The tax refund is one example of mental accounting and buying on credit is another.

Some people believe a dollar charged on plastic affects the bottom line less than a cash payment, which explains why those who spend recklessly with plastic see their monthly debt obligations soar. When it comes to diversifying their portfolios, many investors make decisions in pieces, not recognizing that even marginal decisions can affect the entire portfolio.

Loss aversion - People hate to lose, especially when it comes to admitting they've made an investment mistake. In fact, studies show losing a dollar is two-and-a-half times more painful to investors as the pleasure they derive from *gaining* a dollar. This may explain why many investors gravitate toward low-yielding, "safe" returns of money-market instruments despite their time horizon and the need to follow more aggressive strategies to reach goals.

Another example: During the recent bear market, some investors held on to stocks with dismal earning prospects, believing the loss on paper wouldn't become real if they didn't sell. In the process, these investors watched a significant portion of their net worth disappear as they waited for their investments to reach price levels that never came.

Overconfidence - Many investors falsely believe they are as good as—or better than—everyone else with access to the same information, and they may fall into a similar pitfall when they attempt to time the market.

Unfortunately, articles about one-of-a-kind stock pickers like Peter Lynch may sell magazines but, at the same time, tend to foster this fallacy. In addition, most investors have short-term memories when it comes to their losses, which can lead to unrealistic expectations about their ability. That also may be why people rarely discuss their investment failures at parties and are often reluctant to seek professional financial advice.

Learn to make rational decisions

If you recognize yourself in one or more of the descriptions above, you're not alone. These are just a few of the ways even the best-intentioned investors can veer off course.

For many investors, especially those who desire more structure and discipline around their investment decisions, a qualified financial advisor can be invaluable. Ideally, he/she is aware of and understands the emotional side of investing and has the credentials to tailor a comprehensive investment plan to your financial and personal objectives.

Though not an exact science, behavioral finance can help you better understand and take charge of the irrational, human tendencies that can potentially derail your financial goals. ❖❖❖

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IRS releases 2005 audit statistics

The IRS has released 2005 statistical data providing valuable information about who and how many returns it is auditing, and, as promised, overall audit rates were up.

The table shows audit rates for 2005 and 2004.

	2005	2004
Individual Wage Earners		
Under $25,000	0.52%	0.50%
$25,000 to 50,000	1.48	1.26
$50,000 to 100,000	0.57	0.44
Over $100,000	1.19	1.39
Individual Schedule C Filers		
Under $25,000	3.68	3.15
$25,000 to 100,000	2.21	1.47
Over $100,000	3.65	1.86
Individual Farmers		
Under $100,000	0.48	0.91
Over $100,000	1.01	1.61
C Corporations		
Under $10 million assets	0.79	0.32
Over $10 million assets	20.02	16.74
S Corporations	0.30	0.19
Partnerships	0.33	0.26
Fiduciary Returns (Form 1041)	0.18	0.12
Estate Tax Returns	8.20	7.41
Gift Tax Returns	0.81	0.69

When compared to other wage earners, more individuals with incomes between $25,000 and $50,000 were audited. This is because the IRS focused on perceived abuses of the earned income tax credit (EITC), and this group of taxpayers typically claims that credit.

Audit rates for individual wage earners with incomes exceeding $100,000 went down, reflecting the IRS perception that compliance among this group is up. Audit rates for individuals with Schedule C (sole proprietors) are up as the IRS had previously signaled; however, the rates for farmers were down.

The most significant rate increase was in the large and mid-sized C corporations group. The IRS had promised it would increase audits of these corporations.

Also, note the various ways audits are conducted. Correspondence audits, for example, are typically used for individual taxpayers. This type of audit, though limited and conducted by mail, made up 80% of the 2005 audits. Therefore, it's unlikely your personal return will be selected for a full-blown, face-to-face audit.

Only 20% of the audits were conducted by revenue agents, tax compliance officers and tax examiners, and many of these were corporate audits.

Can you deduct a good time?

Wouldn't it be great to be able to take a tax deduction for your vacation? Combine vacation with a business trip and maybe you can; however, for expenses to be tax deductible, they must meet certain requirements.

Because some taxpayers get carried away in this area, the IRS often challenges such deductions. It's a good idea to know the requirements for deduction before you plan your travel.

If the primary purpose of your trip is business, you can deduct your transportation costs to and from your destination, even when you tack on a few vacation days. With certain exceptions, you'll be able to deduct food and lodging costs *only* for days you actually spend on business.

While you can't deduct food, lodging or airfare for your family, you're still entitled to your own write-offs for a trip that combines business and pleasure, including the single-occupancy rate for lodging on days when you're conducting business.

You can deduct full vehicular travel costs that include your family, just as you would if you were traveling alone. Don't forget to document the business purpose for your trip, the amount of time spent on business during the trip and the expenses. ❖❖❖

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