

# Our Perspectives

“Thoughts From Outside the Box”

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Dear Clients and Friends:

**W**ith the autumn months quickly approaching, thoughts often turn to school, football and here at Meisel, Tuteur & Lewis, P.C., year-end tax planning. The economy is constantly evolving, and keeping up with those changes can be daunting. Rest assured the professionals here at Meisel, Tuteur & Lewis, P.C. are diligently implementing new tax strategies to maximize the results for our clients.

In the fall, Meisel, Tuteur & Lewis, P.C. will welcome additional staff members, enabling the firm to continue its commitment to provide the highest quality service to our existing clients. Our firm's growth allows us to undertake new projects and clients while maintaining our devotion to our current clients and friends.

If there is anything we can do for you, or if you have any suggestions, I would love to hear from you.

Very truly yours,

Michael S. Lewis, CPA  
Managing Shareholder

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## DIVIDEND TAX RATE REDUCTION ADDS TWIST TO TAX PLANNING

By Anthony Pentz, CPA

**A**s you may know, the Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the rate at which qualified dividends are taxed to a maximum of 15 percent. This change has created an interesting wrinkle in tax planning strategies involving taxpayers with excess investment interest expense.

Investment interest expense refers to interest paid on borrowings used

to purchase investment property that will generate taxable income. The deduction is limited to net investment income. Since qualified dividends are not included in the calculation of investment income, the likelihood of investment interest expense being limited is greater than it was prior to the enactment of the Act. Excess investment interest expense is carried forward to future tax years indefinitely.

However, an election can be made to treat dividend income (or capital gains) as ordinary income, subject to the ordinary income rates of the individual, and therefore increase the amount of their investment income. This would allow the taxpayer to increase his or her investment interest expense deduction, effectively reducing the

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## SPYWARE

By David Kerner, IT Manager

**W**ith stories of credit card and online bank fraud on the rise, internet and network security is more important than ever before. We have all recently heard the term spyware; countless articles are popping up everywhere warning of this new internet threat. Spyware is a program that sends information from the user's computer to a third party without the

user's knowledge or consent. Spyware can be downloaded either secretly bundled with another program or automatically without permission. Spyware is generally not harmful to the user as far as a security risk to personal or private information (although it can be) but is more often implemented to deliver advertisements in the form of pop-ups. It can direct a user to a particular web-

site, track a user's buying and surfing habits online, and even automatically change a homepage. In addition to the invasion of privacy, these programs will often slow down a computer drastically or cause conflicts that could lead to a malfunction.

There are three simple ways in which a user can protect his or her PC against spyware.

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## From the Bookshelf...

- Dig Your Well Before You're Thirsty by Harvey McKay
- Only the Paranoid Survive by Andrew S. Grove



## TIME RUNNING OUT FOR EXCHANGING SAVINGS BONDS TO SAVE TAXES

Current holders of Series EE/E savings bonds will no longer be able to exchange them for HH bonds after August 31, 2004 when the Treasury will cease issuing HH bonds. This means that holders of EE/E bonds will lose the opportunity to defer reporting accrued interest on the EE/E

bonds by exchanging them for HH bonds. Such exchanges can permit tax deferral on accrued interest to continue for another 20 years after the exchange. Please call if you are a holder of these bonds and have questions about them.

## Safety Notes...

### SAFETY TIPS FOR KIDS

Teach your children about personal safety at a young age so they can better protect themselves.

- ◆ Map out a route to and from school and walk it with your children. Make sure they follow this same route every day unless they have your permission to go another way.
- ◆ Find out if your school has an attendance call-back program to let you know if your child does not arrive at school.
- ◆ Your child should carry some form of identification, for example, a laminated ID card with his or her name, complete address, telephone number and an emergency contact person and their phone number.
- ◆ Keep up to date records on your child, including a recent photo, a lock of hair wrapped in plastic, age, blood type, height and weight, date and location of last dental x-rays, distinguishing marks, eye color and any other identifying characteristics.

## DIVIDEND TAX RATE

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total tax liability for the year. Example: Taxpayer has qualified dividend income of \$15,000 and no other investment income. His investment interest expense is \$5,000, which would be non-deductible. If the taxpayer elects to treat \$5,000 of his dividends as ordinary income, the investment interest expense would be deductible and would produce a current

year tax savings of \$750 ( $\$5,000 \times 15\%$ ). However, if the taxpayer does not make the election, the \$5,000 deduction would be carried forward until the taxpayer has investment income and could produce a tax savings of \$1,750 ( $\$5,000 \times 35\%$ ), assuming the taxpayer is in the highest tax bracket.

A number of factors must be considered when deciding to make the election to treat dividend income as

ordinary income in order to maximize your investment interest expense deduction. They include, but are not limited to, projected future income levels and tax rates, anticipated timing of deductions, and the time value of money. If you are in a situation where this election could benefit you, one of the tax professionals at Meisel, Tuteur & Lewis, P.C. will contact you to discuss the most optimal course of action for you. ■

## SPYWARE

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1. Ensure your browser security settings are at the default level. Open internet explorer and click Tools at the top of the page, then select Internet Options. Click on the Security tab, select Internet as your content zone, and click on Default Level (medium).

2. Download Microsoft's Security updates. Type [microsoft.com/protect](http://microsoft.com/protect) in your web browser and follow the online instructions.

3. Detect and remove spyware from your computer. There is no one program that can detect and remove all spyware, although Spybot S&D and Ad-Aware are two excellent options. Both can be ob-

tained free of charge at [www.download.com](http://www.download.com).

These three steps will help remove spyware and prevent it from attacking your computer. However, they are not foolproof. If you would like to discuss this issue or any others regarding your computer, please feel free to call me at Meisel, Tuteur, & Lewis, P.C. ■

## WHAT YOU NEED TO KNOW ABOUT TRANSFER PRICING

By William Schwarz, CPA, MST

**W**ith our economy becoming more and more global every day, it is important for taxpayers who conduct business in other countries to give some thought to their transfer pricing policies. Transfer pricing refers to the inter-company charges between related companies doing business in different countries. By manipulating the amounts charged to a subsidiary in another country, it is very easy for a taxpayer to influence the amount of taxable income either in the United States or the foreign country. Consequently, transfer pricing has become an important focus of the international branch of the Internal Revenue Service (IRS). In fact, it has become such a hot topic that documentation-penalty rules exist in some 20+ countries.

In the United States, Internal Revenue Code (IRC) section 482 and the regulations promulgated thereunder set out the rules for transfer pricing. These rules adopt the realistic view that although there is no single appropriate transfer price, a price appropriately reflects income so long as it falls within an arm's length range. Thus, the US standard for transfer pricing becomes

one of economic defensibility, and a range of acceptable prices applies only to the extent that a taxpayer can justify the prices at each end.

In order to determine a suitable price range, the regulations describe five categories of potentially acceptable transfer pricing methods. Each of the methods looks to establish the arm's length range by the use of uncontrolled comparables, meaning that comparable uncontrolled transactions or entities are used to establish the range. Recognizing that this type of information is not always available, the regulations acknowledge that third-party comparables need not be exact in order to serve as benchmarks for related party transfer prices. A great deal of documentation is required in order to set forth the economic defensibility of a particular transfer pricing method.

The main reason that taxpayers must pay attention to their transfer pricing policies is that IRC section 6662(e) imposes a penalty of either 20% or 40% of the underpayment of tax, depending on certain thresholds, in the case of a transfer pricing adjustment. However,

the regulations also provide for a reasonable cause and good faith exception.

There are two different standards for meeting this exception, depending on whether the taxpayer used a transfer pricing method specified in the section 482 regulations. In either case, to satisfy the exception, the taxpayer must have specific and adequate documentation regarding the method used at the time the tax return was filed and must provide this documentation within 30 days of an IRS request. In addition, if certain specific methods are used, the taxpayer must attach a statement to its timely filed income tax return disclosing the method used.

Taxpayers doing business abroad should review their operations to determine any transactions that might come under the provisions of the section 482 transfer pricing rules. Once these transactions are identified, the taxpayer should determine the appropriate transfer pricing method. Proper documentation of this procedure, on an ongoing basis, can help a taxpayer avoid potential penalties down the road. ■

## KEY PERSON LIFE INSURANCE

By Colleen Delaney

**E**very business has key employees vital to its success. Owners and partners are of course key to their companies, but the term key employee extends beyond them. Employees who manage critical projects, maintain vital relationships and generate a substantial amount of revenue, as well as those who have knowledge and experience difficult to replace, are clearly key. The loss of any one of them could adversely affect the profitability and even the continuation of a company, especially in the case of smaller businesses whose key employees more directly affect the bottom line.

In order to circumvent exposure to

such unexpected loss, many businesses invest in life insurance policies for key persons. Of the two types, term and permanent, the former generally incurs the less expensive premium. If the key employee consents to the arrangement, the business then buys the policy, names itself the beneficiary, and pays the premiums. Although the premiums are nondeductible, the proceeds from the policy are tax free and can be used to offset the expenses incurred as a result of a key employee's death, i.e., replacing and training a new employee, meeting compensation obligations to the deceased's family, even buying back the deceased's interest in the business.

Many lending institutions now require a business to invest in key person life insurance in order to sustain viability in the event of the loss of a key employee. Such institutions may also insist on a business-continuation plan instead of or in addition to the insurance policy. A plan of this sort outlines intermediary managers and financial resources in case of a transition period. Once a continuation plan has been designed, a business owner is better able to evaluate his or her need for key person life insurance. If you have any questions about key person life insurance for your business, please contact us. ■

## BUSINESS TAX ADVANTAGES FOR SPORT UTILITY VEHICLES

By Michael Mikos

Currently business owners who purchase certain Sport Utility Vehicles (SUVs) enjoy tax breaks unavailable to those who prefer passenger automobiles. However, restrictions apply to this loophole, which may in fact be closing in the near future.

Heavy SUV's, those having a gross vehicle weight rating (GVWR) of over 6,000 lbs., are not subject to luxury auto depreciation caps and can therefore take advantage of the Sec. 179 expense election and/or Sec. 168 (k) bonus depreciation. The expense election could allow for the entire cost of the vehicle to be expensed in the first year of purchase if certain requirements are met. If the expense election

is unavailable, a bonus depreciation allowance of 50% of the vehicle's cost, as well as the regular first-year depreciation, can create a substantial tax advantage.

Recently the IRS clarified that qualified non personal use trucks and vans are exempt from auto depreciation dollar caps. This exemption allows certain vehicles which do not exceed the designated weight but have been modified for business use to take advantage of the higher depreciation expenses.

With over 40 models of SUVs currently available and the ability to modify others in order to qualify, it is fairly easy to take advantage of these

tax incentives. Unfortunately, the window may be closing. While no legislation has been passed to date, there have been attempts to crack down on preferential tax treatment for SUV's. We will keep you advised as new developments arise in this area.

If you are interested in learning more about or are affected by any of the issues discussed in this article, please do not hesitate to contact a professional at Meisel, Tuteur & Lewis P.C. ■

## AN INSIDE LOOK....



### Individual Achievements:

Andrew Fink, CPA, was appointed to a one-year term as president of the Estate Planning Council of Bergen County effective July 1, 2004. The council is one of the oldest and most prestigious in New Jersey.

Christopher A. Baran was appointed chairman of the NJSCPA Sports & Entertainment Committee for a one-year term.

Anthony Pentz, CPA, was appointed treasurer of the Orange/West Orange Chapter of Unico National, the largest Italian American service organization in the U.S.

### The Stork Club:

Anthony & Evelina Pentz welcomed their first child, Olivia Nicole, born June 16, 2004. Olivia weighed 9lbs, 11oz. and was 21¾ inches long! Both mother and baby are doing well.

**Meisel, Tuteur & Lewis, P.C.** was founded in 1946. The accounting professionals at our firm approach each client with a single goal: to build a solid financial foundation with that client...and then add to it with every subsequent contact. We believe in the value of relationships. We view every client relationship like a partnership and truly believe that our success is a result of yours.

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*"The road to poverty is paved with the good intentions of those who wanted to save but never got around to it."*

*William Nickerson*

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Tuteur  
& Lewis**  
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## NEW BUDGET SPELLS INCREASED TAXES. SO WHAT ELSE IS NEW?

As you probably already know, Governor James McGreevey signed the state budget for fiscal year 2004/2005 on June 30, 2004. In our New Jersey Update issued in early July, we outlined the two most important pieces of legislation related to the budget: the “millionaire’s tax” and the new homestead property tax rebate program. The new budget also includes many other tax provisions that generally increase taxes and fees for many New Jersey taxpayers. Below is a list of the key items, along with a brief summary of the changes.

**Realty Transfer Tax:** In addition to the three realty transfer fees currently provided for by New Jersey law, a new “general purpose fee” has been imposed on grantors of property whose value, as stated on the deed of transfer, is more than \$350,000. This fee is structured as follows: \$0.90 for each \$500 on the first \$550,000 of the value transferred; \$1.40 on each \$500 of the value between \$550,000 and \$850,000; \$1.90 on each \$500 of the value between \$850,000 and \$1,000,000; and \$2.15 for each \$500 of the value over \$1,000,000. The fee applies to transfers taking place on or after August 1, 2004.

In addition, a new fee will be imposed on the buyer of residential zoned real property with a value in excess of \$1,000,000, whether improved or not. This new fee is equal to 1% of the full amount of the consideration.

**Estimated Tax on Income from Sale of Real Property by Nonresidents:** Nonresidents of New Jersey who derive income from the sale of real property in the state will now be required to pay estimated income tax to New Jersey. The legislation states that a county recording officer at the time the deed is filed must be presented with evidence of filing or payment of estimated tax with respect to the gain realized from the sale.

**Cosmetic Procedures:** A new 6% gross receipts tax on certain cosmetic medical procedures has been enacted. The tax is to be paid by the subject of the procedure and collected by the person billing for it at the time of payment. Taxable cosmetic medical procedure is defined as any medical procedure performed on an individual which is directed at improving the subject’s appearance and which does not meaningfully promote the proper function of the body or prevent or treat illness or disease. Reconstructive surgery and dentistry, as defined in the bill, are excluded from the tax.

**Business NOL Deductions:** As you may remember, the New Jersey Business Tax Reform Act of 2002 suspended the corporate deduction for Net Operating Losses for the 2002 and 2003 tax years. Although this suspension was to lapse in 2004, the new legislation allows a deduction for net operating loss carry-forwards only up to 50% of net income. This limitation will be in effect for 2004 and 2005; a 100% deduction will be available in 2006.

**CBT Section 179 Decoupling:** For property placed in service on or after January 1, 2004, New Jersey no longer allows the federal section 179 ceiling amount to be deducted as an expense for New Jersey Corporation Business Tax purposes. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the maximum federal deduction to \$100,000 for 2003 through 2005. New Jersey will allow the prior law maximum deduction of \$25,000.

**New Tire Fee:** Effective August 1, 2004, a fee of \$1.50 will apply to the sale of new motor vehicle tires, including those sold as a component part of a new motor vehicle either sold or leased in New Jersey.

**Electronic Filing Threshold:** Effective immediately, the threshold for mandatory use of electronic transfer as the means of paying New Jersey taxes has been reduced to \$10,000. Thus, taxpayers whose prior year liability was \$10,000 or more must use the electronic funds payment system. Payers of individual gross income tax, transfer inheritance tax, and estate tax are exempted from the electronic funds transfer requirement.

Among other miscellaneous changes, the new budget also includes increases to the cigarette tax, annual fees on ambulatory care facilities and health and maintenance facilities, and new fees for tire removal and hazardous substance transfers and discharges. For a complete summary of the new legislation please visit <http://www.state.nj.us/treasury/taxation/newlegislation2004.htm>.