

# Our Perspectives

“Thoughts From Outside the Box”

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Dear Clients and Friends:

As 2004 draws to a close, I usually remind everyone that it is a good time to assess your financial position and whether your beginning of the year goals were achieved. This year end at the firm is a particularly exciting one, for we have undertaken an evaluation of a different type. With the help of a facilitator, we are examining our entire operation with the ultimate goal of developing a strategic plan for future growth.

While this process has only been going on the last few weeks, there is an air of excitement in the office. Each level of staff has been called upon to participate in giving both positive and negative feedback as to current procedures and client servicing. I expect a written business plan before year end which will be continually updated and refined in the future. Of course, your input would be greatly appreciated, and I recommend to our business clients a similar process.

Since this is the last issue of the year, on behalf of everyone at MT&L, I extend our wishes for a happy and healthy holiday season and new year.

Very truly yours,

Michael S. Lewis, CPA  
Managing Shareholder

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## DEALING WITH DISASTER

By Andrew Rothstein

For some of us, it may be hard to remember the last time so many large storms have ripped through our area. As bad as the damage may have been here in the northeast, it can not compare to what has occurred in Florida. Those individuals who own vacation homes there, as well as other places in the south, have been personally affected by these tragedies. Because the government is well aware of the hardship such storms create, it offers tax incentives to help fix the problems Mother Nature has caused.

In the event that your home has been damaged by a natural disaster, you are able to deduct your

loss, less the amount of insurance reimbursements, subject to 10% of the Adjusted Gross Income (AGI) floor. This deduction must be made in the current year, unless your home is situated in a presidentially declared disaster area, in which case, you can elect to deduct the loss in either the current or the previous year. This election must be made before filing your taxes for the current year and affords you the opportunity to decide which method allows you to receive the greatest tax benefit.

The decision as to when to take a disaster deduction should be based on such factors as AGI in the current and previous years, changes in tax

brackets, and other natural damage to your property. Deducting the losses from the previous year's income can be immediately beneficial. On the other hand, you may also wind up with a gain from a disaster loss, for instance in a case in which insurance proceeds exceed the basis of the destroyed property. In such a situation, excluding or postponing the tax on that gain could be the preferable option.

If you or anyone you know has suffered a loss or simply would like further information on this subject, please contact your tax professional at Meisel, Tuteur & Lewis, P.C.

## MAXIMIZE YOUR CHARITABLE DEDUCTIONS

By Joshua Goldman

If you are thinking of donating your car to charity, you should consider doing so before 2005 to maximize your tax deduction. The President just recently signed into law the American Jobs Creation Act (AJCA), which toughens the rules for charitable donations of cars. Be-

cause the new legislation does not go into effect until 2005, taxpayers can still enjoy the benefits of the current law that allows for greater deductions if the car is donated by the end of this year.

Through the end of 2004, charitable donation laws allow the taxpayer to de-

duct the market value of the donated car, as determined by the donor, according to such factors as the 'blue book' value, the car's mileage, and its condition, all of which should be able to withstand the scrutiny of an audit.

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## Health Notes...

### November is National Diabetes Month

More than 18 million Americans have diabetes today—and a third of them don't even know it. It is the fifth leading cause of death by disease in the United States. Diabetes is more common in African Americans, Latinos, Native Americans and Pacific Islanders. If you feel that you are at risk for diabetes, please take the Diabetes Risk Test by going to the following website [www.diabetes.org/risk-test.jsp](http://www.diabetes.org/risk-test.jsp)

Please visit your health care provider for further information if you feel that you are a candidate for diabetes.

## From the Bookshelf...

♦ **Good To Great** by Jim Collins

♦ **How Full Is Your Bucket** by T. Rath & D. Clifton



## ***NEW SCHEDULE M-3 TO BE USED FOR CERTAIN CORPORATIONS***

Starting with taxable years ending on or after December 31, 2004, corporations with total assets of \$10 million or more on the last day of the year will be required to include a new schedule M-3 with their form 1120. The new schedule provides the Internal Revenue Service with

an in-depth reconciliation of financial statement income to taxable income and will be completed instead of schedule M-1. Taxpayers can view and download a draft version of the new schedule at the IRS's web-site, [www.irs.gov](http://www.irs.gov).

## ***NEW JERSEY INSTITUTES E-FILING REQUIREMENT***

Beginning with the tax year 2004, New Jersey is requiring resident income tax returns (NJ-1040) to be filed electronically. Meisel, Tuteur & Lewis, P.C. can file both Federal and New Jersey returns electronically; however, if you choose,

you may "opt-out" of mandatory NJ e-filing by completing the necessary form, which should be available in January from the state.

## **BE SURE TO MANAGE YOUR EMPLOYMENT TAX SERVICE**

By William Schwarz CPA, MST

**M**any employers are unaware that they remain liable for employment taxes not deposited by their third party service provider. In addition, reliance on a third party to file timely employment tax returns does not constitute "reasonable cause" for purposes of Internal Revenue Service (IRS) abatement of late filing penalties. This is not to say that businesses should not outsource their payroll and employment tax processes; rather, they must take the steps necessary to properly manage their third party relationships.

Selecting the right service provider is an important part of the process. Business owners should ascertain the stability and reputation of a provider and make sure the company has extensive experience. In addition, the potential service contract must be carefully reviewed. It should place a clear obligation on the

third party provider to reimburse an employer for any direct costs incurred as a result of errors or omissions.

Once the service has begun, employers need to set up a systematic monitoring plan. Included should be an annual review of all business tax accounts. An employer can request an IRS transcript of his/her account, which shows all activity recorded. State and local taxing authorities can also provide similar information. Reviewing these transcripts is one way of confirming proper tax deposits and filings.

In addition, employers should maintain direct contact with the taxing authorities. Many times communications and/or deficiency notices will be sent directly to the third party service provider acting as an agent of the employer. This arrangement could

hamper the employer's notification of a potential problem with their tax account.

Finally, an employer should maintain spreadsheets that are reconciled to the quarterly returns and ensure that an appropriate person reviews and approves the returns as well as the transfers and payments to the service provider.

The courts have consistently held that liability for tax and assessments relating to errors and omissions continue to rest with the employer, regardless of any third party arrangement. Many employers, both small and large, find outsourcing the payroll tax reporting function to be practical and even necessary. They must, however, take the steps necessary to properly manage their risk.

## TAX BENEFITS MAKE INVESTING IN RACEHORSES A GOOD BET

By William Angelo

**O**wning racehorses is not only an extremely exciting business venture but often a highly profitable investment. It can, of course, be costly, a risk many horse lovers are willing to take. Let's look at the positive side.

Horses can be purchased privately, through a public auction, or at a claiming race for as little as \$3,500, a relatively small amount of money considering their potential. In addition, many unique tax benefits are offered only to owners of racehorses, not to other taxpayers. Because the equine industry has a \$112.1 billion total impact on the U.S. economy, preferred tax benefits are constantly being made available to those involved.

In order to take full advantage of these potentially huge tax savings, a racehorse owner must be able to prove that his/her horse-related activities are handled in a business-like manner and are not just a hobby. Although this is not easy, once again the IRS is more lenient towards horsemen than to those in most other

industries. If the IRS determines that a taxpayer does indeed have a "profit motive" in the race or breeding industry, any losses incurred relating to the horses can be offset against that taxpayer's income and thus result in significant tax savings.

The depreciation laws written for racehorses are one of the most favorable aspects of owning one of these animals. If a taxpayer qualifies under Section 179, the entire cost of a racehorse could possibly be deducted in the first year of ownership. Even if this qualification is not met, up to 66% of the cost of a horse can still be deducted. If a taxpayer earns \$100,000 in wages in 2004 and has a loss from a racehorse (mostly depreciation) of \$60,000, he or she will pay taxes on only \$40,000. After the initial purchase of the horse, depreciation, which costs the owner nothing, can lead to a large and highly desired loss on his/her tax return.

The reduction in the capital gain tax rate is also highly relevant to individuals in the equine industry. Here's an example. A taxpayer in the 35% tax

bracket sells four horses, resulting in a gain of \$100,000 in a given year. In the same year, the taxpayer has \$100,000 worth of expenses related to his continuing horse operations. Before taxes, this is a break-even transaction: the \$100,000 gain offsets the \$100,000 expenses. However, for tax purposes, the horseman will pay \$15,000 ( $\$100,000 \times 15\%$  capital gain rate) due to his gain on the sale and save \$35,000 ( $\$100,000 \times 35\%$  marginal rate) as a result of his horse-related expenses. Outcome: \$20,000 tax savings.

There are many other tax benefits offered by the IRS to those individuals owning racehorses. Issues such as income averaging, net operating losses, allocation of assets, exchanges, and prepaid expenses can all lead to financial benefits for anyone involved in this business. Further detail regarding all of these issues can be discussed with your tax professional at Meisel, Tuteur & Lewis, P.C.

## MAXIMIZE YOUR CHARITABLE DEDUCTIONS

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If the market value is determined to be between \$250 and \$4,999, the donor can simply obtain a paper or e-mail receipt from the charity. If the car's market value is \$5,000 or more, the donor must get a written appraisal from a qualified appraiser and fill out additional tax forms.

However, beginning in 2005, the AJCA will tighten the rules governing car donation deductions. Under the new legislation, if the car's market value exceeds \$500, the donor can only deduct the charity's gross proceeds from the sale of the car. For

example, if John Q. Taxpayer donates his car and estimates its blue book value to be \$1,500 but the charity only makes \$400 from the sale of the car, that \$400 is all Mr. Taxpayer can deduct. (Under current legislation, he can deduct the full \$1,500 dollar market value.) In addition, beginning in 2005, the AJCA will also require taxpayers to obtain a receipt from the charity if the deduction is \$500 dollars or more. This receipt must include the taxpayer's ID number, the car's VIN number, and an assurance by the charity that the car was sold in a legitimate, arm's length transaction.

In essence, until the end of 2004, it is up to the taxpayer to determine the market value of the donated car and then take that amount as a tax deduction. However, beginning in 2005, new legislation takes the power out of the taxpayer's hands by setting the deductible amount at the price the charity receives from the sale of the car, which may be considerably lower than its market value. It is therefore highly recommended that taxpayers considering donating a car to charity do so by the end of 2004 in order to maximize their tax deduction.

## LAST CHANCE FOR BONUS DEPRECIATION

By Michael Mikos

**B**ecause the bonus first-year depreciation allowance will be ending on December 31, 2004 (unless extended by Congress), business owners considering purchasing certain depreciable assets (equipment, furniture, software, etc.) may want to do so before the end of this year.

Bonus depreciation was created to assist business owners following the September 11<sup>th</sup> terrorist attacks. Taxpayers receive a first-year depreciation allowance equal to 50% of the unadjusted

basis of certain depreciable property, an amount significantly greater than the normal first year expense. Therefore, buying assets in 2004 will allow taxpayers to maximize their depreciation expense deductions on these new purchases. The bonus depreciation allowance is not prorated: even an asset placed in service in December will qualify.

While there will still be relief under code section 179, which allows up to \$100,000 of assets to be expensed in

a given year, there are certain situations in which it would be beneficial for taxpayers to use one or a combination of these deductions this year. Additionally, first-year depreciation expense allowances for vehicles which fall under the luxury auto rules will be significantly reduced in 2005.

If you would like more information on this topic or help determining if you are affected by it, please do not hesitate to contact us.

## AN INSIDE LOOK....



### Individual Achievements:

Michael S. Lewis, managing shareholder of Meisel, Tuteur, & Lewis P.C., has been appointed to a three-year term on the Board of Advisors at the University of Vermont Business School of Administration in Burlington, VT.

Congratulations to Bradley Maneely on his promotion to manager.

Congratulations to Joseph Iovino, Michael Gill and Michael Mikos who have all been promoted to senior accountants.

**Meisel, Tuteur, & Lewis P.C.** announces the following new employees as staff accountants.

Andrew Rothstein grew up in Ridgewood, NJ, and is a graduate of Lehigh University in Bethlehem, PA, Class of 2004.

Joshua Goldman grew up in Denver, CO, and is a graduate of Tulane University in New Orleans, LA, Class of 2004.

Bill Angelo grew up in Clark, NJ, and is a graduate of the University of Delaware in Newark, DE, Class of 2004.

### Engagements:

Best wishes to Bradley Maneely and his fiancée Cynthia Vail, who became engaged on August 13, 2004. A fall wedding is scheduled for October 15, 2005.

**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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*"Obstacles are those frightful things you see when you take your eyes off your goal".*

*Henry Ford*

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## Highlights of the Working Families Tax Relief Act of 2004

The President recently signed into law the Working Families Tax Relief Act of 2004 (The Act). The Act includes “middle class” and marriage penalty relief, a number of extended tax breaks for business, Internal Revenue Code simplification through a uniform definition of a qualifying child, and a number of technical corrections. The following is a list of the more significant provisions of the new legislation.

### Child Credit

The child credit, which is \$1,000 per child for 2004 but was scheduled to drop to \$700 for 2005 through 2008 and to rise to \$800 for 2009, will stay at \$1,000 through 2010. In addition, the 15% refundability percentage is accelerated so that it applies for tax years beginning after 2003, instead of after 2004 as previously planned.

### Marriage Penalty Relief

Two provisions that provide a measure of relief from the marriage penalty are extended by The Act. The provision setting the basic standard deduction for joint filers at twice that of single taxpayers and the provision that increases the size of the 15% tax bracket for married couples filing joint returns, both of which were due to expire at the end of 2004, are extended through 2010.

### 10-Percent Bracket

The scheduled reduction in the amount of income subject to the 10% tax bracket is repealed, effective though 2010.

### Exemption Amount for AMT

For 2004 an individual's Alternative Minimum Tax exemption amount, which reduces the alternative minimum taxable income for 2004, is \$58,000 for married individuals filing jointly and surviving spouses, \$40,250 for unmarried individuals, and \$29,000 for married individuals filing separately. After 2004 the maximum AMT exemption amounts were scheduled to drop to \$45,000, \$33,750 and \$22,500 respectively. The new Act extends the higher exemption amounts through 2005, after which they will revert to the lower amounts.

### Uniform Definition of Child

For tax years beginning after 2004, The Act replaces a series of different eligibility tests for child-related benefits with a uniform definition of a qualifying child. The Act establishes said definition for purposes of the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. Under the uniform definition, in general, a child is a qualifying child of the a taxpayer if the child (1) has the same principal place of abode as the taxpayer for more than one half the year; (2) has a specified relationship to the taxpayer; (3) has not yet attained a specified age; and (4) meets a support test.

The Act retains the pre-Act rule that allows a custodial parent to release the claim to a dependency exemption (and, therefore, the child credit) to a noncustodial parent.

### Extension of Business-Related Tax Relief

The Act extends the life of numerous expired or expiring business related tax provisions. Some extended provisions include the following:

- ◆ The research credit is extended for amounts paid or incurred after June 30, 2004, and before 2006;
- ◆ The work opportunity tax credit and the welfare-to-work credit is extended for wages paid to or incurred by individuals beginning work after 2003 and before 2006;
- ◆ The enhanced deduction for a corporation's qualified computer contributions is extended for contributions made in tax years beginning after 2003 and before 2006;
- ◆ The above-the-line deduction for certain expenses of eligible educators is extended to tax years beginning in 2004 and 2005;
- ◆ Expensing of environmental remediation costs is extended for expenses paid or incurred after 2003 and before 2006;
- ◆ First-time D.C. homebuyer credit is extended to property purchased on or before Dec. 31, 2005.

This summary only highlights the most important changes in the new law. If you have any questions as to how this important tax legislation affects you, please contact your professional at Meisel, Tuteur & Lewis, P.C.

## H.R. 4520, the American Jobs Creation Act of 2004

On Friday, October 22, 2004, President George W. Bush signed into law H.R. 4520, the American Jobs Creation Act of 2004 (Jobs Act). Although mainly directed toward large businesses, the wide ranging law has several provisions affecting individuals and small or closely-held businesses. The following is a brief discussion of those provisions that may affect the largest portion of our client base. This is not intended to be a complete overview of the Jobs Act.

### **Domestic Production Activities Deduction**

The stimulus for the new law was a 2002 World Trade organization ruling that the U.S. tax code's "extraterritorial income exclusion" was a prohibited export subsidy. The law addresses that issue by repealing the exclusion and creating a new deduction for businesses having income "attributable to domestic production activities." Although created because of an international trade dispute, the new deduction could be broadly applicable. When fully phased in, the deduction could be as much as 9% of "qualified production activities income, which, in essence, is the net income attributable to "domestic production gross receipts." In addition to traditional manufacturers, any business might qualify if it produces, grows, or extracts "in whole or in significant part within the U.S." any tangible personal property, computer software, or sound recordings, and derives income from any "lease, rental, license, sale, exchange, or other disposition of" such property. Other qualifying activities include:

- ◆ Performing construction in the U.S.
- ◆ Performing engineering or architectural services in the U.S. for construction projects in the U.S.
- ◆ Producing electricity, natural gas, or potable water in the U.S.
- ◆ Producing films in which at least 50% of the total compensation was paid for services in the U.S.

According to official estimates, more than 10% of small businesses will be affected by this provision.

In addition to this new deduction, lawmakers used the new law as a vehicle for a variety of legislative initiatives that in certain cases have been pending for several years.

### **Nonqualified Deferred Compensation Rules Toughened**

The Jobs Act significantly changes the law of nonqualified deferred compensation (NQDC) and imposes potentially large tax penalties for noncompliance. Unless a NQDC plan meets the new requirements, amounts deferred under the plan are includable in income back to the time of deferral or, if later, when no longer subject to substantial risk of forfeiture and are subject to interest at the underpayment rate plus 1% and a 20% additional tax. The new law, which applies to amounts deferred after December 31, 2004, imposes requirements on NQDC plans in regard to participant elections, distributions, acceleration and funding that likely will necessitate amendments to most plans.

### **Small Business "Expensing" Increases Extended**

Previous legislation increased the annual expensing allowance for fixed assets purchased during taxable years beginning after 2002 and before 2006 to \$100,000 (from \$25,000) and the "phase-out" threshold to \$400,000 (from \$200,000), with annual inflation adjustments and added off-the-shelf software as eligible property. For tax years after 2005, the dollar amounts were scheduled to revert back to \$25,000 and \$200,000, respectively. The Jobs Act extends the increased annual allowance and phase-out threshold through taxable years beginning before 2008.

### **SUV Expensing Allowance Limited**

Previously, SUVs weighing more than 6,000 pounds were not subject to "Luxury Automobile" limitations because their weight put them outside the limitation-triggering definition of "passenger" automobiles. Thus, the entire amount of the SUV was eligible for the expensing allowance discussed above. The Jobs Act tightens this loophole by creating a separate category for SUVs that are rated at a gross vehicle weight of not more than 14,000 pounds and imposes a \$25,000 limit on the deduction. This limit is effective for SUVs placed in service on or after October 22, 2004.

### **Itemized Deduction for State and Local Sales Taxes**

Individuals who itemize their deductions can now elect to deduct state and local sales taxes instead of state and local income taxes. Although the principal beneficiaries are residents of states that do not have an income tax (Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming), the new deduction provides an alternative for taxpayers living in states that impose both income and sales tax. The amount of the deduction can be based on actual taxes paid or IRS-prepared tables. This provision is retroactive to January 1, 2004.

### **S-Corporation Rules Liberalized**

Several new provisions in the Jobs Act make it easier to qualify as an S corporation or to retain that status. Among other things, the new law treats certain family members as one shareholder for purposes of the limit on the number of eligible shareholders, increases the number of eligible shareholders to 100, and provides relief from inadvertently invalid qualified subchapter S subsidiary (QSST) elections.