

Our Perspectives

“Thoughts From Outside the Box”



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Dear Clients and Friends:

As part of our strategic plan which I explained to you in a previous newsletter, we began to search for a slogan which would best embody the ideals and values that characterize Meisel, Tuteur & Lewis, P.C. The logo we chose, which we have trademarked and which will eventually appear on our website and on all printed material from the firm, was selected from entries submitted by staff members in a firm contest. It was a difficult selection: there were many excellent submissions. Ultimately we chose “Standing Side by Side,” a logo we believe describes precisely our relationship with you, our clients. Congratulations to Shane Orbach for his winning entry.

Very truly yours,

Michael S. Lewis, CPA
Managing Shareholder

COVERING COLLEGE COSTS THROUGH SECTION 529 PLANS

By Curtis W. Gambin, CPA

Saving for a child's college education is a primary concern for many of our clients. The rising cost of college tuition is making this task more difficult each year. One type of investment vehicle which can be used to achieve college savings goals is the Section 529 plan. These plans were first introduced in 1997 by the Internal Revenue Service. Saving through 529 plans is more attractive than other traditional forms used to finance secondary education costs, including UGMA/UTMA's, Coverdell Education Savings Accounts, Series EE and Series I savings bonds, and mutual funds because these plans offer more advantageous tax incentives and financial aid opportunities to investors.

As of January 2002, 100 percent of the earnings within a 529 plan became federally tax-exempt. Often, earnings in these types of accounts are also exempt from state taxes, amounting to significant tax savings. In addition, state tax deductions, which are currently available in 23 states, offer further tax savings. It is important to note that since they are so new, 529 plan laws are changing rapidly. With over seventy plans in place, hundreds of invest-

ment options, and fluctuating underlying mutual funds, the universe of 529 plans is quite complex.

Basically, the plans are offered through each state as either prepaid plans or savings plans. Prepaid tuition plans allow a family to lock in the current price of college for future use. An investor can purchase shares worth one year's tuition; these shares will continue to be worth one year's tuition even after several years of increasing tuition rates. Prepaid tuition plans offer a risk-free way to pay for college, as the money invested cannot be lost. Many states also offer tax breaks for investing in this sort of plan. However, there are disadvantages. First, because they are a low-risk investment, prepaid tuition plans have limited growth potential, most offering only 4 to 5 percent interest per year. Moreover, if a parent buys a partial prepaid tuition plan, the student's financial aid eligibility will be considerably reduced. If a full prepaid tuition plan is purchased, the student will not receive any need-based financial aid, which in many cases is used to cover room/board and book expenses.

Section 529 college savings

plans allow the money set aside by parents for their child's education to grow tax-free for as long as the money stays in the program.

When money is taken out for educational purposes (such as tuition, room and board, or books), the parent does not pay federal taxes on any part of it. In addition, these college savings plans offer flexibility: the beneficiary (the student) can attend any accredited college in the United States and many institutions abroad. Benefactors can change beneficiaries as often as they like; and accounts can be opened for any number of people regardless of age. Also, because 529 college savings plans are considered assets of the benefactor and not the beneficiary, there is a low impact on financial aid eligibility. Disadvantages of college savings plans include the risk of losing money since the investment is directly related to the performance of the stock market, and the potential assessment of penalties if money is not used for school; money taken out of a 529 plan for purposes other than education incurs a 10 percent penalty on the earnings, which are also subject to federal income tax.

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CLEAN FUEL DEDUCTION DECREASING AFTER 2005

Taxpayers thinking about purchasing a hybrid vehicle may want to do so before the end of the year. The 2005 clean fuel deduction of \$2,000 will fall to \$500 for 2006 and will expire altogether for 2007 and thereafter. The deduction is available to taxpayers who purchase certain hybrid vehicles. Thus far, the Internal Revenue Service has certified the following vehicles for the deduction:

- ◆ Toyota Prius – Model Years 2001 → 2005
- ◆ Honda Insight – Model Years 2000 → 2005
- ◆ Honda Civic Hybrid – Model Years 2003 → 2005
- ◆ Honda Accord Hybrid → Model Year 2005
- ◆ Ford Escape Hybrid → Model Year 2005
- ◆ Lexus RX 400h → Model Year 2006

The deduction is available whether or not the taxpayer itemizes and must be taken in the year in which the vehicle is first used regardless of the model year.

SUMMER DAY CAMP OFFERS POSSIBLE TAX RELIEF

By Michael Mikos

With summer break right around the corner parents often rely on summer day camps to care for their children while they work. The costs associated with these camps can often be high. Luckily, our good friends at the IRS are always willing to lend a helping hand.

The child and dependent care credit allows parents a certain amount of tax relief from the costs associated with the care of their children while they are working. The credit is a percentage of your costs ranging from 20-35% depending on your income. The maximum allowed cost is \$3,000 for one child and \$6,000 for two or more children, making \$2,100 the highest credit available for two or more children. Keep in mind that a credit is a dollar for dollar reduction of your tax

liability and that this particular credit is non-refundable.

As always there are certain requirements associated with this credit. First, if filing a joint return both parents must have earned income from wages, salaries, self-employment or other taxable wages; in other words be working or looking for a job. The only exceptions are if one parent is a full-time student or is physically or mentally incapable of self-care. Second, your filing status must be married filing jointly, single, head of household, or qualifying widower. Third, the payments cannot be to someone you claim as your dependent on your return. Finally, you must maintain a home that you live in with the qualifying child. Generally a qualifying child is defined as a person under

the age of 13 when the services were provided and able to be claimed on the parents' return as an exemption.

As mentioned above, many summer day (not overnight) camps fall under the child and dependent care credit. This credit may also apply to private home nurses, licensed dependent care centers, nursery school and kindergarten costs, and in some cases household help. If care is provided by your employer, other rules may apply. Last, be sure to get the name, address and tax identification number of any provider as this information will be needed when filing your return.

If you have any questions concerning this credit, please call one of the tax professionals at Meisel, Tuteur & Lewis, P.C.

COVERING COLLEGE COSTS THROUGH SECTION 529 PLANS

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New Jersey offers two Section 529 plans, both of which are savings plan types managed by Franklin Templeton Investments. The first offers a wider variety of investment options, which allows the investor to take on more risk in the hope of higher returns on funds contributed. This plan has contribution limits, the initial minimum being \$250 and the maximum total contribution being \$305,000. Annual fees are \$25 for both in-state and out-of-state beneficiaries. The second plan is the New Jersey Better Educational Savings Trust or NJBEST plan. This plan has fewer investment choices, and is a more conservative vehicle for future college funds. It has a minimum contribution of \$300 annually until the plan balance totals \$1,200. There-

after, there are no minimum contribution requirements. The maximum total contributions may not exceed \$305,000. This plan is not offered to out-of-state beneficiaries and has no annual fees. In addition, the state offers up to \$1,500 in financial aid in conjunction with the NJBEST plan, provided that the beneficiary attends a New Jersey school. As of yet, New Jersey does not allow a state tax deduction for 529 plan contributions. In addition, 529 plans are offered through every state with some states offering multiple plan options. Starting a plan with a state simply based on your state of residency might not be the best option. When choosing a 529 plan, several factors must be weighed in making the ap-

propriate choice. Contribution limits, state tax deductibility, tax-free growth, historical returns, fund manager reputation, investor education, plan accessibility, expense ratios and investment options must all be considered before making a decision.

Section 529 plans are a relatively new and exciting investment choice when considering saving for your child's future educational costs. Of course, every family's particular financial situation is unique. Please contact one of the professionals at Meisel, Tuteur & Lewis, P.C. to discuss in more depth the appropriate college savings plan for your particular situation.

STATES TARGET NON-RESIDENT PARTNERS

By Shane R. Orbach, CPA, MST

In an attempt to gain control over fiscal deficits, many states are turning toward tax compliance enforcement in order to generate additional revenue streams. As part of this initiative, many are focusing on the distributive share of non-resident owner's income from pass-through entities. The non-resident owners of a pass-through entity often file and remit income tax solely in their state of domicile, regardless of the number of states in which the pass-through entity operates. Faced with the daunting task of collecting income tax from non-residents, states have devised a variety of collection methods.

States have predominately used the following four weapons to increase compliance among non-resident owners of pass-through entities: (1) requiring a pass-through entity to file an annual information return or report; (2) requiring a pass-through entity to withhold taxes on behalf of the entity's non-resident owners, based on either distributions made by the entity or the owners' distributive share of income allocable to the given state; (3) requiring non-resident owners of a pass-through entity to submit to the state's jurisdiction for purposes of collecting income tax and to agree to timely file and pay tax on the owners' distributive shares of income allocable to the state; and (4) requiring a pass-through entity with non-resident owners to file a group income tax return on behalf of its non-resident owners, remitting tax based on the owners' distributive shares of income allocable to the state. These weapons are used individually and in combination by each state.

For federal income tax purposes, an entity treated as a partnership or S corporation generally is not required to pay tax on its income. Instead, the entity passes through any profits or loss to its owners who must include the amounts on their personal tax

returns. However, the partnership or S corporation is required to file an annual information return with the Internal Revenue Service (IRS). These information returns enable the IRS to match the items attributable to a pass-through entity with the items that ultimately are reported on tax returns filed by the entity's owners. States that impose an income tax require that an entity treated as a partnership or S corporation file an annual return similar to that filed for federal income tax purpose. Although improvements are being made, states generally lack the necessary resources to match information reported by the pass-through entity with that reported on the owners' tax returns. Consequently, they have chosen to supplement the reporting technique with other more aggressive compliance tactics directed toward non-resident owners of pass-through entities.

As a second line of defense, approximately 30 to 35 states employ some type of "withholding at the source" on pass-through entities with non-resident owners. This technique requires the pass-through entity to withhold an "amount" or "tax" on behalf of its non-resident owners. Generally, the amount withheld is determined by multiplying a non-resident owner's distributive share of income allocable to the state by the highest tax rate applicable to the individual or corporation. A handful of states, including Georgia and Oklahoma, require withholding only in connection with the state's allocable share of distributions to a non-resident owner. Depending on the state, the entity's payment on behalf of a non-resident owner may relieve the non-residents of the obligation to file an income tax return, assuming the non-resident has no other income from sources within the state. In states that still require the non-resident to file a separate income tax

return, remittance by the entity on behalf of the owner gives rise to a credit against the non-resident owner's state income tax liability. Of the states that employ withholding at the source techniques, approximately half forego this requirement provided the partnership or S corporation maintains and/or submits a "non-resident income tax agreement."

Non-resident income tax agreements are one of the newer tactics used by states to increase compliance among non-resident owners of pass-through entities. Generally this technique calls for the pass-through entity to obtain and furnish their non-resident owners' signed agreements to submit to the state's jurisdiction for purposes of collecting income tax and to timely file and pay tax due on the owner's distributive share of income allocable to the state.

The composite non-resident income tax return is another option used by states to encourage the payment of tax on income attributable to non-resident owners of pass-through entities. Provided several conditions are met, most states allow non-resident owners to elect to have a group income tax return, or "composite return," filed on their behalf. The composite payment to be made by the entity is generally the sum of each participating partner's distributive share of income allocable to the state multiplied by the maximum rate applicable to individuals.

As long as states continue to be in financial difficulty and noncompliance persists amongst non-resident owners of pass-through entities, states will continue to explore every possible mechanism available to increase their tax collection efforts. Pass-through entities doing business in a particular state should become familiar with the changing legislation in order to ensure proper compliance.

NEW TAX LAW HURTS CHARITABLE TAXPAYERS

By William Angelo

In the past, tax laws have given taxpayers considerable leeway in deductions claimed for the donation of vehicles to charities, allowing the entire blue book value of cars, boats and recreational vehicles as an eligible deduction. However, as of 2005 and effective for all contributions made after June 3, 2004, a new law passed by the IRS limits this deduction, as well as changing other rules regarding vehicle donation.

Under the new law, the charitable deduction for the contribution of any vehicle exceeding \$500 (excluding inventory property) that is resold by a charity is limited to the gross proceeds received upon resale. Since charities often sell vehicles at auctions or in bulk sales where the prices are below blue book value, donor deductions will be greatly reduced.

Furthermore, the law also imposes new substantiation requirements for contributions of qualifying vehicles. Now a deduction is not allowed unless the taxpayer substantiates the contribution

through a "contemporaneous written acknowledgement" by the charity stating the name and Social Security number of the donor, the vehicle identification number, and a statement that the vehicle was sold by the charity in an arm's length transaction between unrelated parties. The acknowledgement must also show the gross proceeds from the sale and state that the donor's deduction can not exceed that amount. (The charity must provide the acknowledgement to the donor within thirty days of the sale of the vehicle). Penalties apply to charities that knowingly furnish a false or fraudulent acknowledgement. If the charity uses the vehicle rather than selling it or materially improves the vehicle before sale, more stringent rules apply.

The changes don't stop there. For example, prior to the new law, if the total charitable deduction claimed by an individual for non-cash property exceeded \$500, the individual had to file IRS Form 8283 (Non-Cash Char-

itable Contributions); if the gift was more than \$5,000, the taxpayer was obligated to obtain a qualified appraisal, which was not required to be attached to the tax return, except in the case of gifts of art valued at more than \$20,000. Under the new law, if the amount of the contribution of property other than cash, inventory, or publicly traded securities exceeds \$500,000, then the donor must attach the qualified appraisal to the tax return. In addition, whereas in the past, corporations (other than a closely-held corporation, a personal service corporation, or an S-corporation) did not have to obtain a qualified appraisal for non-cash gifts over \$5,000, the new law requires that they do so.

This tax law has changed the way many taxpayers would donate. If you would like to further explore the issues regarding non-cash charitable donations, please call your tax professional at Meisel, Tuteur & Lewis, P.C.

Health Notes...

SUMMER SUN IS HERE!

1. Sun damage is cumulative throughout your life.
2. UV damage from a sunburn is the major cause of skin cancer.
3. One out of five Americans will develop skin cancer in their lifetime.
4. One million Americans will be diagnosed this year with skin cancer.

Remember -
 "Slip, Slop, Slap"
 - slip on a shirt
 - slop on sunscreen
 - slap on a hat



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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"If everyone is thinking alike, then somebody isn't thinking."

General George S. Patton

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