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Client Information Bulletin

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19 Deductible Business Expenses You Might Overlook

Checklist of easy to miss deductions

If you are a small-business owner or a manager, you are probably well aware that you can deduct the ordinary and necessary expenses of operating the business. But did you know that the definition of “**ordinary and necessary**” **business expenses** comprises a lot more than the usual laundry list of personal computers, labor costs and paper clips?

Here are 19 tax-deductible items you may easily overlook or ignore. The deductions for these expenses have been approved through court cases, private letter rulings or IRS regulations and code sections.

1. Answering service and beeper if you are required to be available as part of your job.
2. Audio and videotapes that enhance your business skills.
3. Bad business debts to the extent they are worthless.
4. Bank service charges and similar charges for business accounts.
5. Beverages and snacks for your employees.
6. Business travel incidentals such as laundry, airport shuttles, tips and so on.
7. Computer software and Internet service provider fees.

8. Consulting fees you pay to outside experts.
9. Insurance premiums against fire, storm, theft, accident or similar losses.
10. Legal fees paid in connection with your business.
11. Long-distance telephone calls from home if made for valid business reasons.
12. Magazine subscriptions and other periodicals related to business activities.
13. Passport used for business trips.
14. Petty cash used for business-related expenditures.
15. Physical examination to establish fitness needed for a particular job.

16. Professional dues paid to business commerce organizations.
17. Special clothing required for work (e.g., for safety reasons).
18. Tickets to sporting events given to customers as qualified business entertainment (limited to 50% of the cost).
19. Union dues and similar assessments.

This list is not all-inclusive. Search your records for business expense deductions that are out of the ordinary. Then check with a tax professional to determine if they are deductible or not.

Estate Planning: The Second Time Around

Five suggestions to consider

It is not unusual for middle-aged people to get married for the second, or even third, time. Yet this occasion does give pause when it comes to estate planning. Here are five suggestions you might heed.

1. Set your objectives. One goal is to minimize future problems and conflicts. Spell out in detail your intentions. You need to have an idea of how much responsibility and flexibility you want to give your new spouse in managing the estate.

Also, make provisions in the event that you or your spouse (or both of you) become seriously disabled. For example, you can assign a **durable power of attorney** so that someone you trust can manage your finances. Another important goal is to ensure adequate liquidity so that a forced sale of assets will not be necessary to cover taxes and other expenses at death.

2. Take an inventory of everything you own, its location and its value. The list should include cash, investments, real estate, cars, boats, collectibles, life insurance, business interests, employee benefits, **individual retirement accounts** (IRAs) and other qualified retirement plans such as **Simplified Employee Pension (SEP) plans** or **Savings Incentive Match Plans for Employees (SIMPLEs)**, and outstanding mortgages and notes.

Indicate how you own property -- whether it is owned by you alone, your spouse alone, you and your spouse jointly with or without rights of survivorship, or as community property. Community property is property acquired during marriage when living in certain states. Also, list all of your debts. Include current bills, credit card balances, mortgages and loans. Add an amount -- typically, 8%-12% of your estate -- for funeral expenses, executor's fees, attorney fees and other estate expenses.

3. Decide who gets what. Draw up a list with your name, address, date of birth, citizenship status and Social Security number. Do the same for your spouse. Add to this the names, addresses and birthdates of people you want to support, such as your parents, children and grandchildren.

Should you leave property outright to your beneficiaries? If you do, you won't have any say in what happens to your assets after you die. One possible solution is to use one or more **trust arrangements**. You can name a trustee to manage assets on behalf of your beneficiaries per your instructions. As a result, you may reduce the chance that your spouse will disinherit your children from a prior marriage. Or you can dictate when children get control over the assets you bequeath to them.

4. Assemble an estate advisory team. This may include an executor, guardian, trustee and agents for durable powers of attorney for financial and health care matters. Each player on the team has a role. For instance, the executor pulls together your financial affairs after your death and handles the distribution of your assets.

5. Minimize estate taxes. Any transfer from one spouse to another is completely exempt from federal estate tax under the **unlimited marital deduction**. In addition, the federal tax exemption currently shelters up to \$1.5 million of assets from tax. If your estate is even larger, consider these extra estate-planning techniques:

- ◆ Lifetime gifts: You can make annual lifetime gifts of \$11,000 (\$22,000 if your spouse consents to the gifts) to as many people as you want each year. You might give away property that is likely to appreciate in value.
- ◆ Charitable donations: Charitable bequests are fully deductible from your estate. In addition to outright bequests, you can give a deductible remainder interest that begins after your spouse benefits from the property during life.
- ◆ Life insurance trusts: By transferring your life insurance policies to a properly structured irrevocable trust, the proceeds of the policies will not be subject to federal estate tax.

These are just five ideas to consider. Meet with your professional advisers with respect to the particulars.

Taking Another Look at Roth IRAs

New opportunities for certain retirees

Roth IRAs (individual retirement accounts) were initially created by the **Taxpayer Relief Act of 1997**. This alternative to traditional IRAs has proven to be a popular retirement-saver ever since. Now an obscure tax law change has opened up Roth IRAs to more affluent retirees.

Background: If you earn compensation during the year, you may be able to contribute up to \$4,000 to a Roth IRA (less any regular IRA contributions) for the 2005 tax year. An extra \$500 contribution is allowed if you are age 50 or over. There is no current income tax on the buildup of earnings within the Roth IRA. Also, qualified distributions are completely free of income tax if they are made from a Roth IRA in existence for at least five tax years. **Note:** Unlike traditional IRAs, there are **no minimum distribution requirements** for a Roth IRA owner during his or her lifetime.

However, you cannot take advantage of a Roth IRA if your **modified adjusted gross income** (AGI) exceeds a certain level. The maximum allowable contribution for joint filers is phased out for a modified AGI between \$150,000 and \$160,000 (\$95,000 and \$110,000 for single filers). Also, pre-age 59-1/2, withdrawals (other than **qualified distributions**) are subject to the 10% tax penalty.

What is a qualified distribution? It is a distribution made after age 59-1/2, upon death or disability, or to pay for first-time home-buyer expenses (up to a lifetime limit of \$10,000).

Example: Ms. Green, age 42, contributes \$3,000 a year to a Roth IRA for 25 years. Green is in the 25% tax bracket. Assuming the contributions earn 8% a year compounded annually, Green will have accumulated \$236,863 in her account after 25 years. Compare that to a taxable investment that is earning the same 8%. After 25 years at an after-tax rate of 6%, Green would have accumulated only \$174,469. Of course, these figures are hypothetical and not indicative of any particular investment.

Can't she accomplish the same result with **nondeductible IRA contributions**? Not exactly. **Reason:** Although the contribution amounts are not taxable when they are withdrawn, the earnings are still subject to income tax.

If distributions are made from a Roth IRA that has not been in existence for at least five tax years, the funds are treated as being withdrawn as follows: contributions first, any amount converted from a regular IRA second and earnings third.

Example: Mr. Brown, age 60, contributes \$3,000 to a Roth IRA for four years. Brown is in the 28% tax bracket. Assuming the contributions earn 8% a year compounded annually, Brown will have accumulated \$14,600 in his account after four years.

If Brown then withdraws \$5,000, the distribution is completely tax-free, no matter how the money is used. However, if he withdraws the entire balance of \$14,600, only \$12,000 is tax-free. The remaining \$2,600 is subject to income tax. **Result:** Brown must pay \$728 in

income tax. Again, these figures are hypothetical and not indicative of any particular investment.

Why are Roth IRAs available to more retirees? If your annual AGI is \$100,000 or less, you can convert a traditional

IRA to a Roth IRA and pay the resulting tax. Due to a little-noticed tax provision, mandatory IRA distributions for taxpayers over age 70-1/2 no longer count towards the \$100,000 limit in 2005. Therefore, this may be the first year some retirees qualify for a conversion.

Combined Tax Benefit for Homeowners

According to a new IRS ruling, there is a way you can combine the tax-free home-sale exclusion with a like-kind exchange for a unique tax parlay.

Background: Under the home-sale exclusion, you can exclude from tax the first \$500,000 of home-sale gain (\$250,000 for singles) if you have owned and used the home as your principal residence for at least two out of the past five years.

In addition, you can swap business or investment property tax-free for other “like-kind” property. You’re only taxed on any “boot” you receive in the deal (e.g., as cash or assumption of a mortgage). However, your basis in the new property must be adjusted to reflect the exchange.

By converting your current home into a rental property, you can qualify for the home-sale exclusion and defer any tax on the excess gain when you swap it for a similar property. Similarly, you may qualify for this two-way tax break if you use part of your home as an office. In the new ruling, the IRS says that home-sale exclusion is applied before the like-kind exchange rules.

What Is Your E-mail Style at Work?

Basic rules of e-mail etiquette

The use of e-mail in businesses is prevalent these days, but there is no etiquette or other standard that has been universally accepted. Most people make up their own rules along the way. Nevertheless, by following these guidelines -- and adding a healthy dose of common sense -- you should be able to portray your business in a positive light.

- ◆ **Be concise.** Just as you don’t want to spend an inordinate amount of time composing your messages, clients and prospective clients won’t want to waste time reading them. Make your point quickly and exit gracefully. Some people receive dozens -- or perhaps even hundreds -- of e-mail communications each day, so **brevity** is essential.

- ◆ **Keep it simple.** Don’t get caught up in complex sentence structure and excessive punctuation. Stringing together a group of exclamation points to make a point or repeatedly using a series of ellipses can be a turn-off to your readers. It also detracts from the message itself.
- ◆ **Don’t go overboard on formatting.** Using HTML (hypertext markup language) to format messages in order to produce eye-catching colors, unusual fonts and the like is asking for problems. Some servers simply can’t handle the message and will turn it into gibberish. Even worse, the client’s personal computers can freeze up, turning his or her annoyance at you into out-and-out resentment.

- ◆ **Use abbreviations with discretion.** Abbreviations are widely accepted in e-mail communications, but you may be using terms your client isn't likely to recognize or understand. In other words, feel free to refer to the Internal Revenue Service as the IRS or to say that the message is FYI (for your information). However, do you think that most of your clients would recognize TNSTAAFL (there's no such thing as a free lunch)?
- ◆ **Stay away from "smilies."** A number of codes, often referred to as smilies, have sprung up among e-mail users to signify various emotions. Smilies are fine for chat rooms and electronic bulletin boards, but there's no place for them in a business context. These are unnecessary and will only serve to confuse the uninitiated.
- ◆ **Don't include any information you consider to be private or proprietary.** For all intents and purposes, there is **no such thing as e-mail pri-**

vacy. For instance, your e-mail messages may be routinely read by others in your firm -- or others at the company receiving the e-mail -- through special software.

Furthermore, computer hackers who want to read your e-mail badly enough will be able to do so. Or you could slip up and put the wrong addressee on the message. In any event, don't send anything by e-mail that you would not want to be posted on a company bulletin board.

In summary: By following these basic rules, you will be able to communicate freely with business contacts without any cause for concern. Once again, common sense should prevail.

Facts and Figures

Timely points of particular interest

➔ **Measuring Up** -- It may be time to stop guessing how long tasks take and start knowing. One possibility is to estimate the time you will need to complete a task before you begin it and then track it all the way through. You may need to make adjustments if there is a wide discrepancy between your estimate time and the actual time. If you are on target, then so much the better. This practice could lead to improved productivity in the office.

➔ **Summer Jobs** -- Do you pay your teenaged child to help around the office in the summer? The wages are deductible just as they would be for any other employee. However, be wary: You must pay the child a reasonable salary for services actually performed. In a new case, the Tax Court denied deductions for individual salaries of \$4,200 each paid to a five-year-old and a ten-year-old without any documentation.