



## DYER & ASSOCIATES, P.C.

Certified Public Accountants

10415 Armory Avenue

Kensington, MD 20895

(301) 654-6200 FAX: (301) 692-1990

March 2005

# Client Information Bulletin

## INSIDE

### The Ins and Outs of Probate

### Payroll Taxes: Finding the 100% Solution

### Nearing Retirement? Enter a New Phase

### Four Steps to Take Before IT Upgrades

### Facts and Figures

## How to Keep Track of T&E Expenses

*Recordkeeping is critical for top-dollar deductions*

Year after year, the IRS continues to look at deductions for **travel and entertainment (T&E) expenses** with a healthy dose of skepticism. Therefore, it is important to keep meticulous records of your expenses. Although certain shortcuts may be allowed, here are the general rules to follow in this area.

### Business Travel Expenses

If you travel away from home on business, you can deduct your transportation costs (e.g., airfare), meals, lodging, and related incidental expenses such as cab fare and tips. The deduction for meals is limited to 50% of the cost while other

travel expenses are fully deductible. However, you must keep records of your business travel expenses with a diary or by some other means.

The records for business travel must show:

- ◆ **Time:** The dates you left and returned and the number of days away on business;
- ◆ **Place:** The destination of the business travel;
- ◆ **Business purpose:** The reason for making the business trip; and
- ◆ **Amount:** The cost of each travel expense.

You must also keep receipts of all lodging expenses and other business-related expenses of \$75 or more.

**Note:** If you use the actual expense method for driving a business car, you can deduct normal operating expenses -- gasoline, oil, insurance, repairs, etc. -- attributable to your business use plus an approved depreciation or leasing allowance. The allowance is strictly limited for so-called "luxury cars," but it may be bothersome to keep all the required records for these business car expenses.

Alternatively, you may deduct the **standard mileage rate** by simply multiplying a government-approved flat rate by your total business miles and add the cost of any parking fees and tolls. The rate for 2004 was 37.5 cents per business mile. **Tax update:** The government has hiked the standard mileage rate for 2005 to 40.5 cents per mile, an increase of 3 cents a mile -- the biggest increase in years.

If you begin using the actual expense method for a car, you generally can't switch to the standard mileage rate in a subsequent year. However, you can do it the other way around -- start using the standard mileage rate and switch to the actual expense method if it produces a larger deduction. **Note:** Even if you use the standard mileage rate, you still must keep track of the date, place, mileage and business purpose of your trips.

### **Business Entertainment Expenses**

Generally speaking, you can deduct qualified entertainment expenses that are either directly related to your business or associated with your business. The deduction is equal to **50% of the cost**.

**1.** Entertainment is considered directly related to your business if you actually discuss business during the entertainment and you have more than a general expectation of deriving a business benefit from the meeting. In other words, the entertainment can't be just for goodwill. Furthermore, the entertainment must take place in an atmosphere conducive to discussing business.

**2.** Entertainment is considered associated with your business if it precedes or follows a substantial business discussion. It is not necessary to talk about business matters during the entertainment. If the client is from out of town, the business discussion can take place the day before or the day after the entertainment.

As with your business travel expenses, you must keep detailed records of your entertainment expenses with receipts or credit card statements of \$75 or more. Generally, it is advisable to use a diary or log.

The records for business entertainment must show:

- ◆ The date, location and nature of the entertainment;
- ◆ The amount spent on the entertainment;
- ◆ The business reason for the entertainment or the benefit you expect to derive;
- ◆ The person or people entertained and their business relationship to you; and
- ◆ The details of the substantial business discussion (e.g., date, duration and nature of the meeting) for any associated-with entertainment.

***Final words:** There is no reason to shy away from deducting legitimate T&E*

*expenses on your tax return. You can coordinate these activities with a tax*

*professional.*

## The Ins and Outs of Probate

### *When it makes sense to bypass the process*

For many individuals, probate is as about as desirable as being tied up in jury duty. They know it is inevitable, but they will avoid it if they can. Yet probate is often a fairly innocuous procedure to endure. This is especially true where the decedent has a will that is **properly executed**.

So what exactly is probate? It is the legal procedure for winding up the decedent's affairs, paying debts including medical or nursing home bills, and distributing the assets of the estate. Where there is a will, the heirs typically hire an attorney to have the will validated.

Since probate is a court-supervised process, there are legal fees and other administrative fees to be paid out of the estate. There is also the hassle and delay of a judicial process. For this reason, people often try to pass much of their estate to their heirs outside of probate. This is perfectly legal.

**Case in point:** Any property owned jointly with another person under a designation of "joint tenancy with a right of survivorship" will pass to the survivor automatically upon the death of the decedent without the probate process. Similarly, any assets such as life insur-

ance, retirement funds and bank accounts naming a beneficiary will also pass automatically without probate. In fact, if the decedent sets up a trust naming himself or herself as trustee and the heirs as beneficiaries, all the assets transferred to the trust would pass **outside of probate**.

Since the assets pass to the beneficiary immediately upon the decedent's death, they are not part of the decedent's estate and, thus, avoid probate.

**State law governs probate**, so the actual process will differ somewhat from state to state. Some states have simplified probate for estates with assets under \$100,000. Others have provisions for simplified probate requiring the consent of all the beneficiaries. In most states, probate is relatively painless, unless there is a dispute over the will or over the executor's actions.

**Bottom line:** *Probate is not to be avoided at all costs, but it can be time consuming for certain estates. If your family owns sizeable assets, you might investigate the benefits of a trust arrangement that can bypass probate. Be sure to obtain expert professional assistance in this area.*

## Payroll Taxes: Finding the 100% Solution

### *New case imposes tax penalty on responsible partners*

The “**100% tax penalty**” is one of the harshest provisions in the tax law. Basically, if you are held responsible for unpaid payroll taxes, you may be **personally liable** for an amount equal to 100% of the tax liability. The unpaid taxes come right out of your own pocket.

Furthermore, you are not off the hook if you delegate the job to someone else. You may be held personally liable even if you thought the payroll taxes had been paid on time. Liability may be avoided only if you can show that your failure to deposit the taxes was due to “**reasonable cause**” and not “**willful neglect**.”

As you might imagine, taxpayers who are assessed the 100% penalty often contest the issue in the courts.

**Latest example:** Two partners in an auto parts business hired a bookkeeper to handle their books. The partners reviewed the general business activities at least once a month while an outside accountant reviewed the finances regularly. Although the company bookkeeper, who was also an accountant, handled all the payroll deposits, the outside accountant prepared and filed the partnership’s annual tax returns.

During one of their regular reviews, the partners discovered that two installments of payroll tax deposits had not been made. They immediately paid the taxes

owed by the partnership. Nevertheless, the IRS assessed approximately \$22,000 in penalties against the two individuals.

The District Court in Oregon sided with the IRS. The court wasn’t swayed by the argument that the partners had delegated the duties to their bookkeeper. The bookkeeper was supervised by the partners who conducted regular reviews of the business operation.

**Result:** The two partners were held responsible for the payments.

Obviously, there is no foolproof method, but you can minimize potential problems by taking certain precautions. For instance:

- ◆ Have one employee responsible for paying the taxes and another employee to verify that payment has been made.
- ◆ Assign backups to both employees in case of illness, vacations or other absences.
- ◆ Require a report to be issued to you indicating that the responsibility has been completed.

*Last, but not least, make it your business to personally check to ensure that payment has been made on time.*

### Nearing Retirement? Enter a New Phase

The IRS is making it easier for business owners and managers to phase into retirement gradually. Under new proposed regulations, you will be entitled to receive a pro-rata share of your retirement plan benefits if you continue to work. Previously, you weren't entitled to a plan payout until you were formally "separated from service."

**How it works:** Assuming you meet certain requirements, the retirement benefit will be based on your reduction in hours as a "partially retired" employee. Participation in a phased-in retirement program must be voluntary and the employer must expect the employee to reduce working hours by at least 20%.

Note that you must have reached age 59-1/2 in order to qualify. In addition, you can't take a lump-sum distribution for a phased-in retirement program. Therefore, you might decide to bypass this tax break for a one-time payment that can be rolled over tax-free into an IRA or other qualified plan.

The new rules won't take effect until final regulations are issued. In the meantime, you may start planning for a gradual retirement with partial benefits.

## Four Steps to Take Before IT Upgrades

*Don't buy yesterday's solutions for tomorrow's problems*

Are you looking to upgrade your **information technology (IT) department**? It is often critical for a business operation to maintain a cutting edge during these times of rapid technological advancement. But that doesn't mean you should leap into new purchases before you look.

Here are four steps to take before you make any firm commitments.

1. Identify the reasons for changes. Ask yourself these basic questions at the outset:
  - ◆ Is your current IT system unacceptable for your growing business?
  - ◆ Will new solutions lead to increased productivity and profits?
  - ◆ Has a change in your business operation necessitated an upgrade?

If the answer to one or more questions is "yes," you can proceed to the next step.

**2. Communicate with your IT employees.** If you are looking into a software upgrade, talk to the people who actually use the system. They can provide valu-

able feedback on problems and potential solutions. Don't leave all the considerations in the hands of the higher-ups.

**3. Analyze your needs carefully.** When it comes to IT purchases, companies often over-spend or under-spend. Put yourself in a position for securing the optimum benefit. Reminder: There will be a learning curve before the system is fully functional. You don't want your business to grind to a halt while you implement new software.

**4. Examine your existing processes and procedures.** A new IT system won't do your company much good -- in fact, it might even be harmful -- if you don't have the proper infrastructure in place. Decide what your expectations are and if the new equipment can deliver what you need.

*Usually, there are thousands of dollars at stake when IT upgrades are contemplated. If you act with great haste, you may have to revisit this issue all too soon. Take the time to get it right the first time.*

## Facts and Figures

### *Timely points of particular interest*

- **Just Horsing Around** -- In a new case, the Tax Court determined that a taxpayer was not engaged in a horse breeding and training activity for profit. The Court noted the taxpayer had no prior experience other than riding horses for pleasure. Furthermore, the taxpayer did not maintain adequate records of the activity, did not prepare (or have prepared) financial projections or a business plan, and did not maintain a separate bank account for the activity. **Result:** The annual losses could not be deducted.
- **The Art of the Sale** -- Where is the best place to find new clients for your products or services? Typically, it is hard to sell new products or services to existing clients and even harder to sell them to new customers. The easiest sales often arise when you try to sell offerings from an existing line to existing customers. If your database is up-to-date, you might focus your prospecting efforts on current customers by pitching products or services that are closely related to prior purchases.