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# Client Information Bulletin

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## How to Deduct Winter Convention Costs

*Follow the tax rules for trips inside and outside the United States*

Suppose you have just received an offer to attend a winter business convention in a tropical paradise. The convention will give you a chance to brush up on new developments in your field while you relax. **Tax benefit:** As long as you meet certain tax law requirements, you can deduct the cost of the convention as a business expense.

**Background:** The basic rules for business conventions are the same as the rules for regular business trips. In other words, you can deduct the “ordinary and necessary expenses” incurred while traveling away from home. Of course, the primary purpose of the trip

must be related to your business operation.

As long as the convention takes place in the North American area, you may deduct 100% of your travel expenses and 50% of your business-related meals and entertainment. **Note:** If you are footing the bill yourself, these expenses are treated as miscellaneous itemized deductions subject to the usual 2%-of-AGI (adjusted gross income) floor.

However, if the convention is being held outside the North American area, there is another tax hurdle to clear:

You must show that it is reasonable for the convention to be held outside the North American area. If you do not pass this **reasonableness test** you cannot claim any deductions for the convention.

What places are included in the North American area? The list may be longer than you might think. Currently, it includes American Samoa, Antigua and Barbuda, Baker Island, Barbados, Bermuda, Canada, Costa Rica, Dominica, Dominican Republic, Grenada, Guam, Guyana, Honduras, Howland Island, Jamaica, Jarvis Island, Johnston Island, Kingman Reef, the Marshall Islands, Mexico, Micronesia, the Midway Islands, the Northern Mariana Islands, Palau, Palmyra, Puerto Rico, Saint Lucia, Trinidad and Tobago, the United States, the U.S. Virgin Islands and Wake Island.

How do you pass the reasonableness test if you go outside the North American area? Traditionally, three factors are used for this determination. You must be able to show the following:

- ◆ The purpose of the convention and the activities taking place at the convention;
- ◆ The purpose and activities of the sponsoring organization or groups; and
- ◆ A list of the residences of the active members of the sponsoring organization and the places at which

other meetings of the sponsoring organizations or groups have been or will be held.

As a last resort, you may be able to present other relevant factors that can prove that it is as reasonable for the convention to be held outside the North American area as within it.

Whether you attend a convention inside or outside of the North American area, you must meet strict substantiation requirements. For instance, you should keep a record of the sessions that you attend. In addition, hold onto the brochures and any other documents that detail the activities at the convention.

Finally, remember that the primary purpose of a convention must be business-related. That is not to say you can't enjoy yourself while you are at the convention or indulge in some sightseeing or golfing. But the convention trip cannot be a vacation in disguise.

**Footnote:** *These rules apply to conventions held on dry land. If you are attending a convention aboard a cruise ship, you can claim deductions only if the ship is registered in the U.S. and all ports of call are within the U.S. or its possessions. Furthermore, the total deduction for a convention on a cruise ship is limited to \$2,000 per calendar year.*

# Four Ways to Encourage Creative Employees

## *Tapping the best source of new ideas and products*

It is often thought that the best and most creative ideas originate in the executive suites of a company or the business owner's office. But it is often the workers in the trenches who come up with the brainstorm. After all, their work is closely related to the products or the services.

How can a business owner or manager encourage workers to share their thoughts? Here are four suggestions for keeping new and profitable ideas flowing at a steady pace.

**1. Acknowledge creativity.** If some workers come up with a bright idea that will build sales or cut costs, let everyone else at the company know about it. You might put their names up on the bulletin board or in the company newsletter or select them to represent the company at industry get-togethers.

**2. Reward creativity.** Workers have to know that coming up with a creative idea will pay off for them personally. Rewards can, of course, come in all shapes and sizes. It can be as simple as giving an employee an extra day off or a bigger work area.

However, depending on the type of company and the products and services it sells, the most effective rewards generally take the form of additional compensation (e.g., giving an employee company stock, a bonus or a raise).

**3. Stimulate creativity.** It helps to supply some sort of outlet for creative ideas and suggestions (and even for simply blowing off steam). The tried-and-true suggestion box may be the simplest way to get the ball rolling. Another possibility is to hold a casual once-a-week (or once-a-month) get-together with employees at a local restaurant or some other hangout. Alternatively, you might hold group discussions or forums where employees can speak their minds freely.

**4. Train employees to be creative.** It is a simple, but unfortunate, fact of life: Many people simply don't have the self-confidence to step forward with good ideas. They think that they have nothing to offer their employer other than the mechanical performance of the job that they have been hired to do.

Frequently, educating workers is the best way to overcome this misconception and turn employees into a source of creative ideas. Some companies have hired professionals who specialize in this kind of creativity training, while others have been able to develop their own training programs from the ground up.

*Tapping into the **creative ideas of workers** is usually a win-win situation: The employer is able to increase profits or cut costs while the employees receive extra benefits and take pride in their work. Don't overlook the positive effect this can have on your company.*

## Weighing the Benefits of Age-weighted Plans

*Tapping the best source of new ideas and products*

If you've spent years building up your business, you may not have much time left to save for your retirement. In that case, you might consider an "age-weighted" profit-sharing plan that favors the older employees of the company. This type of plan is perfectly legitimate as long as it meets the nondiscrimination requirements for qualified retirement plans spelled out in the tax law.

**How it works:** All of the basic rules and regulations that apply to regular profit-sharing plans also apply to plans with an age-weighted feature. The plan can have a discretionary plan formula that gives the employer more flexibility than usual -- you can even skip contributions in a year altogether if you choose. Because the age of employees is factored into the formula, this type of plan generally benefits older employees who need to accumulate retirement funds in a hurry.

The contributions are calculated by using the present value of a single life annuity at a specified testing age. This ensures that the plan meets tax law nondiscrimination requirements. A professional adviser can make the necessary calculations.

To give you an idea of the potential benefits, let's take a look at a hypothetical situation.

**Example:** Let's say that Michael is a 50-year-old owner of a small company with six full-time employees, including himself. The company contributes \$39,000 to the plan for the year based on a testing age of 65. (Note that the interest rate assumptions must fall within certain tax law guidelines. A benefits professional can handle the actual calculations.)

**Result:** As the highest-paid and oldest employee of the company, Michael receives almost two-thirds of the total contribution to the plan for the year. His portion represents approximately 63% of the company's entire \$39,000 contribution, or \$24,547.

Contrast this result with a traditional profit-sharing plan based strictly on compensation. Since Michael's compensation is one-third of the payroll, he would be entitled to one-third of the annual contribution, or \$13,000. The age-weighted plan gives Michael an extra contribution of \$11,547.

*Note: Another version of a profit-sharing plan that can benefit older workers is a new comparability plan. In this type of plan, the contribution percentage formula for one category of participants is greater than the other categories. Consult with your professional advisers concerning the best approach for your business.*

### **New Waiver Requirements For CRTs**

The IRS recently issued new requirements for charitable remainder trusts (CRTs) created after June 27, 2005. Under the new rules, a donor must obtain a signed waiver from his or her spouse in order to preserve the tax benefits of the CRT.

**Background:** With a CRT, you transfer assets to the trustee of a charity while you (or another beneficiary) retain the right to receive the income from the assets. Upon your death or a specified term, the remaining assets go outright to the charity. Based on the value of the remainder interest, you can claim a current tax deduction in the year of the transfer. In addition, there's no current tax on the buildup of funds.

The IRS has become concerned that CRTs could conflict with some state laws that prevent a surviving spouse from being disinherited. Thus, it has instituted the waiver requirement, even though detractors claim it is highly unlikely a surviving spouse would pursue a claim from CRT funds.

**New rule:** For trusts created before the June 28, 2005, cutoff date, the CRT will remain valid unless a spouse actually exercises a right of election against the trust assets. For post-June 27 CRTs, however, the trust won't qualify without a timely waiver. Generally, the failure will date back to the inception of the trust. Furthermore, a waiver is required for a change of domicile or residence to a state that provides spouses a claim to trust assets, marriage or any other occurrence that would result in a claim for a surviving spouse.

If the trust fails to qualify, the donor forfeits the up-front tax deduction and the funds will be included in the donor's taxable estate. To compound the problem, the trust will be taxed on capital gains from the sale of assets as well as the accumulation of funds.

# Where Are Your Charitable Donations Going?

## *Five steps to reviewing activities of charitable groups*

A frequent contributor to charitable causes can derive a double benefit for being generous: You have the personal satisfaction of providing much-needed assistance plus you are entitled to a tax deduction based on the value of your gift. However, questions may be raised after you have made your donations. How do you know if the charity is operating on the up-and-up? How are the funds being used?

By taking some extra time, you can determine if charities are using the funds you have donated in a prudent manner. Here are five practical suggestions:

1. For starters, verify that a particular charity is a viable **tax-exempt organization**. If the charity doesn't meet the requirements, you can't deduct your donations to it. Each charity is required to file a financial form providing information on its tax status, programs and the use of funds. You can access this information from the charity if you request it (although the charity can charge a reasonable fee for the service). **Exception:** Churches, synagogues and other places of worship generally do not need to file this report with the government.
2. Take a close look at the organization's marketing materials. Be suspicious of appeals designed to tug on your heartstrings without any real substance or indication of the charity's ultimate purpose. Legitimate solicitations should convey the work that the charity is actually doing.
3. The forms the charity files with the government can be daunting, so you

might instead ask to see the organization's audited financial statement. Many states require these audits for charities receiving more than \$100,000 in donations. If the charity won't provide the report, you can obtain one from the state offices. **Caution:** You might rethink your commitment to a charity that isn't willing to provide financial information.

**Rule of thumb:** It's been estimated that at least 60% of an organization's funds should go to its programs or services. Of course, different charities will have different types of administrative costs, so this should be taken into account.

4. If you intend for your donations to support specific programs, include instructions with your check. A responsible charity will honor your intentions. However, be mindful that fulfilling such requests can put a strain on the charity and increase its administrative expenses.
5. After you have reviewed the financial information, investigate its operating procedures. Consider the individuals listed on the board of directors and whether there are any potential business conflicts. Also, find out if the organization uses a professional fundraising firm. You can run a check on this "arm" of the charity to see if it uses reputable practices.

*Investigating a charitable organization takes some time and effort. By doing so, however, you will be able to make an informed decision about your charitable choices.*

## Facts and Figures

### *Timely points of particular interest*

- ➔ **Employees on a Mission** -- Creating a mission statement is a common way to crystallize the goals and objectives of your business. **Possible idea:** You might have your employees each write a personal mission statement about what they hope to achieve at your company. The statement should be no longer than a paragraph. This is a good way to find out what an employee's expectations are and the intended path of growth.
- ➔ **Investment Advice** -- In a new case, the Tax Court held that amounts paid by a trust for investment advice must be deducted as a miscellaneous expense that is subject to the 2%-of-AGI (adjusted gross income) floor. The trust had claimed the amount was fully deductible from income under a special exemption for trusts and estates. The federal circuit courts have been split on this issue, so it may ultimately have to be resolved by the United States Supreme Court.