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Client Information Bulletin

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Seven Smart Tax Ideas for Year-end

Ways for individuals to reduce tax liability

The end of the year is the optimal time for tax planning by individuals. However, be aware that complications may result from two new tax laws—the **Tax Increase Prevention and Reconciliation Act (TIPRA)** and the Pension Protection Act of 2006 (PPA)—passed this year. With that in mind, here are seven tax ideas to think about this year-end.

1. Charitable donations: As a general rule, you can deduct the full amount of your cash donations on your personal tax return. If a donation is made by credit card at year-end, the gift is deductible in 2006, even if the charge is not actually paid until 2007. For donations of prop-

erty, the full fair-market value may be deducted if the property has been held for more than one year.

Note that the PPA revamps the rules for charitable deductions. Significantly tougher substantiation rules for cash contributions take effect in 2007. In addition, deductions for donations of clothing and household goods donated after August 17, 2006, will be denied unless the property is in "good condition." **Exception:** Regardless of condition, you may deduct single items valued at more than \$500 if you have a qualified appraisal.

2. Income-shifting: It's possible to reduce the overall family tax bill by shifting taxable income from your high tax bracket to other family members in lower tax brackets. For instance, you might transfer income-producing property to custodial accounts for your minor children. **Caution:** Be aware of the "kiddie tax." To the extent that the unearned income received by a child exceeds an annual limit (\$1,700 for 2006), the excess is taxed at the top marginal tax rate of the child's parents.

Prior to this year, the kiddie tax only applied to children under age 14. But TIPRA raised the age limit to 18, so the kiddie tax applies to more children in 2006. Consider switching a portion of a child's investments into tax-deferred or tax-free vehicles.

3. Estimated tax payments: If you do not have enough federal income tax withheld during the year, you may still avoid an estimated tax penalty by meeting one of the "safe harbor" exceptions in the tax law. For instance, no penalty is imposed if annual tax payments for 2006 equal 90% of the current year's liability or 100% of the prior year's tax liability. The percentage for the 100% safe harbor is increased to 110% if your adjusted gross income (AGI) for the prior year exceeded \$150,000.

4. AMT liability: The alternative minimum tax (AMT) applies if your AMT liability exceeds your regular tax liability. The complex AMT calculation involves the addition of certain "tax preference" items and the subtraction of an exemption amount based on filing status. **One benefit:** TIPRA preserves slightly higher exemption amounts for 2006.

Have your AMT liability calculated before year-end. Depending on the result, it may be advisable to shift tax preferences to next year to avoid or reduce AMT liability. Alternatively, you might accelerate income into 2006 if the AMT rate is lower than your top marginal tax rate.

5. Medical and dental expenses: You may deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your AGI. Try to bunch non-emergency expenses (e.g., new eyeglasses or dental cleanings) in the tax year that provides the best opportunity for a deduction. **Note:** Do not forget to include copayments required under a company health insurance plan.

6. Dependency exemptions: Despite recent modifications in the tax rules, parents generally can still claim a dependency exemption for a child who is under age 19 or a full-time student under age 24 as long as the parents provide more than 50% of the child's support. Depending on your situation, it may make sense to add to your support total at year-end to clear the 50% mark. Each dependency exemption for 2006 is \$3,300.

7. Capital gains and losses: If you regularly invest in equities, you can use capital gains and losses at year-end to benefit your tax situation. For example, if you realized capital gains earlier in the year, you may sell stocks at a loss to offset those gains. Conversely, if you are showing prior capital losses, capital gains realized before 2007 are effectively tax-free up to the amount of those losses.

Any excess capital loss for the year may offset up to \$3,000 of ordinary income. The remainder is then carried over to next year.

With the help of a tax professional, you can develop a year-end plan customized to fit your specific needs.

Key Points on Computer Ergonomics

Take measures for comfortable workstations

Consider the amount of time that you spend at your computer at either work or at home—or both. If you are like most people today, it comprises a good portion of your waking hours. Therefore, it is important from a health viewpoint, as well as for your personal comfort level, that the computer workstation be ergonomically sound.

Surprisingly, few people make this a priority in their lives. They simply accept the station as the way it is set up, especially for employees who are assigned computer stations at work. Unfortunately, this can result in discomfort and even serious injury if it is not addressed.

Employers can help the process by considering the health and safety of its employees. This can result in fewer computer-related work absences and increased productivity. For example, a company's ergonomic measures may include:

- ❖ Adjusting the height of working surfaces to reduce long reaches and awkward postures;
- ❖ Putting work supplies and equipment within comfortable reach;
- ❖ Providing the right tool for the job and the right tool handle for the particular worker;
- ❖ Varying tasks for workers;
- ❖ Encouraging short authorized rest breaks;
- ❖ Reducing the weight and size of items workers must lift;
- ❖ Providing mechanical lifting equipment;
- ❖ Using telephone headsets;
- ❖ Providing ergonomically sound chairs or stools at work stations; and
- ❖ Supplying anti-fatigue floor mats.

At this writing, the Occupational Safety and Health Administration (OSHA) is offering a free evaluation checklist that shows ways to improve computer stations. The OSHA guidelines can be accessed online at www.osha.gov/SLTC/etools/computerworkstations/checklist.html.

IRS Streamlines Payments of FSA Expenses

New guidelines for using debit and credit cards

Does your company have a flexible spending arrangement (FSA) on the books? This setup enables employees to use pre-tax dollars to pay for certain health care or dependent care expenses. In a new ruling, the IRS has liberalized the rules for paying FSA expenses.

Specifically, the new ruling encourages the use of debit cards or credit cards. The change can reduce the paperwork load for employers and employees. Reimbursements can be made quickly without having to go through the hassle of substantiation.

Background: The IRS had previously established guidelines for substantiating FSA reimbursements made by debit card or credit card. Receipts or further review are not required if the following conditions are met:

- ❖ The dollar amount of the health care transaction equals the dollar amount of the copayment for that service under the plan covering the employee;
- ❖ The employer permits automatic reimbursement without further review of recurring expenses that match expenses previously approved as to amount, provider and time period; or
- ❖ The merchant, service-provider or other independent third party verifies to the employer that the charge has been incurred for a medical expense.

Now the new ruling expands this benefit to charges that are exact multiples of the specified copayment dollar amount provided by the health care provider, for up to five times the amount. (The service

provider must be identified by its merchant category code.)

If a plan has multiple copayments for the same benefits (e.g., a tiered copayment), exact matches of multiples or combinations of copayments will be considered substantiated. In other words, the transaction cannot exceed five times the amount of the maximum copayment.

The IRS will also allow an employer to implement a system that approves or rejects payment card transactions using inventory control information. Furthermore, it has clarified the rules for direct third-party substantiation. Additional substantiation is not required from the employee if the third party—usually, the health insurance company—informs the employer of the date of service and the employee's responsibility for payment.

Finally, the IRS has made it easier to use a dedicated credit or debit card to pay dependent care expenses through an FSA. **How it works:** The employee pays the initial expenses to the dependent care provider and substantiates the qualified fees by submitting them to the employer.

The plan permits the employee to use a card to pay for the lesser of previously substantiated expenses or the employee's total salary reduction amount to date. The card may be used by the employee to pay for subsequent expenses. This rule change helps employees avoid the requirement that dependent care expenses cannot be reimbursed before the expenses are incurred.

Note: The new IRS guidelines also apply to health reimbursement arrangements (HRAs). These employer-funded plans,

which are limited to health care expenses, are not as prevalent as FSAs.

Five Ways to Stoke a “Hot Team”

How can you fire up employees to work on a special project? One possible method is to develop a “hot team.” Your company may give this group more latitude in an important business project.

Here are five ways to help a hot team perform beyond your usual expectations.

1. Allow team members to bend the rules a bit when the usual restraints will slow them down. Of course, you should apply reason and a dose of common sense.
2. Don't single out team members for criticism. Let them go about their appointed tasks.
3. Listen carefully to the feedback. Trust your people to do a good job for you.
4. Make the goal their passion. By giving up control over the proceedings, you will encourage team members to become vested in the mission.
5. Grant some decision-making power. That doesn't mean you should cede all authority, but you can allow some leeway for workers to act without checking each move for your approval.

At first, you may find that the “hot team” approach works for small projects. Depending on your needs, you might expand this concept for larger operations.

How to Improve Life Insurance Coverage

Five steps for an annual insurance review

If you are like most adults, you already have some life insurance coverage. But is your coverage good enough for your current situation? Since we are approaching a new year, now is a good time to review your policies. Here are five ways you might improve your coverage.

1. Name contingent beneficiaries. Usually, your primary life insurance goal is to provide for your spouse in the event of your death. But what if you and your spouse die in a common disaster or what if your spouse dies before you? Unless there are other provisions, your life insurance proceeds will be distributed to your estate. As an alternative, you should name one or more contingent beneficiaries. Otherwise, life insurance proceeds could pass to individuals whom you did not intend to be beneficiaries.

2. Specify who your beneficiaries are. You should identify all your beneficiaries by their full names and relationships to you. For instance, if you have been married more than once, there may be a contest over the life insurance proceeds if you don't specify which spouse is the beneficiary. Also, simply naming your children as primary or secondary beneficiaries can lead to problems, especially if there are stepchildren, adopted children or children from different marriages. The clearer you make your beneficiary designations, the better the chances that your wishes will be carried out after your death.

3. Review your beneficiary designations. Your life insurance plan is a major part of your overall estate plan. Not keeping it in line with the other aspects of your estate plan can throw everything out of order. Be sure to update or change beneficiary designations whenever there is a change in your family situation (e.g., birth of a child, death of a beneficiary, divorce).

4. Stay flexible. Though you might not change your mind about the beneficiaries of your policy, try to avoid irrevocable designations. You may find it necessary to react to changes in your overall estate plan or your family's situation. Typically, separate policies can help you meet different goals. For example, one can be used to cover funeral expenses; another can be used to benefit your grandchildren. This approach may make it easier for you to make changes in the future.

5. Make sure your policies reflect current law. During the last few years, there have been numerous changes relating to life insurance planning and estate taxes. Consider all the available methods to keep the proceeds out of your estate.

***Reminder:** Life insurance is not “get-it-and-forget-it” proposition. In this ever-changing world, review your policies periodically to see that they continue to meet your objectives.*

Facts and Figures

Timely points of particular interest

- **Deductions Get the Boot**—As a general rule, you can deduct clothing as a business expense only if you need it for safety reasons or as a condition of employment. You can't deduct the cost of clothes that can be worn anytime. New case: A welder tried to deduct expenses for boots, clothes and gloves. But he did not provide any convincing evidence that these items were unsuitable for personal wear. In fact, the welder admitted to wearing the same type of boots in court.
- **The Cutting Edge**—One way to protect sensitive company information is to shred unnecessary paper documents. Before you invest in a shredder, make sure it can handle the volume and type of shredding required. For instance, consider whether the paper will be shredded into confetti rather than strips. Cross-cutting shredders are the most secure. Consult with your local supply stores for more information.