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Client Information Bulletin

INSIDE

**Independent Contractors:
Get Agreements in Writing**

**How to Bridge the
Communication Gap**

**Like-kind Swaps of
Intellectual Property**

**Using Benchmarking
For Your Business**

Facts and Figures

Seven Tax-planning Ideas at Midyear

Ways to reduce your personal income tax bill

Now that your 2005 personal tax return has been put to bed (or you have obtained a filing extension), you can kick back and enjoy the warmer weather...right? Wrong. Tax planning is a year-round proposition. And the tax-planning moves you make -- or don't make -- at midyear can have a substantial impact on your 2006 tax bill. Here are seven common tax strategies to consider.

1. Examine estimated taxes. Life changes that occur during the year -- a new marriage, a divorce, a new baby, a child's marriage, etc. -- may affect your tax picture for 2006. If your tax

payments so far this year are too low, you will have to write out a substantial check when you file your return. And you may owe an estimated tax penalty to boot. You can make up a tax shortfall through estimated tax payments or increase withholding from your paycheck for the rest of the year.

2. Avoid the wash sale rule. Under the "wash sale" rule, you cannot deduct a loss from the sale of a security if you acquire a substantially identical security within 30 days of the sale. To avoid this result, wait at least 31 days before you buy back the same security you sold at a loss. If you want to lock

in your current position for a particular stock but still protect your loss, “double up” by buying the stock now and waiting at least 31 days to sell the original shares. **Note:** If a stock loss is disallowed due to the wash sale rule, at least you can add it to your basis in the stock.

3. Position investments for tax deferral. Now is a good time to review your portfolio and shift some money into investments with which you can postpone income until 2007. For example, you may want to consider Treasury bills, certificates of deposit (CDs) and other short-term investments that will not mature until next year. As a general rule, the income isn’t taxable until the year it is received.

4. Salvage dependency exemptions. Although the rules for dependency exemptions have been modified, the basic thrust is still the same. You can generally claim a dependency exemption for a relative if you provide more than half of the relative’s support and he or she does not have gross income exceeding the personal exemption amount (\$3,300 for 2006).

The “gross income” requirement does not apply to a child who is under age 19 or a full-time student under age 24. If your child is graduating this year, make sure you pass the half-support test to ensure the exemption for 2006.

5. Set up a SIMPLE or a SEP. If you are self-employed, save for retirement through a tax-advantaged plan. For instance, you can establish a Savings Incentive Match Plan for Employees (SIMPLE) or a Simplified Employee

Pension (SEP) plan with relative ease. Although there are technical differences, both plans allow you to contribute generous amounts.

The deadline for SEP contributions is your tax return due date plus extensions. The deadline to set up and contribute to a SIMPLE plan for 2006 is October 1.

6. Send the kids to day camp. You are entitled to a “child care credit” for the cost of caring for your children under age 13 so you and your spouse (if you are married) can be gainfully employed. The credit for taxpayers with an adjusted gross income above \$43,000 is 20% of the first \$3,000 of qualified expenses for one child; 20% of the first \$6,000 for two or more children.

Surprisingly, the cost of sending a child to a summer day camp qualifies for the child care credit. The cost of overnight camp, however, does not qualify.

7. Maximize S corporation losses. An S corporation’s losses are deductible by the shareholders up to the amount of the shareholder’s basis in his or her corporate stock. If it looks like your S corporation will show a loss for the year, make sure that you have sufficient basis in your S corporation stock to take advantage of the loss deduction. You can increase your basis by adding capital to the company’s coffers or lending money to the corporation.

In conclusion: These are just seven midyear tax-planning ideas that may comprise a comprehensive plan. We

would be glad to discuss the best strategies for your particular situation.

Independent Contractors: Get Agreements in Writing

Safeguards for your legal and tax protection

Have you made the break from the regular 9-to-5 (or longer) grind? After years spent working as an employee, you may be operating as an independent contractor for several firms. This generally provides more flexibility than you had before, but also requires a higher degree of legal protection for your work.

Case in point: When you agree to perform services for a client, you are entering into a legal contract. It does not matter if the deal is sealed by just a handshake (although, as you will see, this is strongly discouraged). In effect, you are obligated to do the work and the client is obligated to pay you for it.

Unfortunately, things may not go as planned. Suppose that the client refuses to pay you or argues that you are not living up to your end of the bargain. The client could have a legitimate gripe or could be distorting the facts. In either event, you are facing an uphill battle. Essentially, you will have to convince a court that you are in the right and your client is wrong.

However, there is a relatively easy way to sidestep potential problems: **Put it in writing.** By using a written agreement, you can head off serious disagreements, define expectations for both sides and clarify the terms of the deal. And, should the case ever come to court -- after all, even written contracts are subject to dis-

pute -- you will have the proof in hand needed to support your position.

As an added bonus, a written contract can help establish that you are, in fact, an independent contractor rather than an employee. This can protect you from a challenge by the IRS that you are trying to evade payroll taxes.

What should be included in a written contract for the benefit of an independent contractor? Although the terms will vary according to your situation, a basic written contract should, at the very least, cover the following items:

- A detailed description of the services that will be performed;
- The amount that will be paid for the services (or the formula to be used);
- The length of the services to be provided;
- The manner of payment (e.g., time and place for payment, installments or a lump sum, etc.);
- Any penalties assessed for late payment;
- Responsibility for paying expenses (usually, this falls to the independent contractor); and
- Rights of termination.

Note that the agreement should also reflect information concerning your independent contractor status and refer to any permits and/or licenses required to do the work as well as insurance provi-

sions. Furthermore, make sure that standard legal provisions are included, such as a statement that there are no independent agreements about the terms of the contract.

How to Bridge the Communication Gap

Tools can help expand worldwide operations

In today's ever-expanding business environment, your company may have clients -- or even divisions of your own operation -- located throughout other parts of the world. The communication problems can be daunting. Fortunately, recent technological advances now provide tools for communicating across great expanses. Of course, there are costs involved, but consider the following:

Data distribution: It is important to have the ability to share agendas, research analyses, financial and other business reports and the like through e-mail. The communication is almost instantaneous and mailing costs are saved. Even outsiders who do not have Internet service can gain access with relative ease at a reasonable cost.

Web posting can be another efficient method of communication. This eliminates potential problems of sending cumbersome attachments. However, it requires your company to have storage capability at its web site. A password protected sign-in can be created for selected contacts with appropriate links available for retrieving documents and other information.

Similarly, separate data storage units are available over the Internet. Typically, these link to a user's computer as separate drives. Assuming the storage units

provide a "vault," all visitors granted permission can access files -- but only one at a time.

Finally, a comprehensive solution to consider is a virtual private network (VPN). The VPN uses the Internet to connect to the network. Once the VPN software has been installed on the personal computers, you may be able to share data and other information on your network with people in remote locations. This can be especially beneficial if members of the same firm are located in different offices throughout the world.

Effective communication: Through e-mail or instant messaging, business associates in distant locations can converse with one another as well as anyone from your staff. This has generally become an accepted means of communication for most people in high-profile positions.

For a far-flung group, web conferencing is fast becoming a preferred alternative to the traditional telephone conference call. It enables participants to share document and software applications during a meeting -- including business data and a "white board" for presenting materials -- as a way to enhance normal communications.

Taking this concept one step further, web conferencing may be augmented by

video technology (sometimes referred to as video conferencing). This enables participants to see one another during the conference. The most cost-effective method for handling video conferencing is to integrate the audio portion (i.e., the computers handle the entire communication process).

Another alternative is to use a video-conferencing service provider. With this outside system for providing streaming video, users are bridged into the service

provider's equipment. The fees are based on a per-minute charge as opposed to buying the software and peripherals.

***In summary:** Technology can help alleviate problems that may have plagued your company in the past. Nevertheless, it is important to make the best use of the tools at your disposal. Spend time beforehand planning presentations, conferences and other online communications in a cost-effective manner.*

Like-kind Swaps of Intellectual Property

Can you swap your patents and trademarks tax-free with another company? The short answer is "yes," but the longer answer is "it depends." **Reason:** The IRS imposes strict requirements for like-kind transfers of this nature.

Specifically, the IRS uses a two-part test for like-kind exchanges of intellectual property. First, it determines the nature or character of the rights involved. Then, it examines the nature or character of the underlying property.

New ruling: The IRS denied tax-free treatment for a company's proposed matching scheme involving four broad classes of property. Tax deferral for a like-kind exchange requires specificity and analysis on an item-by-item basis, rather than on a global basis. Similarly, the IRS rejected the company's claim that all trademarks and trade names be considered like-kind, regardless of their use, appearance or form.

Using Benchmarking for Your Business

Study best practices to improve profit margins

Even if your company has been successful in the past, you should be looking to increase profitability. There's usually plenty of room for improvement, especially when you compare your outfit with other operations in the same industry. But you are not quite sure how to get to the next level.

One possibility is to use the business tool known as "benchmarking" (also called "best practices"). This is a process that can help bridge the gap between great ideas and great accomplishments.

How it works: Although there are several potential variations on the basic theme, typically you begin by identifying another company, or a part of your own company, that has achieved significant results through similar opportunities. The process requires you to systematically study the other operation's achievements and practices. After you have determined the best practices, you can develop and implement procedures that will help you improve performance.

Benchmarking is more than just discovering the best practices for a company. It includes setting goals, comparing data and facilitating concepts. It targets ap-

propriate ideas and puts them into action.

How did benchmarking evolve? Traditionally, business managers would study a competitor's product to determine how and why it was superior. Then they began to realize that they might not be asking all of the necessary questions. Eventually, it was ascertained that the competitive advantage stemmed from a number of factors, including:

- The timeframe for shepherding a product from the design stage to market;
- Costs involved at each step of the process;
- The nature of the procedures or formulas being used;
- The systems for managing and motivating the staff; and
- Independent judgments about the product's value (i.e., whether customers will buy the product).

With benchmarking, your company can learn where its performance lags and where it should pinpoint its focus. This practice can eventually filter down to the bottom line.

Facts and Figures

Timely points of particular interest

- **Higher IRS Fees** -- The IRS recently announced big hikes in certain user fees for 2006. These increases, which occur in two stages, go into full effect on July 1, 2006. For example, under the newly revised Employee Plans system, fees for opinion and advisory letters and determination letters for plans will now cost between \$200 and \$15,000 (up from \$125 to \$6,500).
- **Reducing Interruptions** -- Are you bothered by an endless stream of interruptions at work? It can severely impede your progress. One possible solution is to ask this direct question: "Is there something I can do for you?" Depending on the response, you can choose to react immediately or politely explain that this is a bad time for you to talk.