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Client Information Bulletin

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How to “Cash In” on Charitable Deductions

Observe recordkeeping requirements for 2005 returns

The IRS is stepping up its investigation of deductions claimed for charitable donations. Therefore, the records you keep to back up your claims must be able to stand up to the strictest scrutiny. Otherwise, you run the risk that your deductions may be reduced or denied.

What sort of records are we talking about? There are two main categories for cash or cash-equivalent donations.

1. Contributions of \$250 or more: The tax law generally permits you to deduct the full amount of cash contributions or donations made by check. To substantiate these charitable gifts, you are re-

quired to obtain a written acknowledgment from a qualified charitable organization in order to claim a deduction for a donation of \$250 or more.

The acknowledgment must be obtained by the earlier of the date your tax return is filed or the due date of the return (plus any extensions). It should include the following elements:

- ❖ the amount of cash or the check;
- ❖ a description of any noncash property that was contributed; and
- ❖ if any goods or services were provided, the value of the benefit.

Key exception: If the goods or services received consist solely of “intangible religious benefits,” you can substitute a statement to that effect.

What if you make several payments over the course of the year to the same charity? Separate payments generally are not lumped together for these purposes. However, the IRS may treat a series of smaller payments totaling \$250 or more as a single payment if they are made on the same date or within a short period of time.

Note: If donations are made through payroll deductions, each paycheck is regarded as a separate payment for this purpose.

2. Quid pro quo contributions: For a “quid pro quo contribution” (i.e., a contribution that is made at least partially in exchange for goods or services) above \$75, the charity must provide a “good faith estimate” of the goods and services received and the amount of payment exceeding the value of the benefit.

Hypothetical example: Suppose you attend a dinner sponsored by a charitable

organization. The ticket to the event costs \$100, but the dinner is valued at \$40. **Result:** The charity must notify you in writing that the value of the dinner was \$40 and that only \$60 of your donation is deductible on your return. However, a written statement is not required if you receive token goods, minimal services or intangible religious benefits in return for your donation.

Responsibility for disclosing quid pro quo contributions over \$75 rests with the charitable organization. The charity can provide this information in its solicitation or upon receipt of the contribution.

Reminder: *Special rules for noncash contributions remain in effect. You must provide additional information on your tax return if your noncash contributions for the year exceed \$500. Furthermore, if you donate property in excess of \$5,000, you must obtain a qualified appraisal of the value of the property. Silver tax lining: The cost of the appraisal may be deductible as a miscellaneous expense (subject to the 2%-of-adjusted-gross-income floor).*

Can You Protect Your Business Reputation?

Taking steps to counteract unfounded accusations

If you own a business or you are one of the top managers, you know the value of establishing a top-notch reputation. Once that reputation is tarnished, it may take years to recover -- if ever. For instance, suppose you produce a product and your competitor starts a rumor that your product is defective. In that case, your sales are likely to suffer, even though the rumor is false.

Key point: Depending on the circumstances, you may be able to strike back with a lawsuit for business defamation. Although a business generally is allowed to assert that its product or service is superior to another, it is not permissible to knowingly make false statements of fact about a competitor's offerings.

These defamation problems have been compounded by the widespread use of the Internet. Competitors and other parties can communicate via web sites, e-mail, blogs, chatrooms, bulletin boards and the like. In fact, it's difficult to even monitor all the chit-chat about your firm and its products or services. Besides checking references through search engines on a regular basis, you might subscribe to an online service that will provide you with monthly updates.

If you find out that a competitor is spreading false information about your products, you may have a legal course of action. First, you must demonstrate that the information is actually false. It is not enough to show that a competitor is merely using "puffery" by comparing

their product to yours. Second, you must document a drop in business attributable to this false information.

In some cases, false information may not be related to your product, but rather to your business finances. For example, it is not uncommon these days for rumors regarding bankruptcy to circulate. These rumors could be based on something as minor as a bounced check. It is important to act quickly to dispel such a notion.

What can you do? You may want to get in touch with all your major suppliers and clients. You also might consider bringing in public relations experts. The point is you may be able to nip the problem in the bud if you act quickly enough.

At the same time you are setting the story straight with suppliers and clients, you can request a retraction from the guilty party through your attorney. It may be possible for both sides to negotiate an amicable settlement. Otherwise, be prepared to document your losses. As part of the process, you should keep track of client inquiries regarding the false information. This information may be critical to proving your case in court.

On the flip side, be careful making claims concerning your competitor's products or business. While you are free to promote your products above your rivals, you cannot spread lies that do harm.

Estate Tax Changes on the Horizon

Tax payers need to take a practical approach

Estate planning has been under a “dark cloud” for some time due to uncertainty over tax reforms and drastic changes already scheduled to take place. This unsettled state of affairs has left many well-to-do taxpayers in a quandary.

Background: Under the monumental **Economic Growth and Tax Relief Reconciliation Act of 2001** (EGTRRA), several sweeping changes in the federal tax law will culminate with the outright repeal of the estate tax after 2009. However, the “death” of estate taxes will be short-lived: Unless Congress enacts subsequent legislation in this area, the federal estate tax will be revived in 2011 under pre-EGTRRA levels.

To further complicate the matter, various proposals to revise or permanently repeal the federal estate-tax law have been debated in Congress. As of this writing, none have come to fruition.

Ultimate question: Should you count on a repeal of the estate tax, a watered-down version or the revival required by EGTRRA? There is no clear-cut answer. At this time, the most practical approach is to play it safe: Assume that the current law will remain in place and estate tax -- in some form or another -- will continue to exist for the foreseeable future.

Keeping that in mind, here is a brief summary of the main changes under EGTRRA taking place over the next few years.

The estate-tax exemption, available through the unified estate- and gift-tax credit, is gradually increasing. For dece-

dents dying in 2006, it can shelter up to \$2 million from estate tax. This credit shelter will eventually top out at \$3.5 million for 2009 before the estate tax is completely repealed in 2010.

During the same time period covering the increases in the estate-tax exemption, the top estate-tax rate -- which had already been lowered to 46% for 2006 -- reaches 45% for 2007-2009.

Unlike the estate-tax exemption, the gift-tax exemption stays locked at \$1 million for 2004 and thereafter. Furthermore, the gift tax remains in effect after 2009. As with the estate-tax rates, the top gift-tax rate (46% in 2006) will be reduced to 45% for 2007-2009. After 2009, the gift-tax rate will be equal to the top individual income-tax rate, which is currently set at 35%.

In 2010, heirs will no longer benefit from a “step-up” in basis to the value of assets received at death. Instead, they must carry over the decedent’s basis. However, there are two key exceptions to this rule: (1) The basis for qualified assets can be increased by a step-up of \$1.3 million and (2) the basis for assets transferred to a spouse can be increased by an additional step-up of \$3 million.

The **generation-skipping tax** (GST), which applies to certain transfers to grandchildren, is scheduled for the same repeal and revival as the estate tax. Lifetime transfers are eligible for a generous \$2 million exemption in 2006, rising to \$3.5 million in 2009. The top GST rate is reduced to coincide with the reduction in the estate-tax rates.

Call to action: In light of these changes and their impending “sunset,” certain estate-planning techniques such as charitable remainder unitrusts (CRUTs)

and Qualified Terminable Interest Property (QTIP) trusts should be considered. Consult with a professional adviser with respect to your situation.

**Telecommuters:
Watch Out for This Tax Pothole**

The refusal by the United States Supreme Court to hear a new case could signal a move for individual states to begin taxing telecommuters.

The facts: A computer programmer living in Nashville, Tenn., worked for a company located in New York. The programmer only spent 25% of his work time at the New York office; the other 75% of the time he worked from home in Nashville. This arrangement was made mainly for the programmer’s convenience.

When New York’s top court ruled that the programmer was subject to New York State income tax, he objected under the grounds that the state law was unconstitutional. Then he appealed to the highest court in the land. However, the Supreme Court declined to hear the case. In effect, this pronouncement gives a green light to revenue-hungry states to pursue similar types of claims.

Best approach: Consult with a professional tax adviser to see if this latest development could have an impact on your situation.

New Effort Aimed at Taxing Online Sales

The Streamlined Sales Tax Project gains momentum

For most of the past two decades, individual states and retailers have battled over the rights and responsibilities for collecting tax from online sales. Unfortunately, there is no uniform national law to rely on for guidance in this area.

However, a new joint tax initiative represents the most important development towards a resolution. It's called the **Streamlined Sales Tax Project** (SSTP). A multistate pact, the Streamlined Sales and Use Tax Agreement (SSUTA) went into effect on October 1, 2005.

Details: Briefly stated, the SSTP is a computerized program that tracks the sales tax rates of 19 states and their localities. The SSTP automatically adds the appropriate sales tax to all online purchases by residents in those states. As part of the overall project, states are encouraged to offer retailers amnesty on taxes that have not been collected from online sales.

In addition, many of the states have revised their own laws to eliminate some of the confusion and provide greater uniformity concerning "categories" for sales tax. For example, in some states candy is treated as a food; in others, it is not. Thus, candy may be subject to a higher or lower sales tax. The new project is aimed at erasing those kinds of distinctions.

Previously, online merchants sought to avoid sales tax collections by relying on a landmark 1992 Supreme Court ruling. In that case, the Court said that it would be too difficult for retailers to calculate all the possible permutations of the various states. Now the SSTP is seeking to overcome that objection. And no wonder: It's been estimated that state and local governments will have missed out on \$18 billion of online sales in 2005.

One of the key points of the SSTP is to tax online retail sales at the customer's destination rather than the purchase location. This decision has been hotly debated by detractors and proponents.

As of this writing, the states that have agreed to participate in the SSTP thus far are Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Utah, West Virginia and Wyoming. Other states have started taking steps toward inclusion in the program.

More to come: *This is not the final word on the matter. We will report any significant new developments as soon as possible.*

Facts and Figures

Timely points of particular interest

- **New Disclosure Rules** -- The IRS recently issued proposed regulations on the disclosure or use of tax return information by tax return preparers. Key point: Tax return preparers cannot disclose or use tax return information for purposes other than tax return preparation without the knowing, informed and voluntary consent of the taxpayer. These new guidelines also take into account the widespread use of computers in the tax preparation process.
- **Friday on My Mind** -- Human resources experts advise supervisors to avoid giving bad news to employees -- such as a negative performance review or a reprimand -- right before the weekend or a vacation. If the news is delivered on Friday, the employee has extra time to stew about it without being able to take any constructive action. Although it is easier for the supervisor, Friday messages can have a negative impact on morale.