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# Client Information Bulletin

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## Swapping Real Estate Through Multiple Parties

### *How to use a qualified intermediary*

The massive new **Pension Protection Act of 2006** is expected to have a far-reaching impact. It touches on a wide range of topics from retirement plans and IRAs (individual retirement accounts) to charitable donations and Section 529 plans for college savings. Here is a quick summary of some of the key changes.

**Funding defined benefit plans:** The new law requires employers to fund defined benefit plans to cover 100% of the liability as opposed to the current 90% required. Plans that are not fully funded at the beginning of 2008 may gradually

increase funding over a seven-year period.

**Deduction limits:** For 2006 and 2007, the maximum deduction amount is increased from 100% to 150% of plan liabilities. After 2007, the new limit is based on certain target costs, including a “cushion” for projected compensation increases.

**Hybrid plans:** The new law provides legal protection to employers who want to convert a traditional pension plan into a hybrid “cash balance” plan. It insulates employers from age-discrimination law-

suits by employees who could claim such a switch harms older workers.

**Investment advice:** The new law permits providers of IRAs, 401(k) plans and other plans to offer personalized investment advice to participants. Generally speaking, any fees -- including commissions -- received by advisers for these services cannot be based on the investment options selected by the participants.

**Inherited plan assets:** For distributions after 2006, a nonspouse beneficiary can elect to roll over the assets in the decedent's qualified retirement plan to an IRA of his or her own. Previously, this benefit was only available to spousal beneficiaries.

**Automatic 401(k) plans:** Under the new law, it will be easier for employers to establish automatic-enrollment 401(k) plans. Employers can also automatically increase the percentage of contributions by employees.

**Plan-to-Roth rollovers:** Beginning after 2007, participants will be able to directly roll over funds from a qualified retirement plan to a Roth IRA (assuming other requirements are met). Currently, a two-step process is required: (1) You roll over the funds from a qualified plan to a traditional IRA. (2) Next, you roll over from the traditional IRA to a Roth IRA.

**EGTRRA extenders:** Many favorable retirement plan provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) were scheduled to expire after 2010. The new law repeals these "sunset" provisions -- including higher contribution and benefit amounts, catch-up contributions for older workers, faster vesting on em-

ployer matching contributions and various other enhancements -- and makes them permanent.

**Charitable contributions:** The new law tightens the rules for deducting donations of clothing and household items, while enhancing benefits for food and book donations by business entities. It also permits, for the first time ever, tax-free distributions of IRA proceeds for charitable purposes, through the 2007 tax year. Finally, the new law denies deductions for cash contributions unless the donor has written proof as to the amount of the contribution, the date and the name of the charity.

**Conservation easements:** On the plus side, the new law raises the deduction limit for qualified conservation easements from 30% to 50% of adjusted gross income (AGI), if certain conditions are met. This tax break is available only for 2006 and 2007.

**S corporations:** Under the new law, the reduction of a shareholder's basis in stock resulting from a corporate charitable donation equals the shareholder's pro rata share of the adjusted basis of the property. This change affects contributions made through 2007.

**Section 529 plans:** The new law preserves tax breaks for Section 529 plans that were scheduled to expire after 2010. Besides allowing tax-free distributions for qualified higher education expenses, taxpayers can continue to roll over funds to a different state plan each year without changing the beneficiary. Also, investors can still use a Coverdell Education Savings Account (ESA) and 529 plan for the same beneficiary in the same year.

*This brief article only hits the highlights of the new law. It is recommended that*

*you seek professional assistance to determine the impact on your situation.*

## How To Reduce Employee Turnover

### *Five ideas for improving your workplace*

Employees come, employees go. It's a part of doing business. However, if turnover becomes a flow rather than just a drip, it can drown a company in red ink.

How can you prevent increased employee turnover? You could start by improving the general work environment. For example, you might address some of the common concerns of your employees each Friday afternoon. As an alternative, you can try to schedule regular one-on-one meetings on a monthly or quarterly basis.

**Potential result:** Some of the revelations resulting from these meetings may surprise you. You may find that an employee is bored by the day-to-day routine of a job. Perhaps the level of compensation is an issue. Or maybe you need to spell out better guidelines for job performance. Finally, others may have special problems relating to child care or other family obligations.

With that in mind, let's look at five practical suggestions for reducing turnover.

**1.** Offer new challenges. No one wants to stay in a rut. To avoid this problem, you may be able to emphasize an employee's strengths by creating new tasks. For instance, an innovative employee may be asked to look into new product development. This may require the transfer of a worker to a different department or group.

**2.** Sharpen the skills of employees through training seminars. These semi-

nars allow workers to expand their duties and identify how their particular talents can best be utilized. If you do not have the resources for in-house sessions, you may be able to arrange for private seminars or courses at a local university.

**3.** Set flexible compensation standards. Obviously, it is easier to retain key employees if you pay them what they are worth. The problem often is rooted in an inflexible company policy. For instance, an employee who puts in extra hours may feel frustrated by being tied to the same salary structure as those who work strictly from 9 to 5. Result: An employer may have to throw out "the book" on compensation levels.

**4.** If the salary structure cannot be amended, your company may use other methods of compensation to retain valuable employees. A few examples are deferred compensation packages, stock options, bonuses, additional vacation pay or time off.

**5.** Tell employees what you expect of them. Of course, a business manager must be able to recognize and appraise the work an employee does. But his or her responsibilities do not end there. It may be necessary to write out practical guidelines and discuss them periodically with your staff.

*This should result in an ongoing process that encourages communication between all parties. The entire procedure may be a waste if employees do not receive any feedback from your discussions.*

# Six Ways to Collect Business Debts

## *Steps to legally pursue collections*

How can you get customers or clients to pay promptly? Before you do anything, be careful. Reason: For starters, make sure you don't violate any federal laws designed to protect debtors, including the **Fair Debt Collection Practices Act** and related legislation. In brief, you may be fined or forced to pay damages -- or both.

State law could also restrict the debt collection practices of businesses. In addition, debtors may be able to bring civil actions against business owners.

The key is to try to maximize collections for your business operation without exposing it to liability for abusive debt collection practices. Here are six ways you might stay out of trouble while you pursue what is rightfully yours.

**1. Stay on top of your accounts payable.** If a client or customer thinks you have forgotten about a bill, it may become a low priority. If the payment term is the standard 30 days, don't let nonpayment go unaddressed for more than another week or two.

**2. Use the personal approach.** Don't always start out by sending a computer generated form letter. This may be considered a "temporary reprieve." A straightforward call reminding the debtor that the account is overdue is usually more persuasive. **Key point:** Be sure to ask when the bill will be paid.

**3. Follow up.** If a personal communication does not produce payment, follow

up with a registered or certified letter detailing (1) the amount owed, (2) the prior invoice date and (3) the date on which the goods were delivered or the services were provided. Make sure you have proof that you performed your part of the bargain.

**4. Additional follow-up letters can be worded more strongly.** State any additional measures you will take, including litigation, if payment is not received. Caution: Postcards used to demand payment could lead to civil and/or criminal liability under federal law.

**5. Be businesslike.** Avoid sarcastic remarks and name calling. Be truthful and don't pretend you are someone you are not. And do not make your collection letters look like they are coming from a collection agency.

**6. Stay out of court if you can.** You might try to arbitrate the dispute, especially if the debtor claims there is a problem with the goods or services. Alternative dispute resolution is faster and less expensive than court and often produces satisfactory results.

As a last resort, you may be entitled to a tax deduction for bad business debts.

***Practical advice:*** *Don't back down if a tough stance is the only way to solve the problem. With the help of your professional advisers, you can determine the appropriate action.*

### **Learning About Tax-free Scholarships**

Does your child excel in academics, athletics or some other capacity? He or she may qualify for a college scholarship. But what about taxes?

**Basic rules:** If your child is not a degree candidate, the entire scholarship amount is taxable. Conversely, if your child is pursuing a degree, any amounts earmarked for tuition or course fees are exempt from federal income tax.

The IRS treats a student as a degree candidate only if:

- ❖ The student attends a primary or secondary school or is pursuing a degree at a college or university; or
- ❖ The student attends an accredited education institution that is authorized to provide either (1) a program that is acceptable for full credit toward a bachelor's or higher degree or (2) a program of training to prepare students for employment in a recognized occupation.

In addition, there is no tax on amounts used to pay for mandatory books, school supplies and equipment.

## Can You Convert to a Roth IRA?

*New law change increases future opportunity*

The new tax law enacted earlier this year -- the **Tax Increase Prevention and Reconciliation Act (TIPRA)** -- is expected to open up Roth IRAs (individual retirement accounts) to a wider range of participants.

**Background:** If you earn compensation, you may contribute up to \$4,000 to a Roth IRA (less any regular IRA contributions) for 2006. An extra \$1,000 contribution is allowed if you are age 50 or older. There is no current income tax on the buildup of earnings.

However, you cannot take advantage of a Roth IRA if your modified adjusted gross income (MAGI) exceeds a certain level. The maximum allowable contribution for joint filers is phased out for a MAGI between \$150,000 and \$160,000 (\$95,000 and \$110,000 for single filers). Furthermore, pre-age 59-1/2, withdrawals (other than qualified distributions) are subject to the 10% tax penalty.

For this purpose, a qualified distribution is a distribution from a Roth IRA in existence for at least five years that is made

- ❖ After reaching age 59-1/2,
- ❖ Upon death or disability, or

- ❖ To pay for first-time home-buyer expenses (up to a lifetime limit of \$10,000).

If distributions do not meet these requirements (i.e., they are nonqualified), the funds are treated as being withdrawn as follows: contributions first, any amount converted from a regular IRA second and earnings third.

Fortunately, you can choose to convert a traditional IRA to a Roth IRA for the future benefits of tax-free distributions. (Of course, you must pay the resulting tax on the conversion.) However, this option is limited to individuals with an adjusted gross income of \$100,000 or less.

**New law change:** Effective for the 2010 tax year, the new law removes the \$100,000 cap for Roth IRA conversions. For conversions taking place in 2010, you may elect to spread the resulting tax liability over the following two years. In the meantime, you might decide to build up your traditional IRA in anticipation of the time you will be able to convert it to a Roth IRA.

*There are numerous factors to consider as part of a Roth IRA conversion. Obtain professional assistance.*

## Facts and Figures

### *Timely points of particular interest*

- **Information, Please** -- It is likely that your business is listed in several directories and referenced online. **Practical advice:** Don't assume that these listings are completely up-to-date. For instance, make sure that the vital information about your firm -- your address, telephone number, Web site and e-mail addresses, etc. -- is accurate. **Even worse:** You could be paying for an advertisement or service with inaccurate information. Establish procedures for periodically checking the most important directories.
- **Penalty-free Distributions** -- Normally, you cannot withdraw funds from a qualified plan or individual retirement account before age 59-1/2 without paying the 10% penalty tax. But there is an exception for payments due to severe disability. **New case:** An injured mechanic took a lump-sum distribution from his retirement plan after being out of work for two years. Because it could not be determined when he would be able to resume work, his payout was exempt from the penalty.