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January 2007

Client Information Bulletin

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Top New Law Changes for Charitable Donations

Pension Protection Act revamps deduction rules

Despite its name, the new Pension Protection Act of 2006 includes many important tax provisions completely unrelated to retirement plans. For instance, the new law overhauls the tax rules for deducting charitable deductions. Some of the provisions favor taxpayers while others may make it more difficult to claim deductions on your personal return.

With that in mind, the following is a brief summary of the key new law provisions affecting charitable donations.

Cash donations: 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. This change appears to give taxpayers no leeway. Cash donations must be substantiated by a cancelled check, bank record, or credit or debit card statements.

This change is effective for tax years beginning after August 17, 2006 (i.e., the 2007 tax year for calendar-year taxpayers).

Clothing and household goods: Under the new law, deductions for clothing and household goods generally will be denied unless the items are in "good condition." However, the new law does not provide a

technical definition of this term. The change is effective for contributions made after August 17, 2006.

Food and books: The new law extends through 2007 certain enhanced tax breaks under the Katrina Emergency Tax Relief Act of 2005. These deductions apply to donations of food and books made by various business entities. Previously, only a C corporation could benefit from an enhanced deduction. The deduction is equal to the lesser of (1) two times the basis in the property or (2) the basis plus one-half of the fair-market value above the basis.

Conservation easements: 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.

Facade easements: The new law imposes special rules for building contributions in historic districts. Furthermore, the charitable deduction of a facade easement is reduced if a rehabilitation tax credit was claimed for the work. Other technical rules may apply. This is

generally effective for contributions after July 25, 2006.

IRA distributions: Under the new law, a taxpayer age 70-1/2 or over can directly roll over funds tax-free from a traditional or Roth IRA to a qualified charity. The maximum annual cap on tax-free distributions is \$100,000. This tax break is scheduled to expire after 2007.

Fractional donations: The new law restricts deductions for donations of tangible property such as artwork. It effectively requires you to recapture the tax benefits if you fail to give away the entire interest within ten years or if the charity does not take possession during that time. The new law change affects donations made after August 17, 2006.

Of course, this is only a brief summary of the new rules. Obtain more information concerning specific charitable contributions.

Tax filing tip: *Special requirements may apply to donations claimed on your 2006 tax return, including substantiation for cash contributions of \$250 or more. Consult with a tax professional with respect to your personal situation.*

What Does Your Company Stand For?

Image may be everything to clients or customers

Say that a potentially large client is torn between choosing your product or service and a competitor's. In the client's eyes, there is very little separating the two of you. Ultimately, the client simply goes with the outfit he or she has a "good feeling" about.

Do you win the contract when this happens? The answer often depends upon your company's public image.

Establishing a positive image in the business world doesn't happen overnight (not usually, anyway). Instead, a corporate identity evolves over time. For better or worse, it becomes an intangible aspect of your business. And once your image is set in the public's mind, it is often difficult to change.

How is a corporate image developed? Frequently, the business owner or the CEO of the company (if that is a different person) sets the tone. This person's public image and the company's image tend to become one and the same. For instance, Bill Gates and Microsoft are often associated with each other. What's more, the smaller your business, the more likely that your image will become the company's.

Of course, clients and customers also identify a company with the employees they usually deal with. For example, if vendors and suppliers meet with only one salesperson, that person is the company as far as they are concerned. **The upshot:** Employees who have regular contact with the public must be trained to project a positive image for the company.

Furthermore, don't overlook the importance of the atmosphere within the company. If morale is down or workers take little pride in their efforts, it may become apparent to outsiders. You should try to create an environment that indicates a strong work ethic and commitment to excellence.

Does that mean supervisors must keep after employees every single moment? Not at all. Although it may be prudent to establish guidelines, being flexible can be an advantage. For instance, an employer might require its employees to dress in a business-like fashion and be well-groomed. But employees still may appreciate a break in the routine (e.g., "dress-down days" on Fridays).

What can management do to improve a company's image? While there are no guarantees, here are a few possible suggestions.

- ❖ Step back and take a long, hard look at the company. Get some input from outsiders. You may be surprised to find your company's image is not quite what you thought it was.
- ❖ Set some goals for the future. Consider writing a mission statement that reflects your position. The statement doesn't have to be longer than a paragraph, but it should summarize what you hope to achieve.
- ❖ Communication is a two-way street. Employees must know what is expected of them. On the other hand, management should remain receptive to new ideas.
- ❖ Be consistent. For instance, you cannot blame employees for being con-

fused if you insist that “the customer is always right,” but you turn around and berate someone who voices a complaint or criticism.

***Practical idea:** One frequently used marketing technique is to develop an “identity system” for the company. In that way, the company can become readily identified by a specific symbol or logo.*

Extreme Makeover: A New Look for 401(k) Plans

Roundup of significant new law features for plans

Over the last two decades, the 401(k) plan has become a popular type of qualified retirement plan. And no wonder: Employees are able to defer part of their salary to their personal account through pre-tax contributions. These contributions can continue to grow on a tax-deferred basis until they are withdrawn. Furthermore, the company may agree to provide matching contributions (e.g., 50 cents for every dollar of salary deferred).

Of course, a 401(k) plan must meet non-discrimination requirements prescribed by law. Besides overall tax law limits on contributions, the annual limit on elective deferrals for 2007 is \$15,500. **Note:** An individual age 50 or over can make an extra \$5,000 catch-up contribution in 2007.

Update: The new Pension Protection Act of 2006 includes numerous changes for 401(k) plans and other qualified retirement plans. Here are some of the most important features that may give your company’s 401(k) plan a “new look” for the future.

Automatic-enrollment plans: Under the new law, it will be easier for employers to establish automatic-enrollment 401(k) plans. Such a plan requires employees to opt out of participation. It tends to increase participation,

which, in turn, may benefit higher-paid employees. Employers can also automatically increase the percentage of contributions by employees.

Investment advice: The new law permits providers of 401(k) plans and other plans to offer personalized investment advice to participants. Generally speaking, any fees received by advisers for these services, including commissions, cannot be based on the investment options selected by the participants. Also, while personalized advice can be provided to account holders, 401(k) plan providers cannot advise employers about which funds and investments to include in the plan.

Military reservists: Individuals who are called to active military duty may make penalty-free withdrawals from a 401(k) plan. The new law gives reservists up to two years after their service to re-contribute amounts without paying tax on the distributions.

Hardship withdrawals: The new law authorizes the U.S. Treasury to issue new rules concerning hardship withdrawals by beneficiaries of 401(k) plans. More information on this issue will be forthcoming.

Nonspouse beneficiaries: An individual may roll a deceased spouse's interest in a 401(k) plan into an IRA. Then the normal distribution rules apply. The new law extends this flexibility to nonspouse beneficiaries.

Roth 401(k) plans: This feature enables participants to combine some of the benefits of a Roth IRA, such as tax-free distributions after a five-year holding period, with a traditional 401(k) plan. Under the new law, the provision authorizing Roth 401(k)s has been extended beyond 2010.

Finally, many other 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 affecting 401(k) plans -- including higher contribution and benefit amounts, catch-up contributions for older workers, faster vesting on employer matching contributions -- and makes the EGTRRA provisions permanent.

Four Steps to Better Computer Management

Proper management of your company's computers is essential. You can improve your security -- and provide more peace of mind -- by following these basic steps.

1. **Take initial precautions.** Whenever a new computer is brought online, you should apply operating systems updates, install an antivirus program and reset default passwords (e.g., the password for the administrator's account). Consider the use of a firewall program, but check with your information technology personnel or computer adviser first.
2. **Establish a security routine.** This may include automating operating systems and anti-virus updates. Be sure to regularly run a spyware program. If possible, do your own work in non-administrator accounts.
3. **Be prepared for contingencies.** Significantly, you should ensure that the files are backed up regularly. In addition, improve your ability to rebuild the system in case of an infection. Have a plan in place for handling emergencies and facilitating upgrades.
4. **Be suspicious.** Do not open unexpected e-mail attachments or download unknown programs. Don't share your password with outsiders.

IRS Rings Up Refunds for Telephone Tax

New safe harbor amounts approved for individuals

The IRS recently released safe harbor amounts that may be used to claim refunds for the federal telephone tax. The announcement follows a concession earlier in 2006 that the IRS cannot impose the tax on long-distance charges.

Using the IRS-approved safe harbor amounts may be the easiest method for individual taxpayers. However, it may be possible to provide a larger deduction by digging through old records.

Background: The excise tax on long-distance services, which is currently 3%, was initially imposed to help finance the Spanish-American War. The constitutionality of the tax has been contested numerous times over the years. Finally, after suffering several stinging losses in the courts, the IRS agreed to issue refunds or credits for long-distance services billed between February 28, 2003, and August 1, 2006.

Refunds for the long-distance telephone tax must be claimed on your personal tax return for 2006. To help facilitate the process, the IRS has released standard amounts based on the number of personal exemptions. The amounts are as follows: \$30 for one exemption; \$40 for

two exemptions; \$50 for three exemptions; and \$60 for four or more exemptions.

These safe harbor amounts may bail you out if you have not kept statements of all of your telephone charges. However, if you can sort through your records and determine the actual tax paid, you may fare much better. If you choose this approach, you must be able to substantiate the amount of tax charged and the actual amount of tax paid.

Caveat: If you already received a credit or refund from your telephone service provider, you're not eligible for the tax refund.

There is no IRS-approved safe harbor method for businesses and nonprofit organizations. The tax refunds claimed by these entities must be based on the actual amount of tax paid for long-distance charges.

Note: *As of this writing, the excise tax will continue to apply to local telephone charges. However, several bills have been introduced in Congress that would repeal this tax.*

Facts and Figures

Timely points of particular interest

- **No Free Lunch** -- In a new case, a taxpayer offered proof of expenses through several documents, but the information was conflicting or incomplete. For instance, the Tax Court determined he did not provide reliable evidence for the amount, time and place of his meal expenses. Therefore, the deductions were disallowed. **Caveat:** Under the so-called Cohan rule, you may be able to approximate deduction amounts if it is clear that some expenses were incurred.
- **Social Security** -- The Social Security Administration has announced the new “wage base” for Social Security tax. For 2007, the OASDI portion of the tax is 6.2% on the first \$97,500 of an employee’s wages (up from \$94,200 for 2006). The 1.45% HI portion of the tax applies to all wages. **Note:** The wage base for self-employment tax is the same, but the tax rates are doubled. A self-employed person can deduct half of the tax.