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Client Information Bulletin

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Overview of T&E Deduction Rules

Guidelines for business travel and entertainment

Tax deductions come and tax deductions go. However, year in and year out, some of the biggest deductions for business taxpayers are travel and entertainment (T&E) expenses. Not surprisingly, this remains a prime audit target for IRS examiners. Here is an overview of some of the key tax rules for T&E expenses.

Business Travel Expenses

If you travel away from home on business, you can deduct your transportation costs (e.g., airfare), your meals, lodging and related incidental expenses such as cab fare and tips while you are away on business. The deduction for meals is lim-

ited to 50% of the cost while other travel expenses are fully deductible. However, you must keep records of your business travel expenses by contemporaneous diary or some other means.

The records for business travel must show:

1. The dates you left and returned and the number of days away on business;
2. The destination of the business travel;
3. The reason for making the business trip; and
4. The cost of each travel expense.

In addition, you must keep receipts for all lodging expenses and other business-related expenses \$75 or more. Other special rules may apply to deductions for vehicles used for business driving. **Note:** In lieu of deducting actual business-related auto expenses for 2007, you may deduct a flat rate of 48.5 cents per business mile (plus business-related tolls and parking fees).

Business Entertainment Expenses

Generally speaking, you can deduct qualified entertainment expenses that are either directly related to your business or associated with your business. The deduction is equal to 50% of the cost.

Directly related entertainment: Entertainment is considered “directly related to” your business if you actually discuss business during the entertainment and you have more than a general expectation of deriving a business benefit from the meeting. In other words, the entertainment cannot be just for goodwill. Furthermore, the entertainment must take place in an atmosphere conducive to discussing business.

Associated-with entertainment: Entertainment is considered “associated with” your business if it precedes or follows a substantial business discussion. It is not necessary to talk about business matters during the entertainment. If the client is from out of town, the business discussion can take place the day before or the day after the entertainment.

Note that the cost of entertainment that is “lavish” or “extravagant” is not deductible. However, that does not mean you cannot go first class if the situation warrants it.

Similar to business travel expenses, you must keep detailed records of your entertainment expenses. Generally, it is advisable to use a contemporaneous diary or log. The records for business entertainment must show:

- ❖ The date, location and nature of the entertainment;
- ❖ The amount spent on the entertainment;
- ❖ The business reason for the entertainment or the benefit you expect to derive;
- ❖ The person or people entertained and their business relationship to you; and
- ❖ The details of the substantial business discussion (e.g., date, duration and nature of the meeting) for any associated-with entertainment.

Be sure to keep receipts or credit card statements for expenditures of \$75 or more.

***Last stop:** It takes diligence to maintain all the T&E records required by the IRS. With professional assistance, you can develop a methodology that can stand up to scrutiny.*

What Are Your Mortgage Options?

Roundup of latest choices for homeowners

With mortgage rates remaining on the relatively low side throughout most of the country, you may be looking to take out a new mortgage or refinance an existing one. If so, it can be a bewildering process.

Now, more than ever, there is a wide variety of creative techniques available to homeowners. For example, you may be able to choose from fixed or adjustable rate mortgages, or “hybrids” that combine the elements of each one. The following are some of the financing options that may be available in the current environment:

Thirty-year fixed mortgage: Despite all the new financing ideas on the market, the tried-and-true 30-year fixed mortgage remains a staple. **Main reason:** Homebuyers like the certainty of knowing what their payments will be over the long term.

Fifteen-year mortgage: There is a noticeable trend toward a shorter fixed-term rate. In particular, 15-year mortgages have proved popular with some homeowners, especially those who are middle-aged. These loans enable the borrowers to pay off their debts before retirement. Alternatively, a homeowner can pre-pay a fixed-term loan and shorten the payment time accordingly.

Adjustable rate mortgage: Adjustable rate mortgages (ARMs) have been around for years. As the name suggests, the interest rate is adjusted on a regular

basis (e.g., annually). The purpose of this type of program is to allow mortgage interest rates to fluctuate with market conditions. It was recently reported that about 20% of homeowners choose ARMs.

Hybrids: Loans that help homebuyers afford higher priced homes have increased in demand. One such option is the fixed-adjustable mortgage. These loans, sometimes called 3/1, 5/1, 7/1 or 10/1 loans, have a fixed rate for three, five, seven or ten years and then adjust annually after that.

Government loans: For individuals who have trouble qualifying for conventional loans, a government-backed loan may be an option. Programs under the Federal Housing Authority or Veterans Administration may enable you to obtain financing from lenders at reasonable rates.

Niche loans: Environmentally conscious individuals may benefit from loans designed specifically for homes that meet certain energy-efficiency standards. Similarly, “green” loan products might be available to homeowners who are near public transportation. Such loans allow lenders to stretch credit ratios, thereby enabling the borrower to buy “more house” than he or she normally could.

Explore all of the options at your disposal. Do the necessary homework before you choose a particular type of loan.

Line Up Benefits of a Charitable Lead Trust

Satisfy charitable intentions while preserving wealth

A common dilemma: You would like to donate funds to one of your favorite charities, but you also want to protect your family's future well-being. Unfortunately, you do not have enough disposable income to achieve both objectives...or do you?

Possible solution: You might be able to have the same funds do "double duty" through a **charitable lead trust**. A charitable lead trust may be established during your lifetime or through a will (frequently called a "testamentary" trust). In a nutshell, the charity receives a steady stream of income for a set period of time. At the end of the trust term, the funds come back to the beneficiaries you have designated, such as your spouse, children or grandchildren.

In essence, this type of arrangement is the opposite of a charitable remainder trust. With a charitable remainder trust, the beneficiaries are entitled to an income interest for a specified period of time, while the charity receives the trust funds at the end of the term. No matter which type of trust is utilized, the family benefits from a gift- or estate-tax deduction.

However, unlike charitable remainder trusts, there generally is no income tax deduction for donating property to a charitable lead trust. **Exception:** In some cases, you may claim a charitable deduction for the present value of the charity's interest if you are willing to be taxed on the trust's income. More details are available upon request.

The gift- or estate-tax deduction makes it possible to transfer the remainder interest to family members at a relatively low tax cost. Taking this and various other factors into account, the children can wind up with an amount close to what they would have received if they had been given the property outright.

Key point: The estate- or gift-tax deduction is allowed only if the charity's interest is either an annuity or unitrust interest. An annuity interest requires fixed annual payments. On the other hand, a unitrust requires payment each year of a fixed percentage of the trust assets. The trust term can last for (1) a fixed number of years or (2) the life of the donor, donor's spouse, or a lineal ancestor (or spouse) of all of the remainder beneficiaries.

Which type of trust is preferred? Of course, it depends on your situation. However, one possible advantage of an annuity-type trust is that the beneficiaries may ultimately cash in on the appreciation of the trust assets.

Conversely, if the trust does not earn sufficient funds to cover the charity's payments, it will have to dip into principal. With the unitrust arrangement, changes in the value of the property have no such effect. **Another edge:** The deduction for an annuity-type trust is determined by a special IRS table. These figures are adjusted each month to reflect changes in interest rates. The lower the interest rate goes, the greater the deduction for you or your estate.

Caution: The IRS recently announced that it is clamping down on charitable trusts that it considers “abusive.” In other words, the trust cannot be all form and no substance.

As you might imagine, this is not a do-it-yourself proposition. If you are interested in setting up a charitable lead trust, be sure to obtain expert guidance from a professional adviser.

Calling the Tax Cops on Cheaters

Congress is encouraging taxpayers to turn in the worst tax cheats. To prove it means business, it has improved its existing program for “blowing the whistle” on major tax evaders. The IRS recently announced that it is moving quickly to improve on its tax informant operations.

Under the new **Tax Relief and Health Care Act of 2006**, the available reward for whistleblowers has been increased. The payoff is capped at 30% -- with a floor of 15% -- for providing information about a business or individual with an annual adjusted gross income above \$200,000.

The tip must involve taxes, penalties and interest of more than \$2 million. In addition, the IRS must move forward with “judicial or administrative action” based on this information.

Four Ways to Open Your IRA Early

Penalty-free withdrawals of your funds

As a general rule, the contributions and earnings accumulating in your IRA are meant for retirement. That is why the tax law imposes a 10% penalty tax -- in addition to the regular income tax owed -- on distributions made before age 59-1/2.

However, there are several key exceptions to the penalty for early IRA withdrawals. Here are four ways you may be able to withdraw funds penalty-free:

1. Substantially equal payments: You are not liable for the penalty if you take “substantially equal periodic payments” based on your life expectancy or the joint life expectancies of you and a designated beneficiary. The payments must last for at least five years or until you reach age 59-1/2 -- whichever comes later. Also, you must receive at least one payment per year.

There are three permissible methods for computing the required payments under IRS-approved life expectancy tables. Consult with a professional tax adviser for the best method for your situation.

2. Medical expenses: If your family has been hit with some unexpected medical bills, you may not have all the cash you need. In that case, you can withdraw funds from your IRA to pay for those medical expenses. The withdrawals are exempt from the 10% penalty to the extent that the cost qualifies for the medical expense deduction (i.e., unreimbursed medical expenses above 7.5% of

your adjusted gross income). Similarly, if you are laid off or fired from your job, any pre-age-59-1/2 withdrawals are exempt from the tax penalty if the funds are used to pay for health insurance coverage.

3. Home purchases: The tax law includes a special tax break for “first-time homebuyers.” No penalty is imposed on pre-age-59-1/2 withdrawals if the funds are used to buy or build a qualified home. To qualify, the home must be used as your principal residence and you cannot have owned a home within the last two years.

Best of all, the tax break is available for other family members such as your child. However, be aware that there is a lifetime dollar cap of \$10,000 on this first-time homebuyer exception.

4. Education expenses: Many parents are forced to invade their IRAs to help pay for a child’s college expenses. Fortunately, distributions made before age 59-1/2 do not trigger the penalty tax if the funds are used to pay for qualified education expenses. This includes tuition, books, supplies, etc. -- even room and board -- if your child is a full-time student.

***In summary:** These are just four of the exceptions to the 10% penalty tax on early IRA withdrawals. Have your personal situation analyzed to determine if any other exception applies.*

Facts and Figures

Timely points of particular interest

- **Noise Impact** -- Generally, you must have owned and used a home as your principal residence for two out of the past five years to qualify for the home-sale exclusion. **New private ruling:** A taxpayer who bought a home near an airport did not know about the excessive noise from low-flying aircraft. Furthermore, the seller violated local law by failing to inform the buyer that the home was located in the noise impact zone. **Result:** The IRS permitted a partial home-sale exclusion.
- **Management Style** -- How can you become a better business manager? One intriguing idea is to write a job description for yourself. Pretend that your boss will be checking the description every day. Which points would you emphasize? What qualities should you possess? For instance, you might want to become more tolerant of employee mistakes or parcel out work more judiciously. Keep the job description handy as a reminder of what kind of supervisor you should be.