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November 2007

Client Information Bulletin

INSIDE

**Securing Protection for
Computer Data**

**Four Common 401(k)
Mistakes to Avoid**

**Etiquette for
Checking Email**

**Putting a Halt to
Business Interruptions**

Facts and Figures

Roundup of Year-end Tax Strategies

Plan now to maximize potential tax benefits

Now is a good time to assess potential year-end tax-saving opportunities. For instance, it may be possible to shift income and deductions to your personal or business tax advantage. Also, be aware of several complications due to recent tax law changes.

This brief article outlines several popular tax strategies for the end of the year.

Capital gains and losses: Depending on your economic situation, you may want to realize capital gains or capital losses at the end of the year.

- Capital losses can offset capital gains realized in 2007. Any excess capital loss can also offset up to \$3,000 of ordinary income. (The remainder is carried over to next year.)
- Capital gains may be absorbed by capital losses realized in 2007. Any net long-term capital gain for the year is taxed at a maximum rate of 15%. Even better, this special capital gain rate is only 5% for taxpayers in the 10% or 15% ordinary income brackets. **Note:** The 5% capital gain rate is scheduled to decrease to zero in 2008 for eligible taxpayers. This could affect year-end sales of assets.

AMT liability: You could face alternative minimum tax (AMT) liability if a special tax computation involving certain “tax preference” items exceeds your regular tax liability. After you estimate your AMT liability for 2007, you might shift tax preferences to 2008 to avoid or reduce AMT liability. Alternatively, you might accelerate income into 2007 if the AMT rate is lower than your top marginal tax rate.

Section 179 deductions: Under Section 179, your business can elect to currently deduct (or “expense”) most or all of the cost of business assets placed in service during the year. The Small Business and Work Opportunity Tax Act of 2007 increased the maximum expensing amount for this year from \$112,000 to \$125,000. This enables you to purchase even more assets at year-end that will be eligible for fast write-offs.

Charitable gifts: Generally, you can deduct the full amount of cash donations made this year. If a donation is made by credit card or online, you can deduct the gift on your 2007 return, even if the charge is not actually paid until next year. Note: New rules taking effect this year require strict substantiation for monetary contributions, regardless of the amount of the donation.

Medical expenses: It is well-known that you can deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your AGI. Try to group nonemergency expenses (e.g., new eyeglasses or dental cleanings) in the tax year that provides the best opportunity for a deduction.

Estimated tax penalties: If you don't pay enough federal income tax during the year through withholding or quarterly installments, you may be liable for an “estimated tax” penalty. But no pen-

alty is imposed if annual tax payments equal 90% of the current year's liability or 100% of the prior year's tax liability. **Note:** The 100% safe harbor is increased to 110% if your AGI for the prior year exceeded \$150,000.

Business travel: Travel expenses incurred by employees—including airfare, lodging and 50% of the cost of meals—may be deducted if the trips are business-related. When it is appropriate, you can move up business trips planned for January into December. This allows you to write off the travel expenses on your 2007 return instead of waiting until 2008. **Caveat:** Unreimbursed travel expenses must be deducted as miscellaneous expenses subject to the usual 2%-of-AGI limit.

Family income-splitting: You may be able to reduce the overall family tax bill by shifting taxable income from your high tax bracket to family members in lower tax brackets. For instance, you might transfer income-producing assets to your young children. However, be aware of the “kiddie tax.” To the extent that unearned income for a child under age 18 exceeds \$1,700 for 2007, the excess is taxed at the top marginal tax rate of the child's parents.

Note: Beginning in 2008, the kiddie tax applies to children under age 19 (age 24 for full-time students). These higher age limits will be triggered if the child's earned income does not equal or exceed half of his or her annual support. This change could affect capital gain planning for 2008 based on the scheduled zero percent tax rate.

Of course, this is only a brief summary of several ideas to consider. Obtain professional advice with respect to your situation.

Securing Protection for Computer Data

Solutions for managing sensitive information

How can you protect your company's computer system from hackers and other unauthorized users? Surprisingly, the main threat to your operation is not usually from the outside; it often comes from within. In other words, employees are the primary sources of the damage.

For instance, an employee may unknowingly create security problems by sending e-mail attachments to other users in the office. This could result in the spread of computer viruses or worms. **Another problem:** If an employee unwittingly sends attachments outside the office to clients or other parties, it could result in a security breach. Naturally, the situation is magnified for employees who are carrying a grudge.

One common precaution used in the business sector is to establish classifications for data based on the permissible use. For example, data may be labeled as public, internal, restricted and confidential. By implementing these classifications, employees would not be able to gain access to data without the requisite clearance.

Similarly, you should take security measures for laptops used by employees who frequently travel on business. What might happen if an employee left a laptop at the airport or in a cab? To protect against a potential disaster, you can restrict access to sensitive information to

the in-house network. Although it might be inconvenient for employees, limited information would be allowed on laptops. But this method is not foolproof.

Alternatively, your company may use Basic Input/Output System (BIOS) passwords on laptops. Although BIOS passwords can still be circumvented by sophisticated hackers, they are a viable deterrent to most outsiders.

Another idea is to use full disk encryption in combination with BIOS passwords and restricting sensitive data on laptops. This would enable the entire disk to be encrypted (i.e., it is unreadable to everyone except for authorized users). This is the most effective solution for many companies.

Finally, if your company is using USB drives, be aware that these devices can easily transfer data. If an employee loses a USB device, the information is available for virtually anyone to see and read. As with laptops, use of encryption may be the best solution.

Final word: *Employee training is critical. Your workers must become aware of how an e-mail can easily be retrieved by a competitor or another person who means your company harm.*

Four Common 401(k) Mistakes to Avoid

Take steps for a comfortable retirement

For most employees, employer-funded pension plans are a thing of the past. The most popular type of retirement plan today is the 401(k), which requires you to defer part of your regular salary. Nevertheless, you can still fund a comfortable retirement if you avoid some common mistakes.

Everyone's situation is different, but here are four prime examples of what we mean.

1. Failure to participate: Can you imagine turning down a pay raise? Probably not. Nevertheless, many employees fail to take advantage of the match that an employer provides for elective deferrals to a 401(k) plan.

For instance, suppose your employer offers to provide a matching contribution of 50 cents on the dollar. If you are able to defer \$10,000 to your 401(k) this year, your employer must kick in \$5,000 more. That's an extra \$5,000 for not doing anything more than your regular job.

What's more, these contributions can grow substantially, due to the power of tax-deferred compounding. Let's say you contribute \$10,000 annually, so your employer provides a matching contribution of \$5,000 each year. If you earn 7% annually on the funds, you will have accumulated \$593,780 after 25 years.

Note: The maximum dollar amount that may be deferred to a 401(k) plan for 2007 is \$15,500 (\$20,500 if age 50 or over).

2. Errors in diversification: The most obvious type of diversification mistake is the failure to do it at all. Just as you would be advised to diversify within your personal portfolio, the same holds true for your retirement plan holdings. Other mistakes include "over-diversification" such as spreading out 401(k) dollars in every possible mutual fund or other investment option and "under-diversification" where a disproportionate portion of the pie is devoted to a single investment or type of investment. It is important to find the proper balance.

In the end, an allocation among stocks, bonds and cash should be based on your age, your expected retirement age, the amount you are contributing each year and your tolerance for risk.

3. Early distributions: Your 401(k) plan is meant to be a savings vehicle for retirement. However, participants often cannot resist taking out distributions, especially if they are changing jobs. As a general rule, a distribution made prior to age 59½ is subject to a 10% penalty tax on top of the regular income tax that is owed.

If you switch jobs and roll over funds from your 401(k) to an IRA or another qualified plan, the rollover is exempt from current income tax if completed in a timely fashion.

4. Borrowing from your plan: Along the same lines, you should be discouraged from taking a loan from your 401(k). Even though you will effectively be paying yourself back, it will be more difficult to meet your objectives for retirement. You will not have access to the funds you could have earned if the principal had remained intact. Of course,

borrowing may be necessary in an emergency, but this should be viewed as a last resort.

***Best approach:** This doesn't have to be a do-it-yourself proposition. Seek advice for managing your assets when it is appropriate.*

Etiquette for Checking E-mail

Do you constantly check your e-mail in business meetings? Although there may be extenuating circumstances, this is generally disruptive to others. Here are a few helpful tips to follow concerning this practice.

- If you must bring your mobile device to the meeting, use it with discretion. Set it on “vibrate” to minimize disturbances.
- Consider the other attendees. Staff members may be more tolerant of distractions than clients or customers.
- Respond only when it is absolutely necessary. If a response can wait, let it.
- Step out of the room to send or receive urgent messages. Don't make a big deal out of it.

Finally, if you expect to keep checking your e-mail during a meeting, you might simply choose not to attend.

Putting a Halt to Business Interruptions

Use insurance to provide necessary protection

Are you the owner of a successful business? Without you, there might not even be a business to talk about. So what would happen if you should suddenly fall ill or suffer a disabling accident? Or suppose a natural disaster strikes and puts the business temporarily out of commission.

Typical answer: In all likelihood, the business would struggle until normal activities could be resumed. In the worst case scenario, the business might even go under. Yet this doesn't have to happen if you have taken the proper precautions.

How can you keep your business from running aground? One possibility is to use "business interruption" insurance. It can generally be added to a property insurance policy or included in a business policy package.

This type of insurance pays many of the normal and customary operating expenses of your business during the down time. It generally covers such items as rent, electricity, telephone, heat, water, laundry, depreciation, salaries of employees and other fixed expenses.

Certain other types of expenses, however, may not be covered by business interruption insurance. For instance, it is not likely

that the costs of goods, wares or other merchandise will be included in the coverage. Also, the policy may not cover compensation (e.g., salary, bonuses, commissions or other fees) that is payable to the owners.

Furthermore, the total amount of benefits generally is limited to the lesser of (1) the qualified expenses actually incurred (provided that you were liable for these expenses six months prior to the disability) or (2) the maximum benefits that are payable under the coverage.

How long does business interruption insurance pay out benefits? It depends. Although the length of the term may differ from policy to policy, benefits usually are paid for a period of one or two years. That should be enough time for you to decide whether it's worthwhile to keep the business going or not.

Naturally, there are numerous variations in the form of business interruption insurance. If you decide to opt for coverage, choose the package that "fits right" with your business.

***Note:** Business interruption insurance is not for everyone. But it often is a sensible choice for a sole proprietor or the owner of a small- to medium-sized business operation.*



Give Us A Call!

Do you have any questions or comments about **Client Information Bulletin** or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

Facts and Figures

Timely points of particular interest

- **Random Audits**—The IRS is launching a new compliance study concerning individual taxpayers. The study, which will initially focus on 13,000 randomly selected returns for the 2006 tax year, is expected to provide valuable data for reducing the nation's tax gap. The majority of individuals tapped for an audit will have specific lines of their returns confirmed through in-person examinations with IRS staffers.
- **Emotional Issue**—Normally, legal damages are exempt from income tax only if they are related to physical injuries. **New case:** A taxpayer claimed that her ex- employer black-listed her for disclosing environmental hazards. She was awarded damages for emotional distress. Initially, the D.C. Court of Appeals ruled that it was unconstitutional to limit the tax exclusion to physical injuries, but now it has reversed itself.