

• January/February 2005 •


Superior Thinking. Unmatched Integrity.

Temporary One-Week Sales Tax Exemption on Certain Clothing and Footwear

Attention shoppers! If you shop in New York City and Suffolk County between Monday, January 31 and Sunday, February 6, 2005, eligible clothing and footwear will be exempt from sales tax. As long as the items cost less than \$110, per item, they are exempt from the New York State and local Sales and Use Tax of 8.625% and 8.75%, respectively.

Note that Nassau County has not elected to participate in the program and clothing and footwear still will be subject to the Nassau


sales tax portion of 4.5%. Westchester County also has elected not to participate. Depending on where you live in Westchester County, the local sales tax rate will vary. Local taxing authorities have to legislate an exemption from locally imposed sales and use tax.

Most clothing and footwear are eligible for the exemption. If you would like a listing of exempt and taxable items visit the New York State Department of Taxation and Finance website at www.nystax.gov. 

Increase In Standard Mileage Rate

Attention drivers! The standard mileage rate for business use of autos during 2005 will be 40.5¢ per business mile, up from 37.5¢ a mile for 2004. If an employee is reimbursed at 40.5¢ per business mile, the employee will not have to report the reimbursement as taxable income. However, the employee must

substantiate to the employer the time and business purpose of the auto's use.

For autos operated in connection with charitable activities, the rate used for calculating your deduction remains at 14¢ per mile. For medical and moving expense deductions, the rate increases to 15¢ per mile, up from 14¢ per mile in 2004. 

Notable and Quotable

In his capacity as head of the New York State Society of CPAs' SEC Practice Committee, Director of Quality Control **George Victor** was quoted in a front page article in *The Trusted Professional* about stock options.

Holtz Rubenstein Reminick is pleased to welcome the following people to the firm:

- Audit Manager **Mara Citrin**, with 10 years' previous experience, working with clients including not-for-profits and real estate companies, and conducting 401(k) audits. She earned Bachelor's and Masters degrees from Hofstra University.

- Audit Manager **John Massaro**, who has 17 years' previous experience, working most recently with real estate, construction, and medical practices. He has a BA degree in accounting from New York Institute of Technology.

- Audit Semi-Senior **Theresa Cappellani**, who has previously worked with medical practices, manufacturers and construction contractors. She has a BBA degree from Hofstra University.

(continued on page 2)

This Issue

- Temporary One-Week Sales Tax Exemption on Certain Clothing and Footwear
- Increase in Standard Mileage Rate
- Production Activity Deduction
- *CyberNotes*: WebMD.com, ActsofKindness.org
- Kimball Case Offers Encouragement to Tax Experts for Family Limited Partnerships
- IRS Releases Tables for Computing Sales Tax Deductions
- *The Adviser Corner*: New Automatic Rollover Regulations for Employee Benefit Plans
- Record Retention Schedule
- HRR Holiday Good Works
- DFK's 2004 Fees Exceed Half a Billion US Dollars
- IRS Rules on a Defective Grantor Trust Technique
- *DFK Firm Spotlight*: Foederer DFK

Index of 2004 HRR Adviser Articles

It has been our pleasure to provide you with additional financial information in our newsletter this year.

For your reference, we offer an index of articles we published in 2004. To access it, visit our website at www.hrrllp.com and click on the HRR Adviser link under "Firm News."

Production Activity Deduction

The production activity deduction created by the American Jobs Creation Act of 2004 is equal to the lesser of 3% (for 2005 and 2006; 6% for 2007 through 2009; 9% for 2010 and later) of taxable income or qualified production activities income. Qualified production activities income is qualified production gross receipts less the related cost of goods sold and other deductions and expenses directly and indirectly related to qualified production gross receipts. One of the exclusions from qualified production gross receipts are receipts from property leased, licensed or rented for use by a related person.

Related persons are defined as persons that are members of a controlled group of corporations or an affiliated service group, or are other entities under common control. Therefore, the exclusion from qualified production gross receipts does not apply to property leased by the taxpayer to a related person if the property is subleased or held for sublease by the related person to, and for the ultimate use of, an unrelated person. In addition, the exclusion does not apply to the license of computer software to a related person for reproduction and sale, exchange, lease, rental or sublicense to, and for the ultimate use of, an unrelated person.

The deduction is limited to 50% of the W-2 wages paid by the taxpayer as an employer. Thus compensation paid to independent contractors will not be included in the deduction limitation. In order to maximize the deduction, manufacturers and other eligible producers may be more inclined to hire employees rather than independent contractors.

Unanswered Questions Regarding The Manufacturer's Deduction

In December, Holtz Rubenstein Reminick Tax Manager Joel Ackerman attended a two-day Federal Real Estate Tax Conference in Washington, D.C., which featured many prominent speakers in the real estate taxation arena. One of the most interesting speakers was George Manousos, from the Office of Tax Legislative Counsel from the United States Department of Treasury, who spoke on the recent IRS developments regarding real estate.

Most specifically, Mr. Manousos discussed the IRS's dilemmas regarding the new manufacturer's deduction. The IRS received the same guidance that the public received through the new tax law. He stressed that there are many questions regarding the deduction that have to be clarified over the next year before taxpayers take advantage of the new provision.

(continued from page 1)


Notable and Quotable

We also welcome the following entry-level auditors:

- A native of Uzbekistan, **David Arany** earned a B.S. degree in accounting from St. John's University and is a member of the AICPA.

- **Amy Crean** has over three years previous private accounting experience. She graduated with a BBA degree in finance and accounting from Hofstra University.

- **Jeremy Goldberg** earned B.A. degree in psychology before getting his Masters in accounting, both from Hofstra University. He is a member of the NYSSCPA.

- **Swapna Lakshman** earned a B.S. degree in mass communications from Oklahoma City University before getting her Masters in accounting from St. John's University. 


He posed the following as unanswered questions regarding the deduction's application to the real estate market (and other industries), which still are being reviewed and will lead to future guidance by the IRS:

How do you define construction? Do the gross receipts from construction include any profit made on mark-up of add-ons?

Is sale of land included in the profits derived from construction?

Real estate construction uses many sub-contractors. The manufacturer's deduction only is based upon W-2 wages. Is there any specific way that sub-contractors can be included?

Are the engineering and architectural services for construction projects included as an industry applicable for the manufacturers provision?

Interestingly enough, Mr. Manousos requested that the attending tax practitioners contact him if they had any potential answers or suggestions in these unanswered questions. To contact Joel, call 631-752-7400 x-262 or E-mail JAckerman@hrrllp.com. 

CyberNotes

WebMD.com


How do you combat dry skin in the dead of winter? Maybe you're taking too many hot showers. You can get some handy tips on this and much more at WebMD.com.

WebMD.com provides services and advice to patients and doctors alike, offering an A-to-Z Condition Center (or, more accurately, A-to-W – "Aging" to "Women's Health"). Care to take a self-depression test? Want tips for chocolate lovers with diabetes? Need laundry tips for sensitive skin? It's all there, and more, at WebMD.com.

ActsofKindness.org

Be sure to mark your calendar, because Random Acts of Kindness Week is February 14-20, 2005.

The Random Acts of Kindness™ Foundation inspires people to practice kindness and to "pass it on" to others. They provide free educational and community ideas, guidance, and other resources to kindness participants through their website at www.actsofkindness.org.

These random acts of kindness require no money -- How about letting that car pass in front of you on the road? Or shoveling an elderly neighbor's driveway the next time it snows? If you need some inspiration on your random act of kindness, visit www.actsofkindness.org. 

Kimbell Case Offers Encouragement to Tax Experts for Family Limited Partnerships

An estate planning strategy that has long met with resistance in various court decisions and IRS rulings was granted somewhat of a reprieve in a recent decision handed down by a federal appeals court.

The Fifth U.S. Circuit Court of Appeals (*Note: New York is in the second circuit*) threw out a lower court ruling and dismissed the IRS's objections to that case. The decision has revived enthusiasm for the family limited partnership ("FLP").

Here's how it works:

A wealthy person transfers assets he/she owns to a partnership typically formed with their children. The parent can either gift additional interests in the partnership to the children over time or contribute assets along with the children's assets and retain a proportionate interest in the FLP. This strategy could remove large amounts of money from the estates of these wealthy individuals and transfer the property virtually tax-free to their heirs.

The major resistance these vehicles have met is that the grantor transferring the majority of the assets to the FLP has been held to have retained too much control over the partnership and hence the underlying assets of the partnership. A decision handed down in the same court last year for that very reason caused tax experts to either restructure or unwind their partnerships and look for other tax planning strategies. This most recent decision offers new life for the family limited partnership, but cautions planners and strategists alike to be careful about key aspects of setting up these partnerships.


The Kimbell case revolves around the estate of Ruth Kimbell who died in March 1998 at the age of 96. At the time of her death, the value of the assets in a limited partnership that was formed only a few months before her death was about \$2.4 million. The estate claimed a large discount (49%) in valuing the decedent's interest in the partnership on the federal estate tax return. The IRS contended that the transfer of the assets to the partnership

IRS Releases Tables for Computing Sales Tax Deductions

As was discussed in the November/December 2004 issue of the *Holtz Rubenstein Reminick Adviser*, under the American Jobs Creation Act of 2004, individual taxpayers have been given the option to deduct state and local sales tax, in lieu of state and local income taxes, for the years beginning in 2004 and 2005.

The Internal Revenue Service has posted on its website (www.irs.org) Publication 600, *Optional State Sales Tax Tables*, which taxpayers may use for their 2004 income tax returns. The tax law authorizing this optional deduction for state and local sales tax instead of state and local income tax was enacted too late in the year to include the tables in the tax instruction books.



Taxpayers may deduct the actual amount of sales tax paid or use the amount from the sales tax tables. Keep in mind that the tables reflect only state amounts. The table instructions explain how to add an amount for local sales taxes (such as New York City). Taxpayers who elect to use the tables are allowed, in addition to the table amount, to include any sales tax paid on motor vehicles, aircraft, boats, homes (including mobile and prefabricated) or home building materials. 

several months before her death was not for adequate and full consideration and that the full value of the assets should be included in her gross estate.


The lower court concurred and by issuing a summary judgment concluded that the IRS had such a strong legal case that it did not have to rule on its merits. The Appellate Court, in its findings, concluded that the lower court erred when it ruled that, as a matter of law, family members cannot enter into a bona fide transaction and that a transfer of assets for a pro rata partnership interest is not a transfer for full and adequate consideration. It also stated that the lower court failed to consider recorded evidence to support the estate's position that the transfer was a bona fide sale. The Appellate court cited that the estate established several key objective facts in support of its position that the transfer was a bona fide sale and not a disguised gift or sham transaction.

The key facts established by the estate included that: (1) the decedent retained sufficient assets outside of those

transferred to the FLP for her own support, (2) she did not commingle FLP assets with personal assets, (3) partnership formalities were satisfied and the contributed assets were actually assigned to the FLP, and (4) there were credible non-tax business reasons for the FLP's formation.

The Appellate court's reasoning and conclusions are as important an aspect of this case as the decision itself. It decided to send the case back to the lower court to make determinations on issues that were not addressed, but should have been, at the lower court level.

It is not anticipated that the IRS will surrender in its fight to discredit the FLP and may well continue its fight in other circuits around the country. However, what this decision does demonstrate is that a well-structured FLP, along with carefully drawn agreements, is still a viable estate planning technique.

To find out more about setting up an FLP, contact Senior Tax Manager Barry Nagler at 631-752-7400 x-354 or BNagler@hrrllp.com. 

New Automatic Rollover Regulations For Employee Benefit Plans

By Jay Feingold, CPA



Jay Feingold

Under current regulations, certain employee benefit plans are permitted to provide an automatic “cash-out” to terminated participants. As of now, for qualified defined contribution and defined benefit retirement plans the cash-out has been in the form of a lump sum distribution to a terminated participant with a vested account balance (or present value of a vested accrued benefit for a defined benefit plan) of \$5,000 or less, in the absence of a benefit election made by the participant. But as of March 28, 2005, plans that include automatic cash-out provisions will be required to roll over amounts that are greater than \$1,000 and less than or equal to \$5,000, into an individual retirement account (“IRA”) or individual retirement annuity. Balances of \$1,000 or less may still be distributed as a lump sum.

The Department of Labor (“DOL”) has issued safe harbor conditions to protect plan fiduciaries with respect to a plan administrator’s designation of an institution to receive the automatic rollover and the initial investment choice for the rolled over funds. The safe harbor rules also extend to distributions of \$1,000 or less, if a plan elects mandatory roll over of these amounts.

Safe Harbor Rules

- 1) The present value of the distribution cannot exceed \$5,000. In calculating this maximum, a plan administrator may exclude amounts that a participant rolled over from another plan, thus allowing for some distributions that include rolled over funds to effectively exceed \$5,000.
- 2) The distribution must be rolled over into an individual retirement plan (IRA or annuity).

- 3) The fiduciary must enter into a written agreement with an individual retirement plan provider that must specifically address certain items related to the IRA’s investments and fees. Generally, rolled-over funds must be invested in an investment that is a) designed to preserve principal and provide a reasonable rate of return; b) seeks to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the individual retirement plan; and c) offered by a state or federally regulated financial institution (such as a bank, savings association, credit union, insurance company, or investment company registered under the Investment Company Act of 1940).

Additionally, fees charged by the individual retirement plan provider must not exceed the fees and expenses charged for comparable individual retirement plans established for non-mandatory rollover reasons; and, the participant must have the right to enforce the terms of the contractual agreement establishing the individual retirement plan.

- 4) Participants must be provided with a summary plan description (“SPD”) or summary of material modifications (“SMM”), that describes the rollover provisions.
- 5) The fiduciary’s selection of an IRA provider and the investment of funds must not result in a prohibited transaction.

Next Step For Plan Sponsors

Plans with cash-out provisions should consider the following alternatives:

- 1) choosing to continue to require mandatory cash-outs, or

- 2) choosing to eliminate the cash-out provision for balances exceeding \$1,000.

Choosing to Require Cash-Out Distributions. Choosing to continue cash-out distributions will require the selection of an IRA provider, evidenced by a written agreement, and the selection of an IRA investment. The DOL has indicated that investment products meeting the safe harbor requirements typically would include money market funds, interest-bearing savings accounts, certificates of deposit and stable value products issued by a regulated financial institution.



Additionally, the plan sponsor will

need to amend the plan document to reflect the automatic rollover provisions and will need to prepare the required employee communications (revised SPD or SMM). Tax notices sent to participants who separate from service will also need to be updated for the new provisions. The IRS has issued a sample plan amendment to assist plan sponsors with these requirements. Procedures should be put in place to ensure compliance with the regulation by March 28, 2005.

Choosing to Eliminate the Cash-Out Provision For Balances Exceeding \$1,000. Choosing to discontinue automatic cash-out distributions will require a plan amendment to remove the applicable provision. A plan sponsor may elect to eliminate the provision completely or a plan sponsor may elect to eliminate the mandatory cash-outs of balance exceeding \$1,000, as the automatic rollover rules are not required for balances of \$1,000 or less. Plan sponsors will need to prepare the required employee communications (revised SPD or SMM) and will also need to update any tax notices that are sent to participants.

For assistance with this or other retirement plan matters, contact Audit Manager Jay Feingold at 631-752-7400 x-213 or JFeingold@hrrllp.com.

Record Retention Schedule

How long must you keep business records? The Internal Revenue Service and individual states have requirements for different types of records, some of which should be saved for a few years, others that you should never throw away. As a general rule of thumb, when costs must be substantiated, keep the records until you sell the item (plus several years thereafter). Other record retention time periods are delineated below.

Note that these recommendations apply for paper records as well as computerized records and paperless systems.

Tip: This Record Retention Schedule should, itself, be retained in your records. 

Accident reports/claims (settled cases)	7 years	Internal audit reports (longer retention periods may be desirable)	3 years
Accounts payable ledgers and schedules	7 years	Inventories of products, materials, supplies	7 years
Accounts receivable ledgers and schedules	7 years	Invoices	7 years
Bank reconciliations	3 years	Limited Liability Company (LLC operating agreement)	Permanently
Bank statements	7 years	Monthly trial balances	7 years
Capital stock and bond records	Permanently	Option records (expired)	7 years
Cash books	Permanently	Partnership agreements	Permanently
Charts of accounts	Permanently	Patents	Permanently
Checks, including substitute checks (cancelled - see exception below)	7 years	Payroll records and time sheets	7 years
Checks, including substitute checks (i.e. taxes, property purchases, special contracts, etc. Checks should be filed with the papers pertaining to the transaction)	Permanently	Personnel files (terminated employees)	3 years
Computer records (back-ups of all financial records)	Permanently	Petty cash vouchers	3 years
Contracts and leases		Physical inventory tags	3 years
Expired	7 years	Plant cost ledgers	7 years
Still in effect	Permanently	Property appraisals	Permanently
Copyrights	Permanently	Property records (including costs, depreciation reserves, year-end trial balances, depreciation schedules, blueprints and plans)	Permanently
Corporation charter, minute books, and bylaws	Permanently	Purchase orders	7 years
Correspondence (general)	2 years	Requisitions	2 years
Correspondence (legal and important matters)	Permanently	Retirement and pension records	Permanently
Deeds, mortgages, easements, and other property records	Permanently	S Corporation election	Permanently
Disability benefits records - for employees	7 years	Stock and bond certificates (canceled)	7 years
Deposit slips	3 years	Subsidiary ledgers	7 years
Employment applications	3 years	Tax returns and work papers, including records to support carrybacks and carryovers	Permanently
Expense reports	7 years	Trademark registrations	Permanently
Financial statements	Permanently	Training manuals	Permanently
General ledgers, journals	Permanently	Trial balance sheets	Permanently
Insurance policies (expired)	3 years	Union agreements	Permanently
Insurance records	Permanently	Vouchers for payments to vendors, employees, etc.	7 years
		Withholding tax statements - for employees	7 years

HRR Holiday Good Works

Continuing the firm's long-standing tradition of altruism, the staff of Holtz Rubenstein Reminick gave their time and their financial support to a wide range of local and national causes throughout the holidays.

As they do each year, Audit Managers **Paul Becht** and **Harold Deiters** collected toys from various businesses (including Holtz Rubenstein Reminick) for the Marine Corps' Annual Toys for Tots program. The toy drive is in connection with their involvement in the Young CPAs Committee of the New York State Society of CPAs ("NYSSCPA"). Over 3,000 toys were collected and distributed to less fortunate children throughout Long Island.

Marketing Director **Flo Federman** and support staffers **Clare Burns**, **Kim Califra**, **Joyce Clarke**, **Carol Hanington**, **Rosemary McMenamin**, and **Janet Nieves** participated in "Operation Santa Claus," answering Dear Santa letters and sending gifts to less fortunate families.

Mei Lam, from the New York City office's business department, donated to the "Family Helping Family" Foundation, set up to buy cardiac monitors for local police cars, to save lives in emergencies.

Senior Auditor **Paul Sanchez** and his family donated clothes to the Salvation Army, donated canned goods to City Harvest, donated new toys to Toys for Tots and bought gifts for their church's Giving Tree.

The Long Island support staff of the firm adopted a family – donating a huge goody basket of food, toys, and money to a less fortunate local family. 



DFK's 2004 Fees Exceed Half a Billion US Dollars

The 176 member firms of DFK International achieved a significant landmark in fiscal year 2004. DFK International is the prestigious worldwide association of accounting firms for which HRR Partner Alan E. Weiner sits on its Executive Committee. In the year ending September 2004, the association exceeded the half billion-dollar mark for the first time, thanks to a 15% increase in consolidated fees.

DFK Firm Spotlight: Foederer DFK

DFK International is the worldwide association of independent accounting and business advisory firms in which Holtz Rubenstein Reminick is actively involved. Through our affiliation, we are able to provide enhanced services to you and to other clients throughout the United States and the world.

This issue we spotlight one of DFK's members in the Netherlands – **Foederer DFK**. We invite you to visit them at www.foederer.nl. 

"Following growth of 20% in the previous year, we are delighted again to have recorded one of the highest rates of growth amongst the leading international accounting networks," comments DFK International Executive Director Simon Fraser.

DFK International now has 293 offices worldwide and in excess of 6,500 personnel. To find out more about the global reach DFK offers to Holtz Rubenstein Reminick clients, visit their website at www.dfk.com. 

IRS Rules on a Defective Grantor Trust Technique


The IRS has issued a revenue ruling addressing estate and gift tax issues when income taxes on defective grantor trust income are reimbursed to the grantor.

A defective grantor trust is an irrevocable trust structured so that the grantor, rather than the trust or its beneficiaries, will be taxed on the trust's income without the trust being included in the grantor's estate.

An important advantage of a defective grantor trust is to have the income tax on trust income paid by the grantor without being treated as a gift to the beneficiaries. The ruling makes it clear that a grantor's payment of income tax on trust income taxed to him/her is not a gift to the beneficiaries.

The ruling provides that if the grantor is required to be reimbursed for the income taxes out of trust assets, under the trust instrument or local law, all of the trust's assets are included in the grantor's estate and subject to estate tax. The Internal Revenue Service will apply this holding only for trusts created after October 3, 2004.

If the trustee, as an unrelated person, has the discretion to make the reimbursement, regardless of whether the discretion is exercised, none of the trust's assets will be included in the grantor's estate. However, such discretion combined with other facts like an understanding or arrangement between the grantor and the trustee regarding the trustee's discretion may cause the trust assets to be included in the grantor's estate for Federal estate tax purposes.

For more information, contact Senior Tax Manager Sid Leibowitz at 631-752-7400, x-265, or SLeibowitz@hrrllp.com. 

To change contact information for the HRR Adviser, please contact us at info@hrrllp.com.