

• July/August 2005 •

*Superior Thinking. Unmatched Integrity.*

## Coming in 2006 – The Roth 401(k)

The Treasury Department has released proposed regulations on the Roth 401(k), which was created under the 2001 tax law. Beginning January 1, 2006, employers will be able to offer both the traditional 401(k) and Roth 401(k) plans.

A traditional 401(k) reduces the current year's income, but will be taxed when withdrawn, while a Roth 401(k) contribution is more like a savings account - no current deduction to the taxpayer who contributes and no tax when the funds are withdrawn later in life (plus, no tax on the earnings).

The Roth 401(k) plan will not have income limits like those for the Roth IRA. A single person earning \$110,000 or a married couple earning \$160,000 cannot make contributions to a Roth IRA; this will not be true for the Roth 401(k). Maximum contributions to a Roth 401(k) will be the same as those to

a regular 401(k) – so employees will be able to contribute up to \$15,000 next year – the maximum employees can put in to either a regular 401(k) or a Roth 401(k) plan. Though employees will not be able to contribute \$15,000 to a regular 401(k) plan and another \$15,000 to a Roth 401(k) plan, they can split the \$15,000 between the two plans. Employees over the age of 50 can make additional contributions of \$5,000 to a regular 401(k) plan next year for a total of \$20,000.

The Treasury Department says catch-up contributions will also be available under the Roth 401(k). Unlike traditional 401(k) plans, employee contributions to Roth 401(k) plans would be made with after-tax dollars. The employee would be able to withdraw the money (both the employee's contribution and the income earned thereon) tax-free as long as he/she held the account for at least five

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## Notable and Quotable

Director of Quality Control **George Victor** discussed reporting foreign revenue and financial statements in *Newsday's* Top 100 Companies section. George also discusses Sarbanes-Oxley fees and other statistics in an upcoming issue of *Inc. Magazine*.

What are the pros and cons of buying vs. leasing company cars? That's what Senior Tax Partner **Alan Weiner** discussed, in an interview for *BusinessWeek Online*. Alan also was quoted in a *Newsday* article on the real estate taxes included in LIPA bills.

Lots of frequent flyer miles for staff attending industry conferences recently:

- Our firm was very involved in the planning of this year's DFK Multi-Disciplinary Conference in Los Angeles. Audit Partner **Barry Garfield** helped organize the conference, as did Tax Manager **Joel Ackerman**, who also led a discussion on federal tax credits. Speakers also included Tax Partner **Arnie Haskell** (about the new Schedule M-3 affecting corporations with assets above \$10,000,000), and Audit Manager **Jay Feingold** (about employee benefit plan audits). Attending the

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*Want to know if your hybrid vehicle is eligible for tax deductions? Turn to page 3!*

## Grace Period for “Use It or Lose It” Cafeteria Plan Rule

Cafeteria plans allow employees to pay for qualified benefits (health flexible spending arrangements and dependent care assistance programs – to name two) with pre-tax dollars. Previously, cafeteria plans could not allow an employee to use contributions for one plan year to pay for a benefit provided in a subsequent year. This “use it or lose it” rule required that any unused contributions remaining in the employee’s account at the end of the year be forfeited back to the employer.


The IRS has announced that employers may modify their cafeteria plans to allow for a 2-1/2 month grace period. If the plan is amended, any contributions left over at the end of the plan year could be used up until the 15<sup>th</sup> day of the 3<sup>rd</sup> month after the plan’s year-end. The employee could only use the contributions that are carried over for the same type of benefit they were originally set aside for. For example, unused amounts elected to pay or reimburse medical expenses in a health

flexible spending arrangement may not be used to pay or reimburse dependent care or other expenses during the grace period.



The net effect of this change is that participants may have as long as 14 months and 15 days to use the benefits or contributions for a plan year before the amounts are forfeited.

An employer may adopt a grace period for the current cafeteria plan year (and subsequent years) by amending the plan document before the end of the current plan year. For example, if an employer modifies its calendar year plan before December 31, 2005, the election would apply for the first time in 2005, and unused contributions could be carried over until March 15, 2006.

For more information, contact Holtz Rubenstein Benefits Consulting President Mark Senders at 631-396-0350 or [MSenders@holtzbenefits.com](mailto:MSenders@holtzbenefits.com). 

## IRS Fringe Benefit Audit Techniques Guide

When are fringe benefits to an executive abusive? The IRS has a new audit guide that shows what examiners are looking for.

Executives may receive benefits that are not available to other employees. These benefits are in lieu of or in addition to their salary. What the IRS is looking for is whether or not the benefit is taxable or non-taxable, has been properly accounted for by the corporation/partnership, and that the executive has included proper amounts as income.

The audit guide employs a three-part test when determining the taxability of fringe benefits. The agent must: identify the benefit, assume that it is taxable, and assign a value to the benefit; see if there are any statutory provisions that exclude the benefit from income; and value any portion of the benefit that is not excludable from the executive’s gross income. The values of these benefits are typically the value the executive would pay in an arm’s length transaction. Some of the more common benefits include, but are not limited to: luxury box tickets; executive dining rooms; corporate provided computers and equipment; club dues; loans; and personal use of company owned aircraft.

There are some common issues involved with the above benefits. For instance, all club memberships and dues are not deductible by the corporation. Often companies try to disguise these payments as wages.

IRS also will be looking at personal loans to officers. The Sarbanes-Oxley Act now bans personal loans to executives of public companies. Loans that were in existence before the effective date of the Act (July 30, 2002) cannot be renewed. Agents are being told to look for loans that are being used to disguise compensation where there are low interest rates and unusually long repayment terms. A meal offered to employees on site and for the convenience of the employer is not taxable income to the employee. However, if this benefit is offered solely to highly compensated employees, the benefit may be taxable depending on certain income thresholds of the executive.

For more information, contact Senior Tax Manager Sid Leibowitz at 631-752-7400 x-265 or [SLeibowitz@hrrllp.com](mailto:SLeibowitz@hrrllp.com). 

### CyberNotes

#### [yogajournal.com](http://yogajournal.com)


**Yogajournal.com** is the free online version of *Yoga Journal* magazine. Definitions of terminology are provided for beginners as well as advice on when to practice and what style of yoga is most appropriate. There are more than 100 searchable anatomical poses. The site provides photos and detailed directions on how to deepen poses thereby making them more advanced. The content is incredibly rich, with articles and Q&As that touch upon dieting, beauty tips, and meditation. There is also a travel section that encompasses Yoga on the road and Yoga vacations.

#### [BHG.com](http://BHG.com)

Looking for design inspiration and great how-to’s for your home? Check out **BHG.com**. On the *Better Homes and Gardens* site, use the “House and Home” section where there is an array of decorating ideas. Search through articles to see what the pros have to say about selecting outdoor furniture, painting rooms or using decorative accents. Slide shows are available to develop design ideas on every room in the house. Use the Arrange-a-Room tool to create a room layout with everything from doors and furniture to flat-screen TVs. In addition to home design improvements, the site includes sections related to recipes, health and gardens. 

## Attention Attorneys: Law Firms Required to Withhold Tax on Referral Fees

A law firm obtained some clients through referrals from its own associates. The firm did not withhold income taxes on the referral fees paid to its associates and instead reported the fees on Form 1099.

The New York Supreme Court, Appellate Division held that the law firm was required to withhold New York personal income taxes on those referral fees since associates were considered employees of the firm, not independent contractors. Therefore, the referral fees paid to the associates were considered wages for income tax purposes. 

## Record Retention – Payroll Matters

*This is a supplement to the Record Retention Schedule issued in the January/ February 2005 Adviser, which is available under the “Firm News” section of our website, [www.hrrllp.com](http://www.hrrllp.com).*

**Note:** While 4 years is the minimum retention period, it may be advisable to retain the records for a longer period in case of a contractual dispute, a question relating to retirement plans; et.al.

For Federal tax purposes, employment tax records must be maintained for at least four years after the later of: the due date of the tax for the return period to which the records relate, or the date the tax is paid. Below is a summary of the specific records that must be maintained for income, Social Security and Medicare taxes, and for Federal unemployment tax.


**Income, Social Security and Medicare Taxes.** The following records must be kept for at least four years after the due date of the employee’s personal income tax return (generally, April 15) for the year in which the payment was made:

- Employer identification number;
- Employee’s name, address, occupation, and social security number;

## New Hybrids Certified for Clean-Burning Fuel Deduction

The 2006 Lexus RX 400h and the 2006 Toyota Highlander Hybrid both have recently been added to the IRS list of vehicles eligible for the clean-burning fuel deduction. Individuals who purchase these vehicles new may claim an above-the-line deduction of \$2,000 on their personal income tax return. You do not have to itemize deductions on your tax return to claim this deduction.

Under The Working Families Tax Relief Act of 2004, the amount of the deduction for certified vehicles placed in service in 2005 and 2006 is \$2,000 and \$500, respectively. No deduction will be allowed after 2006. For this purpose, “placed in service” means when title to the vehicle is taken and it is driven off the dealer’s lot because no business use is required. Furthermore, ownership is required. Therefore, if you are leasing a vehicle, you would not be eligible for the deduction.

A complete listing of hybrid vehicles certified by the IRS for this deduction can be found at [www.irs.gov](http://www.irs.gov). Enter “hybrid” in the search box for articles listing the vehicles that qualify. 



- Total amount and date of each payment of compensation, including reported tips and the fair market value of non-cash payments and any amount withheld for taxes or otherwise;

- Amount of compensation subject to withholding for federal income, Social Security and Medicare taxes, and the amount withheld for each tax;

- The pay period covered by each payment of compensation;

- The reason(s) why the total compensation and the taxable amount for each tax are different, if that is the case;

- The employee’s Form W-4;

- The beginning and ending dates of the employee’s employment;

- The statements provided by employees reporting tips received;

- Support for wage continuation payments made by an employer or third party to an employee under an accident or health plan;

- Fringe benefits provided to employees and any required substantiation;

- Any requests from employees to use the cumulative method of wage withholding;

- Adjustments or settlements of taxes;

- Copies of returns filed (on paper or magnetic media), including Forms 941, 943, W-3, 6559, Copy A of Form W-2, and any Forms W-2 sent to employees but returned as undeliverable; and

- Amounts and dates of tax deposits.

**Unemployment Tax.** Employers subject to the Federal Unemployment Tax Act (FUTA) must keep the following information for at least four years after the due date of Form 940 (or 940-EZ) or the date that the required FUTA tax was paid, whichever is later:


(1) the total amount of employee compensation paid during the calendar year;

(2) the amount of compensation subject to FUTA tax;

(3) state unemployment contributions made, with separate totals for amounts paid by the employer and amounts withheld from employee’s wages (currently, Alaska, New Jersey, and Pennsylvania require employee contributions);

(4) all information shown on Form 940; and

(5) the reason(s) why total compensation and the taxable amounts are different, if that is the case.

For more information, contact Tax Manager Brendan Logan at 631-752-7400 x-253 or [BLogan@hrrllp.com](mailto:BLogan@hrrllp.com). 

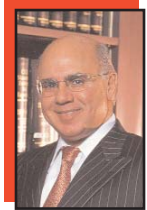
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**Assessing Litigation Risk Through Valuation**

By Martin P. Randisi, CPA, ASA

A distributor who services the West Coast takes you to dinner and says he'd like to buy your company... You were served with papers for divorce and your attorney wants to know what your business is worth... A competitor is making knockoffs of your product; you need to present the court with the economic damages for your lost profits.



**Martin P. Randisi**

What do you do in situations like these? How can you be prepared so you are not caught by surprise?

When a lawsuit occurs or a question of valuation comes up, owners usually call their corporate attorney and accountant. They consult friends who tell horror stories about nasty divorces and business breakups. However well meaning your friends are, in litigation, misinformation is worse than no information.

Holtz Rubenstein Reminick has one of the largest full time Litigation and Valuation Consulting ("LVC") groups in the New York Metropolitan region, with over 2,000 engagements, hundreds of trial appearances and litigation partners with over 30 years' experience.

Clients and their attorneys use our services for one of two reasons: they are being sued (litigation), or need help with corporate and risk planning (which is the preventative side of litigation and valuation services). The old adage about the certainty of "death & taxes" is true – but other certain things are also true, including divorce, business breakups and litigation. Corporate planning and business appraisals may be of benefit to you.

**Valuation and risk assessment**

Isn't it ironic how a business owner will carefully monitor the changes in market value of their investment portfolio, yet doesn't know the market value of

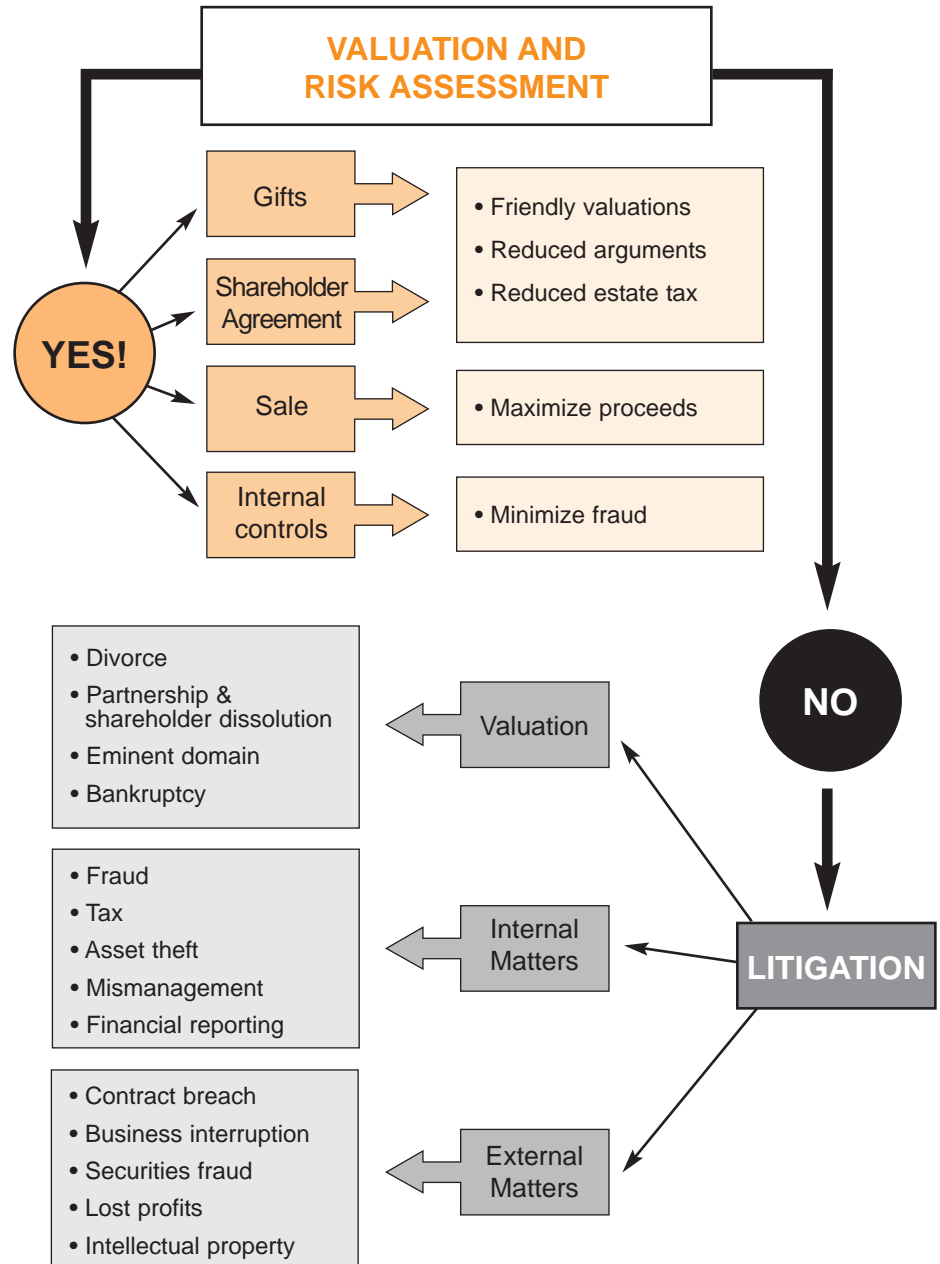
his/her own company? Do you know the P/E (price to earnings) ratio of your company? Your company is the cornerstone of your wealth, yet it is an anchor whose size and weight you may not know.

**Litigation**


The drama of our opening paragraph is real. For example, during corporate formation, we typically recommend the

shareholders develop an appraisal methodology to monitor their business value. Is it better to spend a little money now (to do a risk assessment) or a lot more later (in litigation)?

The chart below encourages you to become more involved in corporate and litigation risk assessment so as to minimize the pain and suffering of litigation.



In future issues of this newsletter, look for more information about the appraisal process and its "friendly" or "preventive" uses, like estate planning, buy, sell and shareholder agreements, and wealth creation.

For more information on commercial and personal litigation or business valuation, contact LVC Partners Martin P. Randisi (631-719-3456, MRandisi@hrrllp.com) or John McAteer (631-752-7400 x-380, JMcAteer@hrrllp.com) 


## New Language on Accountant & Attorney Correspondence


You soon will see a new “legend” appearing on the written communications you receive from your accountants and attorneys, including Holtz Rubenstein Reminick.

Recently, the Treasury Department issued final Regulations that impose certain rules for practitioners who represent taxpayers before the Internal Revenue Service. The purpose of these rules, under Circular 230, is to address the abusive tax opinions of the 1990s.

The new Regulations go beyond formal tax opinions and tax shelter advice by not exempting routine tax communications. However, they try to create a balance by allowing practitioners to “opt out” of the stringent rules and procedures that are necessary to issue a formal opinion. The “opt out” procedure allows practitioners to insert a prominently disclosed statement on their correspondence stating that the written advice was not intended or written to be used, and cannot be used by the taxpayer, to avoid penalties that may be imposed on the taxpayer. This allows practitioners to communicate with their clients in a cost effective manner.


When a formal opinion is necessary and the rules in forming that opinion are complied with, the “legend” will not appear on the written opinion. Since oftentimes this language will be embedded in the writer’s word processor and email signatures, you may see it on any message, whether tax related or not.

For more information, contact Tax Partners Arnold Haskell at 631-752-7400 x-390, [AHaskell@hrrllp.com](mailto:AHaskell@hrrllp.com) or Susan Teicher at 212-697-6900, [STeicher@hrrllp.com](mailto:STeicher@hrrllp.com). 



**Reminder –**  
**New York State Sales Tax Rates Changed**

As reported in the May/June 2005 *Adviser*, effective June 1, 2005 the combined New York State and local sales and use tax rates have changed.

The New York City rate that was stated in the aforementioned issue of the *Adviser* should have been 8-3/8%. 

## Related Parties Denied Capital Gain Deferral in Like-Kind Exchange

How to delay recognition of gain from the sale of property? A common, but very complex, tax-planning technique is through a “like-kind exchange.”

Generally, no gain or loss would be recognized on an exchange of like-kind properties that are held for productive use in a trade or business or for investment. However, if it’s not a straight-up trade, certain conditions, when met, will qualify a transaction as a proper exchange and provide an opportunity for deferring any gain on the original property sold.

In order for the gain to be deferred, the taxpayer must transfer to, and receive like-kind properties from, a qualified intermediary. If the taxpayer identifies the new property within 45 days from the sale of the property and receives it within 180 days of transferring the old property, gain on the original property sold could be deferred.

To facilitate these exchanges properly, taxpayers should use a qualified intermediary (i.e., a person who is not the taxpayer, an agent, related person to the taxpayer, or a related person to the agent). Qualified intermediaries enter into a written exchange agreement with the taxpayer and, as required by this agreement, acquire property from the taxpayer, transfer this property, acquire like-kind replacement property, and transfer this replacement property to the taxpayer.

According to the Internal Revenue Code, if a taxpayer and a related person exchange like-kind property and within two years either one disposes of the exchanged property, any gains deferred under the like-kind provisions do not apply. Any gain, therefore, must be taken into account as of the date of the disposition.

Also, within these exchange provisions, the gain deferred from a disposition of exchanged property cannot be taken into account if the exchange or disposition transaction had as one of its principal purposes an avoidance of Federal income tax.

In a recent Tax Court case, a taxpayer was unable to defer gain on the sale of real estate holdings that were indirectly sold to a corporation related to the taxpayer.


Teruya Brothers, Ltd. is a Hawaii corporation whose business activities include purchasing and developing residential and commercial real property. During the taxable year in issue, Teruya owned 62.5% of the common shares of Times Super Market, Ltd.

Teruya exchanged its properties (Ocean Vista and Royal Towers) for like-kind replacement properties formerly owned by Times. A qualified intermediary immediately sold Ocean Vista and Royal Towers to unrelated third parties. Times received the proceeds, plus additional cash from Teruya.

Although the transactions went through an unrelated qualified intermediary, this like-kind exchange was not accepted as a properly executed exchange in the Tax Court. The Tax Court held that the transactions were equivalent to direct exchanges of properties between Teruya and the related party (Times), followed by the related party’s sales of the properties to unrelated third parties.

In general, such transactions made with related parties do not qualify for the like-kind treatment. However, there is an exception to this disqualification if tax avoidance was not one of the principal purposes for the transaction.

In this case, the taxpayer failed to demonstrate this qualification as they were unable to offer an explanation for why a qualified intermediary was used, other than in an attempt to circumvent the limitations on like-kind exchanges between related parties. Therefore, the court concluded that Teruya could not defer gain under the like-kind exchange rules.

If you have any questions regarding like-kind exchanges contact Tax Manager Joel Ackerman at 631-752-7400, x-262, or [JAckerman@hrrllp.com](mailto:JAckerman@hrrllp.com). 

## Unreimbursed Business Expenses Disallowed Due to Inadequate Substantiation

Learn lessons from a recent Tax Court case in which a taxpayer had unreimbursed business expenses disallowed due to inadequate substantiation. The taxpayer was a sales representative who claimed unreimbursed automobile and entertainment expenses on his tax return. To substantiate the expenses, the taxpayer produced a spreadsheet for the automobile expenses listing the trips taken, the mileage and the clients visited, and credit card summaries to support his entertainment expenses.

IRS regulations state that no deduction is allowed for expenses incurred for travel expenses, including meals, entertainment, and automobile expenses, unless the taxpayer substantiates certain elements of the claimed expenses. Under the substantiation requirements, a taxpayer must substantiate the amount, time and business purpose of the expenditures and provide adequate records or sufficient evidence to corroborate his or her own statement.

For this purpose, adequate records are defined as a diary, a log or a similar record and documentary evidence that, in combination, are sufficient to

establish each element of each expenditure or use. To be adequate, a record generally must be written and must be prepared at or near the time of the use or expenditure.

The court ruled that the taxpayer could not deduct the automobile and entertainment expenses because he failed to maintain reliable written records of each business trip and also failed to record the information contemporaneously with the claimed expenditures. The taxpayer's mileage logs contained numerous inconsistencies that could not be explained by the taxpayer.

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### Notable and Quotable


conference were Partners **Anthony Bracco**, **Paul Finegan**, **Tim Mulcahy**, and **Susan Teicher**, as well as Audit Director **George Victor**.

- Not-for-Profit Partners **Beatrix McKane** and **Gordon Siess** heard the latest government updates at the AICPA National Not-for-Profit Industry Conference in Washington D.C.


- In his position as Vice President of the Americas, **Alan Weiner** updated attendees on the latest information about DFK International and DFK/USA at the annual meeting of DFK Canada, in Calgary, Alberta.

- Chief Marketing Officer **John Kmetz** lectured at a 3-day international conference at Johns Hopkins University entitled, "Reading and Writing the Pedagogy of the Renaissance."

- Marketing Director **Flo Federman** attended the Association of Accounting Marketing Conference in Orlando, Florida.

**Gordon Siess** has been elected to serve on the YMCA of Long Island Corporate Board. At their Annual Meeting, retired Partner **Dan Segal** was formally introduced as its new Chairman. 

In addition, the taxpayer's credit card summaries combined both personal and business expenses that didn't include information regarding the business purpose nor with whom the client dined. The taxpayer didn't provide any other written substantiation to corroborate any of the entries and also testified that he reconstructed most of the evidence several years after the deductions were taken. The lack of proper written substantiation as well as the timing of the evidence led the court to disallow the deductions.


For more information, contact Tax Manager Jason Chin at 631-752-7400 x-261 or [JChin@hrrllp.com](mailto:JChin@hrrllp.com). 

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### Coming in 2006 -- The Roth 401(k)

years and the person is at least age 59 ½ years when the money is withdrawn. Employers can match employee contributions to the Roth 401(k) in the same way that they can match employee contributions to a 401(k) plan. The employer match to a Roth 401(k) would be done with pre-tax dollars and would be kept in a separate account. When the employee withdraws the employer contribution, he/she will owe tax on the amount withdrawn.

There are many unanswered questions with respect to the Roth 401(k). Most notably, what will happen to the Roth 401(k) after 2010, when the 2001 tax law is set to expire? Hopefully this and other questions will be answered in short order.

If you have any questions regarding Roth 401(k) plans, please contact Tax Manager Brendan Logan at 631-752-7400 x-253 or [BLogan@hrrllp.com](mailto:BLogan@hrrllp.com). 

To change contact information for the HRR Adviser, please contact us at [info@hrrllp.com](mailto:info@hrrllp.com).

### DFK Firm Spotlight: KFMR Katz Ferraro McMurtry, P.C.

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 a member firm in Pittsburgh, Pennsylvania. We invite you to visit them at [www.kfmr.com](http://www.kfmr.com). 