

• March/April 2005 •

Superior Thinking. Unmatched Integrity.


Holtz Rubenstein Reminick and Rand Consulting Group Join Forces

Our Firm continues to expand and enhance its services to clients and others in the Long Island/New York City metropolitan area.

The merger with Rand Consulting Group, which was effective February 1st, brings Marty ("Marty") P. Randisi, CPA, MBA, ASA, into our partnership group and makes us one of the largest, and best, regional mid-sized forensic accounting, litigation support, and valuation firms.


In the litigation area, the firm provides investigatory accounting and fraud

auditing for economic damage computation, lost profit, breach of contract, construction claims, and white-collar crimes. Its valuation services assist owners in estate and gift planning, buy-sell agreements, marital disputes, sales/acquisitions, and corporate planning. In addition, the group offers specialized auditing and forensic skills for compliance, monitorships, and evaluation of internal controls.

Marty can be reached at 631-719-3456 or mrandisi@hrrllp.com. 

Form 941 Gets an Overhaul

In 2002, the Internal Revenue Service, along with a team of subject matter experts, set out to redesign Form 941 – Employer's Quarterly Federal Tax Return. Concerned that the old form was not clear and easy to understand, the IRS decided it was time for an overhaul. The IRS also brought in "plain language" contractors to

assist in the effort. The redesigned form looks substantially different than the old version and is much easier to understand. The form is less cluttered, has more white space, and is written in plain language. The new Form 941 for 2005 can now be found at www.irs.gov/pub/irs-pdf/f941.pdf 

Notable and Quotable

Litigation Support Partner **Joel Podgor** appeared on national television, interviewed on the CBS Early Show about Survivor winner Richard Hatch's tax evasion of his TV winnings. Joel said he found it "shocking that somebody wouldn't report the income when it's so blatant and obvious and it's all over the TV that he earned it."

Tax Partner **Alan E. Weiner** has been chosen to be included in the 59th edition of Marquis Who's Who in America®. The 2005 Edition features the nation's 100,000 highest achievers – a select group of men and women from all significant fields of endeavor.

Alan recently represented DFK/USA at the annual European Partners' meeting of DFK International, the worldwide association of independent accounting and business advisory firms. Held in Brussels, the meeting centered on the auditor's responsibility, a topic that continues to be of global interest.

Tax Partner **Arnie Haskell** gave an overview of the income, gift, and estate tax consequences of charitable giving at a Nassau County Bar Association seminar.

Audit Partner **Howard Weiner** discussed the compliance requirements of the Sarbanes-Oxley Act at a conference of the Risk and Insurance Management Society.

George Victor, the firm's Director of Quality Control, has been appointed to the education commission of the Diocese of Rockville Centre, responsible for overseeing the operations of the Catholic school system.

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Ford Escape Certified for Clean-Burning Fuel Deduction

Recently, the IRS has certified the 2005 Ford Escape as eligible for the clean-burning fuel deduction. Individuals who purchase this vehicle now may claim a deduction of \$2,000 on their personal income tax return (even if they claim the standard deduction).

The Working Families Tax Relief Act of 2004 increased the amount of the deduction for certified vehicles placed in service in 2004 and 2005 from \$1,500 and \$1,000, respectively, to \$2,000. The deduction will be limited to \$500 for vehicles placed in service in 2006 and 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. Furthermore, ownership is required. Therefore, if you are leasing a vehicle, you would not be eligible for the deduction.

Other vehicles eligible for the clean-burning fuel deduction as certified by the IRS include the 2001-2005 Toyota Prius, 2000-2004 Honda Insight, the 2003-2005 Honda Civic Hybrid, and the 2005 Honda Accord Hybrid. 


Many Corporations (and Their Accountants) Face Additional Workload to Complete New Tax Return Schedule M-3

In January 2004, the Internal Revenue Service announced that C corporations with total assets of \$10 million or more as of the ending balance sheet date would have to complete a new Schedule M-3 beginning with their 2004 tax return. The Schedule M-3 provides a more precise definition of book income and a more detailed reconciliation of book income to taxable income than the Schedule M-1, the traditional reconciliation of book income to taxable income, does.

Since the initial announcement, the IRS has issued the final version of instructions to the Schedule M-3 and the form itself. The form and instructions evolved in response to questions and comments submitted by tax practitioners, among others. Some questions regarding the new schedule remain unresolved, and additional questions are certain to be raised as corporations and tax preparers work with the form in its initial year. The IRS announced that it will create a page on its web site to address questions and discuss developments with regard to the Schedule M-3.

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Notable and Quotable


Congratulations to Senior Tax Accountant Molly Dong for earning her CPA credentials.

Audit Managers Adeline Lee and Harold Deiters from the firm's Litigation and Valuation Services Group are now both certified accredited business valuers ("ABV"). 

At a recent panel discussion that included both IRS officials and tax practitioners, the panelists agreed that completion of this new schedule places an additional burden on taxpayers and tax preparers. In an effort to reduce this burden in the initial year, the IRS reminded taxpayers that certain information on the Schedule M-3 does not have to be completed on 2004 tax returns; however, taxpayers still must make specific disclosure on the appropriate line items for book-tax differences on any of the approximately 70 income and expense items listed on the schedule.

Deborah M. Nolan, commissioner for the IRS Large and Midsize Business Division, conceded that the Schedule M-3 will be used as an audit selection tool. Nolan said that the Schedule M-3 will result in increased audit risk for some taxpayers and decreased risk for others.

One of the features of the Schedule M-3 that will help the IRS use it as an audit selection tool is the requirement that the taxpayer classify book-tax differences as permanent differences or temporary (i.e., timing) differences. The Service views permanent differences as presenting a greater audit risk than temporary differences. The Service also will use a materiality concept in selecting returns for examination.


The Internal Revenue Service intends to expand the Schedule M-3 to S corporations and to partnerships; therefore, owners of these entities should anticipate the obligation to file this schedule. 

CyberNotes

Investopedia.com

Check out this investor education site for help on understanding investment concepts. Investopedia defines a few thousand finance and investment terms. Terms are explained in such a way that even a beginner can understand. The dictionary is searchable by keyword, alphabet, or through 15 categories, such as Mutual Funds and Retirement Planning. Articles and Tutorials can be viewed based on investment style and level, including Beginners, Active Traders and Retirement. Keywords within articles are hyperlinked to definitions. Use the site as an investment primer, or bookmark it for the next time you're puzzled by an investment term.

Xap.com

Xap.com is a great college planning site offering planning timelines, test prep tools, school profiles and financial aid information. The site is full of campus pictures and information pertaining to what is important to the selection process at a particular school. Xap.com has a college matching wizard based on many factors including location, academics, sports, religious affiliation and frat life. Use the Financial Aid Wizard to become more familiar with funding available to you. Be sure not to miss all the great tips to save on tuition, like becoming a resident dorm adviser or using corporate tuition assistance. 

Can An Estate Deduct Interest On Loans That Also Benefited a QTIP Trust?

The IRS has ruled in favor of an estate taking a deduction for interest it paid on a loan that was used to pay for federal and state estate taxes. It was acceptable to the IRS even though the loan benefited a qualified terminable interest property ("QTIP") trust that was included in the estate.

FACTS:

Dan had established a revocable trust ("Trust") during his lifetime. Sarah, Dan's wife, predeceased him. Sarah left shares of common stock in a corporation ("Corporation") and other assets to Trust. Her executor made a QTIP election for the assets passing to Trust. As a result of the QTIP election, Sarah's estate claimed a marital deduction for the portion of Trust with respect to which the election was made.

Dan later passed away. His estate ("Estate") included stock in Corporation, other closely held business interests, and the portion of Trust that made up the QTIP. The QTIP election defers tax until the death of the second spouse when the property is included in that spouse's estate.

Because Dan's estate consisted mainly of closely held assets, it would not have been prudent for the executors to sell stock in Corporation to pay federal and state estate taxes. They decided instead to secure a commercial loan with the Estate and Trust as co-borrowers, to pay these taxes.


Dan's estate asked the IRS to rule that the interest be deductible as "administration expenses" since "such expenses were actually and necessarily incurred in the administration of the decedent's estate."

RULING:

IRS recognized that Estate and Trust were co-borrowers of the loans. As required by law and stated in the trust instrument, Estate would request contribution from QTIP (as part of Trust) for its share of estate taxes. Based on this information, the IRS ruled that interest on the loan to pay federal and state estate taxes was deductible as an administration expense, if it is determined that the loan was necessary for the administration of the estate. The ruling stated that it was expressing no opinion on whether or to what extent the loan was necessary for the administration of the estate. Note: The loan should be considered necessary for the administration of the estate because without it the stock in the corporation would have to be sold.

CAVEAT:

Taxpayers should consider requesting a

"Private Letter Ruling" when they want to know the tax consequences of their actions before they enter into them. Only the party who requests a private letter ruling can rely on what the IRS decides. 

COBRA Regulations For Medical Plans Notification


Final notices under the regulations concerning the contact and timing of the COBRA law allowing continuation of the coverage under group medical and dental plans have been issued by the Department of Labor. These regulations went into effect for plan years beginning after November 26, 2004.

They cover six types of notifications:

1. *Initial Notice* – must be provided to an employee and spouse within 90 days from first day of coverage. A sample notice is given which meets all the content requirements. This notice requirement can be satisfied by including the necessary information in the Summary Plan Description ("SPD"); however, in order to satisfy the spousal notification, merely delivering the SPD to the employee at work will not suffice.
2. *Election Notice* – must be provided to qualified beneficiaries by the plan administrator within 14 days of being notified of a "qualifying event."
3. *Notice of COBRA Unavailability* – must be provided by the plan administrator within 14 days and explain the reason for denial.
4. *Notice of Termination of COBRA Coverage* – must be provided by the plan administrator if the COBRA coverage expires prior to the maximum time period. This notice must be provided as soon as possible after the determination is made that the coverage will terminate.
5. *Qualified Beneficiary Notice* – Plans are required to establish reasonable procedures for individuals to use in notifying the plan administrator of qualifying COBRA events. If no procedures are developed, a written or oral statement from a beneficiary to those employees who are considered responsible for the administration of the plan will be sufficient.
6. *Notice of Qualifying Event* – requires the employer to notify the plan administrator when COBRA triggering events occur. These would include termination of employment, death, or reduction of hours or

Medicare entitlement. This notice must include information to allow the administrator to identify the plan, the employee, the date of the event and the type of event.

This is a summary of the new finalized regulations. The rules regarding COBRA are complicated and there are significant penalties for non-compliance. It is wise to consult with your adviser on these matters to avoid costly problems.


For more information on this critical subject, contact Mark Senders, CLU at Holtz Rubenstein Benefits Consulting, 631-752-7400, ext. 355, or msenders@holtzbenefits.com. 

New York City Real Property Tax Rebate

In a recent announcement, the Internal Revenue Service examines the treatment of a New York City real property tax rebate for Federal income tax purposes.

In July 2004, New York City established a program that provides for a rebate of real property taxes paid on certain residential property by homeowners. The amount of the rebate is \$400 or the property's annual tax liability, whichever is less. In the fall of 2004, New York City issued rebate checks to qualified homeowners.

For cash basis calendar year individual taxpayers, the Internal Revenue Service addressed how to handle the New York City rebate program. Generally, homeowners who receive a rebate of real property taxes that were deducted on a prior year's return must include the rebate in gross income in the year received to the extent of any Federal income tax benefit. Homeowners aren't required to include the rebate in gross income if the real estate taxes were not previously deducted. In either case, however, the rebate must be included in gross income to the extent it exceeds the taxes paid by the taxpayer.

Note: The same principles would apply to a refund of real estate taxes resulting from a tax certiorari (tax reduction) proceeding. 

Health Insurance Portability and Accountability Act

By Al Conti, MPA

As most health care providers know, there are three specific rules enacted under HIPAA, the Health Insurance Portability and Accountability Act of 1996 – the Transaction rule (originally to be implemented in October 2002 and delayed), the Privacy rule (implemented in April 2003) and the Security rule (to be implemented April 20, 2005).



Al Conti

The Privacy and Security rules have had the most impact on the public and providers. Both have many standards that interface as a result of the final rules.

What does this mean for individuals seeking health care services? Each individual receives from a health care provider a notice of privacy practices (NPP) that spells out the specific rights of the individual. These include:

- the right to request restrictions on certain uses and disclosures of information,
- the right to look at or get a copy of your health information,
- the right to request a list of certain types of disclosures of your information,
- the right to request a correction of existing information or add the missing information to your patient record,
- the right to complain if disclosure of information is made without proper authorization (Providers must obtain your written authorization before using your health information or sharing it with others), and

- the right to revoke this written authorization form at any time if the information has not been relied upon.

The healthcare provider (covered entity) has the right, as allowed by law, to utilize your health information without authorization for the following: treatment, payment, and operations; to comply with the law or to meet important public needs; to disclose completely or partially "de-identified" information; or incidental disclosures that may occur due to treatment, payment, and operations.


Health care providers should have the following in place:

- Established assignments of a Privacy Officer ("PO"), a Security Officer ("SO"), and documentations of such with job responsibilities.
- All staff, including volunteers and students, must be trained on HIPAA basics, with continued training programs and the orientation of new employees.
- Completed risk analyses for all three rules that highlight what is additionally required for compliance.
- Established policies, procedures, and forms either separately documented or interfaced with current operational manuals.

If you are a vendor that provides services and support to a health care provider, you must have a *Business Associate Agreement* ("BA") in place. A BA is a separate document, in addition to your contract with the health care provider, which says you will take all reasonable efforts to safeguard all health information you utilize, as would the covered entity. In addition, all BAs must implement administrative, physical, and technical


safeguards protecting the confidentiality, integrity, and availability of electronic protected health information ("EPHI").

So what should be the HIPAA New Year's resolutions for 2005? Be aware that covered entities must be in compliance with the Security rule by April 20, 2005. We suggest a review of existing processes related to HIPAA's Privacy and Security rules. The review should include the notice of privacy practices and acknowledgement of receipts, training, and documentation, physical and technical security, business associate agreements, and disclosures of protected health information.

Holtz Rubenstein Reminick has developed a new program that will allow you to review your implemented HIPAA processes. Our new program is called the **HIPAA Inquiry and Observation (I & O)** – a short discussion of existing HIPAA practices of selected areas of critical importance in protecting the Privacy and Security of Protected Health Information. To discuss the HIPAA I & O further, contact Senior Manager Al Conti at 631-752-7400 x-356 or AConti@hrrllp.com. 

Law Firm 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. The court ruled that these 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. 

Individual Retirement Accounts - An Updated Matrix

	Deductible IRA Contributions for 2004 and Future Years	Nondeductible IRA for 2004 and Future Years	Roth IRA	Nonworking Spouse IRA	Rollover of Existing Regular IRA to Roth IRA	Coverdell Education Savings Accounts (formerly Education IRA)
Adjusted gross income limit - single	\$45,000 for 2004, \$50,000 for 2005 and thereafter	No income limit	\$95,000 - Partial deduction available for adjusted gross income between \$95,000-\$110,000	N/A	\$100,000	Same as Roth IRA
Adjusted gross income limit - married	\$65,000 for 2004, \$70,000 for 2005, increasing to \$80,000 by 2007	No income limit	\$150,000 - Partial deduction available for adjusted gross income between \$150,000-\$160,000	\$150,000 - Partial deduction available for adjusted gross income between \$150,000-\$160,000	\$100,000	\$190,000 - Partial deduction available for adjusted gross income between \$190,000 - \$220,000
Maximum contribution	Cannot exceed the greater of earned income or \$3,000 for 2004, \$4,000 for 2005 through 2007 if under 50 years old; \$3,500 in 2004, \$4,500 in 2005, \$5,000 for 2006 and 2007, if 50 years old or older.	Same as Deductible IRAs.	Same as Deductible IRAs.	Same as Deductible IRAs.	N/A	\$2,000 per year, per child
Comments	Available to individuals not participating in an employer plan <u>or</u> single and married taxpayers whose adjusted gross income does not exceed the income limits even if they participate in employer sponsored plan. The contribution limits increase to \$5,000 by 2008 for individuals under 50 years old and to \$6,000 by 2008 for individuals 50 years old or older. Individuals with low or moderate incomes can claim a non-refundable credit, based upon contributions to their IRAs, not to exceed \$2,000. The credit is equal to an applicable percentage of their contribution (not to exceed 50%) based on an individual's filing status and modified adjusted gross income. The income limits are \$25,000 for single filers and \$50,000 for joint return filers. (This applies to Deductible and Nondeductible IRAs, Roth IRAs, and Nonworking Spouse IRAs.) The maximum credit amount is \$1,000.	Anyone can make non-deductible IRA contributions. Contribution limits increase the same as for Deductible IRAs	This is a non-deductible contribution. It must be designated as a Roth IRA at the time it is set up. Distributions of principal and built-up dividends, interest and capital gains are tax-free if certain specified conditions are met. Contribution limits increase the same as for Deductible IRAs.	Nonworking spouse can make contributions even if working spouse is a participant in an employer sponsored plan.	Existing IRA accounts can be "rolled over" to a Roth IRA. A personal Federal and State income tax is incurred on the amount of the rollover.	The IRA document must provide that: 1) All contributions must be in cash. 2) Contributions cannot be made after the beneficiary reaches age 18. 3) Annual contributions may not exceed \$2,000. Earnings on contributions will be distributed tax-free provided they are used to pay a beneficiary's post secondary education expenses. The funds also can be used to pay for public, private and religious elementary and secondary school expenses. When the beneficiary reaches age 30, any balance remaining in the account must be distributed within 30 days and the earnings portion will be includible in the beneficiary's gross income.

NOTE: In no case can contributions to an individual's various IRAs for the taxable year exceed the revised annual limits. However, contributions still can be made to a Coverdell Education Savings Account in addition to the amount made to all other IRAs.

Business Real Property Owners: It Is Not Too Late To Plan Now For Your 2004 Taxes

Note: If you act promptly, you can reduce last year's (2004) income tax expense.

Hidden within the walls, roof, plumbing, electrical system and many other aspects of your commercial (and residential) real estate are annual federal income tax savings just waiting to be discovered. Through a specialized depreciation procedure called "cost segregation," property owners who have built, purchased or renovated a building in the past several years have an opportunity to save significant tax dollars this year.

The principal goal of a cost segregation study is to increase cash flow from real property which was recently constructed or purchased (or inherited), as well as significant tenant leasehold improvements. This cash flow is attained by accelerating depreciation expense deductions and decreasing the property's overall taxable income.

Through this analysis, the components of a building are reclassified into proper class "lives" according to government legislation, case law and IRS revenue rulings. *For businesses that own or lease a facility, depreciation is one of the most significant, but often overlooked, opportunities to reduce income tax liability.*

DFK Firm Spotlight: DFK Mexico

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.

In this issue we spotlight the 15 Mexican DFK member firms. We invite you to visit them at www.dfk.com.mx/. 

The tax benefits resulting from a deferral of tax payment and accelerated depreciation are easily demonstrated. For example, for each million dollars that is reclassified from a 39-year life into a 7-year class life, the taxpayer realizes approximately \$230,000-\$310,000 in additional cash flow over the first five years. Also consider that for each million dollars that is reclassified into a 15-year class life, the taxpayer realizes approximately \$90,000 to \$232,000 in additional cash flow over the first five years. These examples demonstrate staggering tax benefits of which most commercial property owners are not taking advantage.

For commercial real estate constructed (or significant tenant improvements) and placed in service between September 11, 2001 and December 31, 2004, these savings are even greater as a 30-50% "bonus" depreciation deduction is available to all costs allocated through the study to these accelerated class lives (5-years, 7-years, and 15-years), providing a significant tax deduction up-front.


In the American Jobs Creation Act of 2004, leasehold improvements were classified to significantly shorter 15-year property life versus the previous 39-year recovery period classification. This change is significant for leasehold improvements placed in service between October 22, 2004 and December 31, 2004. Since the recovery period was shortened, the improvements qualify for a 50% bonus depreciation for this short period of time.

It is a common misconception that in order for a cost segregation study to be completed, the real property must be placed in service in the current tax year. Even older buildings qualify and often result in a significant tax deduction and an increase in cash flow.

Does this mean we would have also lost the opportunity to take this "bonus" expense for properties constructed since September 11, 2001? No, the IRS has provided a "catch-up" deduction for all depreciation not taken in previous years (including the bonus) in the current year's return by filing an automatic change in accounting method along with the tax returns in 2004.

In April 2004, the IRS issued an internal document titled *Cost Segregation Audit Techniques Guide* for the express purpose of assisting Internal Revenue Service examiners in the review and examination of cost segregation studies. The document defines a number of principal elements that auditors should look for in both the approach to the study itself (such as, how unit costs and engineering "take-offs" are determined), as well as the data and documentation that should be contained within the final report (such as, the engineering procedures utilized and a statement of assumptions and limiting conditions).

Cost segregation translates into valuable cash flow that can be used in important revenue-producing areas of your business, as opposed to unnecessarily putting tax dollars down the drain.

Holtz Rubenstein Reminick LLP has performed and implemented many cost segregation studies. Whether or not you are a client, we can help determine the potential tax benefits that a cost segregation study can provide for your real estate property. For more information, contact Tax Manager Joel Ackerman at (631) 752-7400 ext. 262 or JAckerman@hrrllp.com. 

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