

Holtz Rubenstein Reminick Sponsors an Evening with Dr. Hans Blix


Recently, Dr. Hans Blix, the former leader of the U.N. Monitoring, Verification and Inspection Commission that searched for weapons of mass destruction in Iraq, spoke to about 200 lawyers, educators and members of the general community at the Hilton Hotel (Long Island).



Hans Blix and
Partner Alan E. Weiner

Presented by the Suffolk County Bar Association and its Academy of Law, and co-sponsored as a public service by Holtz Rubenstein Reminick

LLP, Dr. Blix provided the audience with an unprecedented understanding of the inspectors' work in Iraq, their findings, and conclusions.

Dr. Blix also described his meetings with George W. Bush, Tony Blair, Jacques Chirac, Dick Cheney, Condolezza Rice, Colin Powell and Kofi Annan, offering a first-hand account of the tensions and drama of the months leading up to the invasion. 

Notable and Quotable

As tax season was winding down, two newspapers of note chose to avail themselves of the talent pool at Holtz Rubenstein Reminick. We refer to it as a "double Weiner treat." Partner **Howard Weiner** was quoted by the *Wall Street Journal*, as an expert in the field of auditing public companies, about the extensive reviews of accounting firms by the Public Company Accounting Oversight Board ("PCAOB"). The PCAOB was created under the 2002 Sarbanes-Oxley Act (commonly referred to as "SOX").

The other **Weiner** partner (**Alan**) was quoted on the same day in *Newsday* about big Long Island companies that don't pay taxes. The article focused on companies that are Real Estate Investment Trusts (commonly referred to as REITs) and companies with net operating tax loss carryforwards. In both cases cited by the reporter, Alan noted that "...these are a legitimate part of the tax law" and they "encourage investment."

Alan also was featured in *Newsday's* "Ask The Expert" about the favorable income tax benefits that can be derived from an increased income tax basis after the death of a joint owner. He also appeared in *Newsday's* special section for newlyweds; the "Achievements" and "Accolades" columns of *The Suffolk Lawyer* and *The Nassau Lawyer* newspapers; and the online edition

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2005-2006 New York State Budget Bill

The 2005-2006 New York State budget bill was signed into law in April by Governor George Pataki. Note that the next day, 2005 supplemental budget amendments were enacted, amending various provisions previously enacted as part of the 2005-2006 budget package. The following is a summary of the most significant provisions enacted:

Franchise Tax

Single Sales Factor Formula:

The current three-factor allocation formula comprised of property, payroll and a double-weighted sales factor that is applicable to corporations doing business in and outside New York State is transitioned to a single-sales factor formula over three years, beginning January 1, 2006. The sales factor will constitute 60% of the business allocation percentage for taxable years beginning after 2005, 80% for taxable years beginning after 2006, and 100% for taxable years beginning after 2007.

Note: The single sales factor, as a general rule, will not benefit the owners of "S" corporations or partnerships (including limited liability companies).

Small business tax rate:

For taxable years beginning after 2004, the tax rate applicable to small businesses is reduced from 6.85% to 6.5% and the income threshold for the special rate is increased from \$200,000 to \$290,000.

Note: For "S" corporations, the tax on taxable income does not apply for tax years beginning in 2003, 2004 and 2005. An "S" corporation pays a fixed dollar minimum, based on its gross payroll, ranging from \$100 to \$10,000. However, for tax years beginning after 2005, "S" corporations will pay the higher of a tax on taxable income or the fixed dollar minimum tax, based on its gross payroll, ranging from \$100 to \$1,500.

Capital base maximum tax:

For the corporate franchise tax capital base, effective for taxable years beginning after 2004, the maximum tax amount is increased from \$350,000 to \$1 million for all taxpayers other than manufacturers.

Personal Income Tax

Surcharge Phaseout:

The temporary tax rate increases

enacted in 2003 will expire as scheduled by the end of 2005.

Sales and Use Tax

Clothing and Footwear:

The sales tax on clothing and footwear for items costing less than \$110 is continued through March 31, 2006.

Note: Two 1-week holiday periods (August 30, 2005 to September 5, 2005 and January 30, 2006 to February 5, 2006) are established for eligible items costing less than \$110.

Localities have the option as to whether or not to participate in the statewide exemption. Nassau County, for example, has not participated in prior sales tax holidays.

Note that temporary sales tax suspensions have a way of becoming permanent via continuing postponements.

Tax Rates:

A temporary sales tax rate increase of 1/4% enacted in 2003 is allowed to expire on May 31, 2005 as originally scheduled. However, effective June 1, 2005, the legislation increases the additional Metropolitan Commuter Transportation District ("MCTD") sales tax rate from 1/4% to 3/8%. The New York State sales tax, when combined with the MCTD tax and local tax, will result in tax rates of 8.625% for both Nassau and Suffolk counties and 8.5% for New York City.

Credits

Emerging Technology:

The legislation establishes a new credit program for qualified emerging technology company facilities, operations, and training. Applicable to taxable years beginning after 2004, eligible taxpayers may qualify for a refundable credit with respect to certain research and development property, research expenses, and high technology training expenditures. The value of the credits may not exceed \$250,000 per eligible taxpayer per year.

Low-Income Housing Credit:


The annual limit of the aggregate amount of the credit available for the construction or rehabilitation of low-

CyberNotes

Careguide.com

Use this site to find useful information to help you make better decisions regarding your elderly loved ones. Take the "CareGuide Assessment" to tailor article selection, providing those that apply to your particular situation on housing, health, finance and more. Read about everything from assisted living to safe household design. You can also get helpful checklists in the "Living Alternatives" section to make a comparison between hospice facilities.

PetEducation.com

This site contains a comprehensive collection of in-depth articles written by veterinary professionals. Topics range from what to do if a power outage shorts your home aquarium (*Be sure to download and read BEFORE an outage!*) to obedience training for your dog. Browse by animal type, including small pets, reptiles and ferrets. You can also check the "Resources" section for non-technical descriptions of veterinary procedures, abbreviations, drugs and alternative medicines. 

income housing buildings is increased from \$6 million to \$8 million.

Miscellaneous

LLC/LLP Filing Fees:

In 2003, the state increased filing fees for Limited Liability Companies ("LLCs") and Limited Liability Partnerships ("LLPs") from \$50 to \$100 per member or partner, with a minimum fee of \$500 and a maximum of \$25,000. The legislation continues these increases (which were applicable for 2003 and 2004) through 2006, and continues to impose a filing fee of \$100 on single-member LLC ("SMLLC") filers.

Empire Zones:

The legislation allows for 12 additional empire zones and extends the sunset date for the empire zone program from March 31, 2005, until June 30, 2011.

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

New Electronic Filing Requirements for Large Corporations and Tax-Exempt Organizations

The IRS has released new regulations that require certain large corporations and tax-exempt organizations to electronically file their income tax or annual information returns beginning tax year 2005, due in 2006. These electronic filing requirements only apply to entities that file at least 250 returns during a calendar year, including income tax, excise tax, information and employment tax returns.

Example: A corporation that must file 100 Forms W-2, 146 Forms 1099-DIV, a Form 940 (Annual FUTA Return), four Forms 941 (Quarterly Federal Tax Returns) and a Form 1120 (C Corporation Income Tax Return) is over the 250 return limit by two returns.

For 2005 returns due in 2006, corporations with total assets of \$50 million or more must file their Forms 1120 and 1120S (S Corporation Income Tax Return) electronically. In addition, tax-exempt organizations with total assets of \$100 million or more will be required to file their 2005 Form 990 (Return of Organization Exempt from Income Tax) electronically.

For 2006 returns due in 2007, all corporations and tax-exempt organizations with \$10 million or more in assets will need to file their tax returns electronically. In addition, private foundations and charitable trusts will be required to electronically file their 2006 Form 990-PF (Return of Private Foundation) regardless of size.

For e-filing purposes, an entity's assets are determined based on total assets at the end of the tax year as reported on its Form 1120, 1120S or 990.

For more information, please contact Tax Partner Tim Mulcahy at 631-752-7400 x-325 or TMulcahy@hrrllp.com. 

Are You a New York State (or City) Resident?

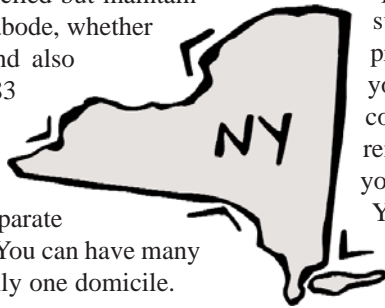
This is more of a complicated question than you may think.

Note: Although this article will focus on New York State (City), the same principles apply for all states.

You are deemed to be a resident of New York State if you are domiciled in the State or if you are not domiciled but maintain a permanent place of abode, whether or not you own it, and also spend more than 183 days of the taxable year in the State. Residency and domicile are two separate and distinct concepts. You can have many places of abode but only one domicile.

Domicile is determined by your intention to make the State your "true" home. To determine this intent, the State looks at such factors as to how much time

you spend in New York; where you vote; have your car registered; maintain bank accounts; club memberships; where mail is received; and where you seek professional services. The State also will look at the size and value of your dwelling in New York versus the size of your dwelling outside the State; where you keep your artwork, collectibles and other "near and dear" items; as well as your business and family ties to the State. All of these factors are important but not conclusive, as the question of your intentions, is subjective. The burden of proof is upon you to evidence your non-domiciliary status as convincingly as possible. And remember, if the State classifies you as being domiciled in New York, the number of days that you are in New York during the year (unlike what follows below) doesn't matter – you are taxed on all of your income.



You will be considered a "statutory resident" if you maintain (that is, own,

rent, or have use of) a permanent place of abode in New York and spend more than 183 days in the State during the taxable year. You are considered to have spent a day in the State if you are physically present for any part of the day. An exception is made for a day in New York that is related to travel by airplane, train, bus, or continuing travel through the State that started outside the State and will go to a point outside the State.

The burden of proof, as to whether you were or were not in the State (and/or City) on any day is on you. You must prove to the State that you were not in the State on any day that you say you were not in the State. The New York State tax returns, for both residents and non-residents, each ask whether you have a place of abode in New York State or New York City. Excellent records as to your whereabouts for every day of the year must be maintained. Included in the items that the State will review to determine your whereabouts are credit card Statements; EZ Pass charges; and frequent flyer statements.

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Extension of Deadlines for Smaller Public Companies and Foreign Private Issuers

By George Victor, CPA

Recently the Securities and Exchange Commission announced that smaller public companies (“non-accelerated filers”) and foreign private issuers have been granted additional time to comply with the requirements of the Sarbanes-Oxley Act of 2002 under Section 302 - *Certification of Disclosure in Companies’ Quarterly and Annual Reports*, and Section 404 - *Management’s Report On Internal Control Over Financial Reporting and Certification of Disclosure In Exchange Act Periodic Reports*.



George Victor

New Compliance Requirement Dates

Under the delayed compliance requirements, these entities must begin to comply with the financial reporting internal control requirements for the first fiscal year ending on or after July 15, 2006. This represents a one-year extension from the previous compliance date of July 15, 2005.

The reason for this extension was to offer temporary relief for smaller public companies that had concerns about the significant burdens and additional cost associated with complying with the new rules. In addition, foreign companies faced additional challenges in preparing financial statements following international accounting standards.

New Initiatives from the Securities and Exchange Commission

In conjunction with the extended deadline, two initiatives from the SEC currently are underway. First, the SEC has established an Advisory Committee on Smaller Public Companies to assist the SEC in evaluating the current securities regulatory system relating to smaller public companies, including the internal control requirements.

Second, the Committee on Sponsoring Organizations (“COSO”) has established a task force to expand the existing COSO framework and provide more guidance on how it can be applied to smaller companies. It intends to publish these guidelines this summer.

COSO is a framework for internal control that is widely recognized in the United States. Many persons involved in Section 404 will be looking forward to the expanded framework and hope that COSO offers some practical guidance to the implementation of Section 404.

Importance of Planning for Compliance Effectively and on a Timely Basis

Section 404 is one of the most critical components for compliance with the Sarbanes-Oxley Act and, in general, has been found by many to be the most onerous. Companies need to devote the necessary resources to ensure that appropriate internal controls over financial reporting are properly implemented and operating effectively.

What Your Company Should Be Doing Now


Companies should use this extension of time to make a critical assessment of their internal control systems and implement the necessary changes to ensure compliance with Section 404 requirements. In addition, it is important to plan this project timely to ensure that a sufficient window of time is available for the Company’s independent auditor to examine the internal control system, evaluate its effectiveness and issue an opinion.

What Should Be Done If Problems Are Found – Remediation Strategy

In instances where an internal control system is ineffective, sufficient time should be planned for remediation, to ensure that controls are effective for the period examined by the independent auditor. Remediation is the process whereby management may correct deficiencies identified in the evaluation process, or implement new controls in cases where insufficient or no controls existed. Remediation, however, must be completed *prior* to the independent auditor’s report date, and must allow sufficient time for the independent auditor

Did You Notice? Apostrophes in Absentia


Where did all the apostrophes go? That’s the question that we had when we saw the March/April *HRR Adviser* that you received. It certainly was not what we approved when we okayed the print edition.

The printer has apologized profusely and corrected it for the web edition of that *Adviser*. So, if you would like to see the missing apostrophes, go to www.hrrllp.com and click on Firm News. 

to assess the design and operation effectiveness of the internal controls.

Coordinating Compliance Work With Your Independent Auditor and Outside Consultants

It is important that the entire process relating to Section 404 compliance be carefully coordinated with the company’s management, independent auditors and outside consultants. This is even more critical if problems are detected and an action plan needs to be formulated. The recent extension affords companies the opportunity of time to address those matters. Companies should take advantage of the additional time afforded by the SEC extension in order to effectively plan for compliance and coordinate these efforts with their independent auditor and outside consultants.

For questions you have regarding this extension or for information regarding compliance with SEC or Sarbanes-Oxley requirements, please contact George Victor at (212) 792-4867 or GVictor@hrrllp.com. 

2005 Depreciation Limits and Auto Lease Inclusion Amounts

The IRS has issued dollar limits and new lease income inclusion tables for business automobile, light truck, and van depreciation. These amounts are based on prior year numbers that are adjusted annually for inflation. But before we discuss these limitation and inclusion amounts, let's recap the depreciation rules for business use vehicles.

Generally, the tax law states that any passenger automobile costing more than a certain amount is subject to "dollar caps," more commonly called the luxury-auto limitation. Put simply, the annual depreciation deduction for these vehicles will be limited. Surprisingly, the 2005 definition for luxury is set at a dollar amount of \$14,800 – a far cry from what the auto industry would consider luxury. However, the exception to this rule is when the vehicle weighs more than 6,000 pounds fully loaded (including passengers and cargo).

The IRS has two separate sets of depreciation dollar limits for the 2005 year that are applicable for non-electric vehicles. One is for light trucks and vans (passenger vehicles that are built on a truck chassis including sport-utility vehicles [SUVs] and minivans) and the other is for passenger vehicles that are not light trucks and vans.

For annual Depreciation limits, see the table below:

	For 2005	For the second tax year	For the third tax year	For each succeeding year
Automobiles	\$2,960	\$4,700	\$2,850	\$1,675
Light trucks and vans (weighing less than 6,000 pounds)	\$3,260	\$5,200	\$3,150	\$1,870

Expensing


As mentioned earlier, light trucks and vans with a gross vehicle weight of more than 6,000 pounds are exempt from the luxury auto limitations. If the vehicle is used 100% for business purposes, that vehicle may be accounted for under an expensing election as opposed to being capitalized. Generally, for property placed in service during 2005, the maximum "expensing deduction" is \$105,000. However, heavy SUVs (over 6,000 but not over 14,000 lbs) placed in service after October 22, 2004 are subject to a \$25,000 limit on the amount that may be expensed.

Taxpayers should be forewarned about this expensing election when it comes to SUVs. New York State has decoupled from Federal law in this area and requires any amount of SUV depreciation taken under the expensing election to be added back when preparing the New York State tax returns. The problem is that once the amount has been added back for New York State purposes, it is lost forever and the taxpayer will never get the benefit of that deduction. The practical effect of claiming the maximum expensing election is that it will cost the taxpayer additional New York State income taxes, after a Federal income tax benefit from deducting the taxes, of approximately \$1,300.

Note: For corporations, partnerships and individuals, New York City also has decoupled from Federal law. However, upon sale of the SUV, the gain or loss will be adjusted to reflect the limited deductions allowed for city purposes.

Leasing


Taxpayers who lease automobiles for business purposes may deduct a portion of the lease payments based on the business use percentage of the automobile. The taxpayer may deduct the entire cost of the lease if the vehicle is used 100% for business purposes. So that taxpayers who lease vehicles do not escape the luxury automobile limitations, they must include a certain amount in income each year from the auto lease inclusion tables. These amounts are based on the fair market value of the leased vehicle and are adjusted for inflation annually. The auto lease inclusion tables do not apply if the fair market value of the automobile is less than \$15,200 (\$16,700 for light trucks and SUVs).

Navigating the maze of rules that surround the depreciation of business automobiles, light trucks, and vans can be complex. If you need assistance in determining how to depreciate your vehicle or would like to discuss planning opportunities, contact Senior Tax Manager Sid Leibowitz at 631-752-7400 x-265 or SLeibowitz@hrrllp.com. 

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Are You a New York State (or City) Resident?

The effect of a domicile or residency determination is that you will be taxed on all of your federal income, no matter what its source and no matter where it is earned, as opposed to being a non-resident with New York "source" (generally income from wages, business investments, or rents) income, where New York only would tax you on that source income. For those with a place of abode in New York City and another place of abode in New York State but outside of New York City, these same rules apply when determining whether you are a New York City domicile or resident.


For more information, contact Tax Partner Susan Teicher at 212-697-6900, x-890 or STeicher@hrrllp.com. 

Husband and Wife Team Plead Guilty to Tax Fraud

A husband and wife operated a scaffolding company and were charged with \$2.9 million dollars in payroll fraud and multiple counts of mail fraud. The wife also faces charges of signing false tax returns.

The couple pled guilty to paying the employees in cash and concealing payments from the Internal Revenue Service. From 1997 to 2003, the couple paid its employees at least \$2.9 million dollars in unreported wages. The couple also provided workers compensation insurance companies with fraudulent payroll records and forged copies of tax returns reporting lower wages than the already fraudulent wages reported to the IRS. They also omitted workers and understated other workers' hours in monthly payroll reports that were provided to the administrators of the Laborers' Union Trust Funds.

When sentenced the couple could face up to five years in prison each and the wife an additional three years for signing the false tax returns.

Moral: The IRS is especially unforgiving when it comes to payroll matters. 

Bad News, Good News for Taxpayers Seeking to Deduct Legal Fees

In the current litigation climate, it is not at all uncommon for a jury to award a multimillion dollar verdict to a plaintiff. Defendants seeking to avoid such verdicts frequently will settle a case for a substantial amount. In either circumstance, a significant portion of the plaintiff's award will go to the attorney who pursued the litigation on his behalf. The tax treatment of these attorney fees has been a subject of controversy.

To see why, consider the following example: In a product liability action, plaintiff receives an award (or a settlement) of \$3 million, of which \$1 million goes to the attorney, leaving the plaintiff with \$2 million.

On the above facts, taxpayers have argued that they received gross income of only \$2 million, because the agreement between the plaintiff and the attorney meant that only \$2 million vested in the plaintiff, and the remaining \$1 million was the property of the attorney. Some states go so far as to provide that the attorney in such a situation has a property right in the amount received from the defendant.

The IRS has argued that the taxpayer has \$3 million of gross income and that the \$1 million attorney fee is an expense incurred to produce that income. Under this approach, the attorney fee is treated as an itemized deduction, and is subject to various limitations, discussed below.

Here's why it matters. If the taxpayer is correct, he has \$2 million of taxable income, a level that brings him well into the 35% maximum tax bracket. Assuming no other income or deductions, the taxpayer has a

\$700,000 tax liability and is left with \$1.3 million.

If the IRS is correct, the taxpayer has \$3 million of gross income, and has a \$1 million miscellaneous itemized deduction. Because miscellaneous itemized deductions are allowable only to the extent that they exceed 2% of an individual's adjusted gross income (AGI), only \$940,000 of the legal fee is allowed as a potential itemized deduction (i.e., the amount in excess of \$60,000, or 2% of AGI of \$3 million). Next, itemized deductions are reduced by 3% of the taxpayer's AGI in excess of \$142,700, resulting in a further disallowance of \$85,719, and a net allowable deduction of only \$854,281. Therefore, the taxpayer is left with taxable income of \$2,145,719. Applying the same 35% tax rate as in the previous example, the tax liability is \$751,002.

But things get worse. For purposes of the alternative minimum tax ("AMT"), itemized deductions are disallowed in full. Therefore, the entire \$3 million of gross income would be subject to tax at the 28% AMT rate, resulting in a tax liability of \$840,000, or \$140,000 greater than the liability that arises if the attorney's fee is excluded from the taxpayer's gross income.


Note: In a high tax state such as New York, it gets "more worse" since the state (and city, if applicable) income taxes that are paid on the award are not tax deductible for AMT purposes.

Several circuit courts had addressed the issue and a split had developed among the circuits. The Second Circuit Court, which covers New York, agreed with the IRS position, holding that the entire attorney's fee is includable in the taxpayer's adjusted gross income.

Rather than leave the resolution of the matter entirely to the Supreme Court, Congress passed legislation holding that certain attorney's fees are deductible even by taxpayers who do not itemize deductions. While this provision is favorable to taxpayers, it only applies to fees paid after October 22, 2004, the date that the legislation was signed by President Bush. In addition, the new law only applies to attorney fees paid in connection with a claim of unlawful discrimination, a claim against the United States government or a claim under a specific provision of the Social

Security Act. Legal fees paid in connection with a wide variety of claims are unaffected by the 2004 law.

That left the Supreme Court to speak up, and it did so in January. Reversing the decision of two Courts of Appeal, the Supreme Court held as a general rule, when a litigant's recovery constitutes income, the litigant's income includes the portion of the recovery paid to the attorney as a contingent fee. Although the court refused to address certain arguments that the taxpayer raised, based on technical grounds, the decision essentially resolves the issue. Absent further legislation from Congress, a taxpayer who prevails in a lawsuit, other than one of the types covered by the 2004 legislation, could incur a substantial alternative minimum tax liability because the entire recovery, without reduction for attorney fees, will be subject to the alternative minimum tax.


For information, contact Senior Tax Manager Barry Nagler at (631) 752-7400 x-354. 

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Notable and Quotable

of *Business Week* regarding the New York State Sales Tax.

Tax Manager **Joel Ackerman** is becoming his own speakers bureau. He, along with Partner **Arnie Haskell**, recently discussed the tax benefits of *cost segregation studies* to groups including AG Edwards brokerage company, the Suffolk County Bar Association, and Citibank.

The staff and partners of the firm magnanimously purchased 77 boxes of Girl Scout cookies for US troops in Afghanistan, Kuwait and Iraq. The firm generously agreed to pay the shipping costs. 

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

DFK Firm Spotlight: DFK Canada

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 the 14 Canadian DFK member firms. We invite you to visit them at www.dfk.ca. 