Worldwide Representation by DFK INTERNATIONAL

HOLTZ RUBENSTEIN REMINICK adviser

• November/December 2004 •

Superior Thinking. Unmatched Integrity.

American Jobs Creation Act of 2004

Highlighted over the next few pages of this expanded version of the HRR *Adviser* are some of the key provisions of the American Jobs Creation Act of 2004, signed by President Bush this fall.

Tip: Pay attention to effective dates, some of which may affect your tax picture for 2004, and read our "Tips."

Repeal of the Extraterritorial Income Exclusion

In November 2000, in response to pressure from the World Trade Organization ("WTO"), the U.S. Congress repealed the tax regime of the foreign sales corporation ("FSC") which provided tax benefits to U.S. exporters; however, it immediately was replaced with a new concept that excluded what became known as "foreign extraterritorial income" from taxable income and provided tax benefits at least equal to the former FSC regime. It also expanded the applicability of the new exclusion to individuals and flow-through entities, which previously were prohibited from obtaining benefits from the use of foreign sales corporations.

In August 2001, the WTO issued a final report that concluded that the extraterritorial income provisions were not in compliance with certain WTO trade agreements. On January 14, 2002, an appeal by the U.S. was denied and the WTO ruled that the extraterritorial income provisions amounted to an illegal trade subsidy and threatened to impose sanctions on the U.S. It subsequently ruled that the European Union ("EU") was entitled to impose over $4 billion a year in trade sanctions against the U.S.

In March 2004, the EU began imposing an additional tariff of 5% on a list of more than 1,600 U.S. exports with an aggregate value of approximately $4 billion. The retaliatory tariff escalates automatically by 1% per month until it reaches 17% by March 2005. By the time Congress passed the act, the sanctions had risen to 12% on affected U.S. exports.

Accordingly, this act repeals the controversial extraterritorial income regime generally for transactions occurring after December 31, 2004. The act does, however, provide a two-year transition period. For transactions in 2005, an 80% extraterritorial income ("ETI") deduction would be available and for

(continued on page 2)

This Issue

- American Jobs Creation Act of 2004
- *CyberNotes:* Tipping.org, WackyUses.com
- New Benefit and Contribution Ceilings in 2005
- A Bah Hambug Before the Holidays
- Social Security Update – 2005
- *The Adviser Corner:* What Is Your Business Worth? Signs That You Need a Business Valuation
- Working Families Tax Relief Act of 2004
- Save the Date! What is Your Business Worth?
- New Jersey Limits Net Operating Loss Deductions
- Year-End Tax Strategy – Investment Timing Decisions
- Gifts to Family Members
- *DFK Firm Spotlight:* Geffen Mesher & Co., P.C.

Notable and Quotable

Fresh from his election to the board of the Huntington Chamber of Commerce, Partner **Neil Geschwind** now is serving on its Finance Committee. In addition, Neil has been elected Executive Vice President of Congregation Beth-El in Massapequa, where he will take over as president in the spring.

International auditing standards and paperless auditing were the main topics at the DFK Latin American meeting held in Antigua, Guatemala. Partner **Alan E. Weiner**, who serves as Vice President of the Americas for DFK International, represented DFK in that capacity. DFK International is the prestigous worldwide association of independent accounting firms.

Although the meeting was conducted in Spanish, many attendees are bi-lingual and were gracious in translating the proceedings to Alan.

Many of our staff have been out on the road, speaking in various capacities:

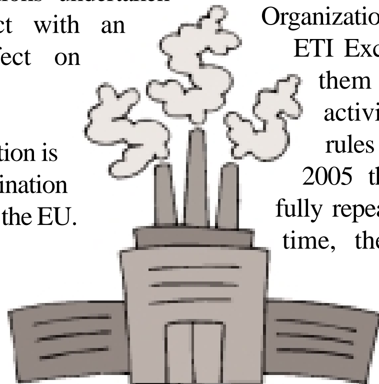
- The firm's annual not-for-profit fiscal workshop was well attended. Partner **Gordon Siess** discussed preventing fraud; Partner **Beatrix McKane** gave an IRS and governmental update; Senior Manager **Patrick Yu** reviewed the responsibilities of audit committees; Senior Manager **Ellen Labita** went over common errors in endowments and revenue; and Holtz Rubenstein Benefits Consulting President **Mark**

(continued on page 8)

(continued from page 1)

American Jobs Creation Act of 2004

transactions in 2006, a 60% deduction is available. The act also provides for a "binding contract" rule whereby ETI benefits would be fully available for transactions undertaken under a binding contract with an unrelated person in effect on September 17, 2003.



Enactment of this legislation is expected to lead to the termination of the sanctions instituted by the EU. Since the EU must affirmatively act to remove the tariffs, the exact timing of a response from the EU is not certain.

Congressional leaders believe the new legislation is in compliance with WTO guidelines and will not be challenged by the EU; however, on November 5, the EU, through the WTO, requested consultations with the United States over the transitional and grandfathering provisions of the new law. EU Trade Commissioner Pascal Lamy has said that the EU would challenge the new law's transitional rules and its grandfathered contracts. He did, however, welcome the repeal of the extraterritorial income exclusion regime and promised to lift the ETI sanctions effective January 1, 2005.

Manufacturing Activity Deduction

In response to the imposition of sanctions on U.S. products by the World Trade Organization, Congress repealed the ETI Exclusion Rules and replaced them with a manufacturing activity deduction. The ETI rules will be phased out from 2005 through 2006 and will be fully repealed in 2007. At the same time, the manufacturing activity deduction will be phased in from 2005 through 2009 and will be fully effective in 2010.

Qualified taxpayers including C corporations, S corporations, partnerships, individuals, estates, and trusts, will be eligible to deduct 3% of the lesser of the taxpayer's taxable income (adjusted gross income for individuals) or "qualified production activities" income for 2005 and 2006. For 2007 through 2009, the deduction will be 6%. For 2010 and thereafter, the deduction will be 9%. The deduction cannot exceed 50% of the W-2 wages paid by the taxpayer as an employer during the tax year. The deduction also is allowed for Alternative Minimum Tax purposes.

"Qualified production activities" income is the taxpayer's domestic production gross receipts less the related cost of goods sold, other deductions, expenses, and losses directly related, and an allocable portion of other deductions, expenses, and losses which are not directly related to production gross receipts.

Domestic production gross receipts are receipts derived from any sale, exchange, lease, rental, license, or other disposition of qualified property that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States. It also includes any qualified film or video produced by the taxpayer as long as it is not pornographic (not defined) and at least 50% of the total compensation relating to the film production is for services performed in the United States. Also included is the sale, exchange, lease, rental, license or other disposition of electricity, natural gas, or potable water produced by the taxpayer within the United States. Construction performed in the United States and engineering or architectural services performed in the United States for construction in the United States qualify as domestic production gross receipts.

Tip: It should be noted that this provision would benefit, in addition to manufacturing companies, other businesses, such as builders and contractors in the real estate industry.

Excluded from domestic production gross receipts is the sale of food and beverages prepared by the taxpayer at a retail establishment; the transmission of electricity, natural gas, or potable water; and property leased, licensed or rented for use by a related person.

For pass-through entities including partnerships, S corporations, estates, and trusts, the deduction is generally applied at the partner, shareholder or beneficiary level.

Depreciation Provisions: *Section 179 Changes*

Under current law, the maximum amount a taxpayer can deduct for property placed in service under Section 179, is $100,000. This deduction is phased-out for

CyberNotes

Tipping.org

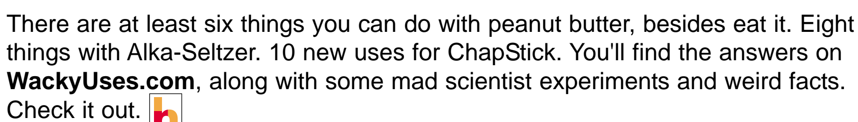
You give tips all the time -- at restaurants, in taxicabs, etc. The holidays are a particularly busy time, because of end-of-the-year tipping -- to your mailman, garbage collectors, paperboy, etc. How do you know how much to tip?

Tipping.org takes away the guesswork for you. The website gives guidelines, for the United States and internationally, on proper tipping amounts.

Tipping.org advises that during the holidays you tip your babysitter two nights' pay; tip your cleaning person at least a week's pay; day care workers should get $15 - $25 and a gift; and although government agencies prohibit employees from receiving money as a gift or gratuity, the U.S. Postal Service does allow people to be nice during the holidays and asks that holiday tips have a cash value of no more than $20 and a letter of appreciation to the supervisor.

By the way, the word TIP is considered by many to be an acronym: T.I.P. - "To Insure Promptness" or "To Insure Prompt" service

WackyUses.com



There are at least six things you can do with peanut butter, besides eat it. Eight things with Alka-Seltzer. 10 new uses for ChapStick. You'll find the answers on **WackyUses.com**, along with some mad scientist experiments and weird facts. Check it out.

property purchased in excess of $400,000 during a taxable year. For 2004, the maximum expensing amount has been increased to $102,000 and the phase-out threshold has been increased to $410,000 due to inflation.

This provision was set to expire for tax periods ending after December 31, 2005. The Act has extended the provision for an additional two years (tax years beginning in 2006 and 2007). The Act also extended through 2007, the allowance for "off-the-shelf computer software" as qualifying Section 179 property.

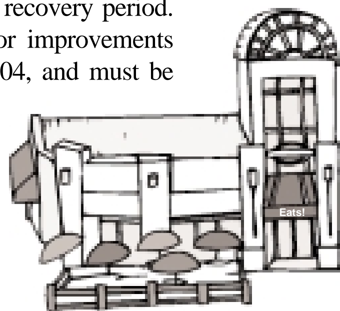
Effective for property place in service after October 22, 2004, a taxpayer can deduct the first $25,000 (down from $100,000) of any sport utility vehicle (SUV) only if it weighs 14,000 pounds or less and a gross vehicle weight of more than 6,000 pounds. These vehicles must be used primarily in a trade or business (for more than 50% of the time). Any cost in excess of $25,000 for the SUV must be depreciated under the general depreciation rules.

Tip: Under New York State law, a taxpayer never gets a tax benefit if the SUV expensing election is made for Federal purposes. This weighs against taking advantage of the Federal expensing election.

Leasehold Improvements

The Act reduces the recovery period for qualified leasehold improvement property and qualified restaurant property from 39 years to 15 years. This brings the recovery periods for such improvements closer to a more realistic period for a tenant's lease term. Property must be depreciated on a straight-line basis over the 15-year recovery period. This change is effective for improvements made after October 22, 2004, and must be placed in service before January 1, 2006.

Tip: For property placed in service on or after January 1, 2006, the recovery period is 39 years.



"Qualifying leasehold improvement property" is defined as any improvement made to an interior portion of a nonresidential building provided that:

a. the improvement is made subject to a lease,
b. the improved portion of the building will be occupied exclusively by the lessee (or sub lessee),
c. the improvement must be placed in service more than three years after the building has been occupied and first placed in service (by any person, not necessarily the taxpayer).

Tip: Leasehold improvements in new buildings are subject to a 39-year amortization period because it doesn't meet to 3-year use agreement.

Improvements that contribute to the enlargement of the building, improvements to an elevator or escalator, any structural component benefiting a common area, or any changes to the internal structural framework of the building do not qualify as qualifying leasehold property.

Tip: If the lessor makes qualifying improvements to the property, a subsequent owner of the improvement (by purchase of the building) will not qualify for the reduced recovery period; however, if a Cost Segregation Study is performed when the new owner takes title, there could be a significant tax savings opportunity by having a proper building cost allocation made to the 5-year or 7-year recovery periods, rather than to the 39-year recovery period for building costs.

Note: If you think that you might be eligible for increased current depreciation on property owned by you (no matter when purchased) or on a future acquisition, contact Partner Arnold Haskell, or Manager Joel Ackerman, at 631-752-7400 to discuss a cost segregation study.

"Qualified restaurant property" is any improvement attached to a building if the improvement is placed in service more than three years after the building was first placed in service and more than 50 percent of the building's square footage is used for the preparation of meals or the on-site consumption of such meals. Thus, "qualified restaurant property" must meet requirements that are fewer than those mentioned above for "qualified leasehold improvement property." Additionally, the owner of the property can claim the deduction.

Amortization of Start-up and Organizational Expenses

Under current law, expenses incurred to start-up or legally organize a corporation or partnership (including a limited liability company) were allowed to be deducted ratably over 5 years from the date the business started. The Act provides that a corporation or partnership may elect to deduct up to $5,000 of these expenses paid or incurred after October 22, 2004 in the tax year in which the trade or business begins. The $5,000 allowance is reduced by expenditures incurred exceeding $50,000. The remainder of any start-up expenditures is deductible ratable over 15 years (or 180 months), starting in the month the business started.

This provision benefits small businesses whose organizational expenses are $5,000 or less. Larger start-up companies now will be required to amortize most or all of these expenses over 15 years rather than the prior 5-year amortization period.

Start-up expenses incurred on or before October 22, 2004 qualifies for the 60-month amortization; however, the $50,000 phase-out, as mentioned above, is inclusive of all expenses paid during the 2004 calendar year.

S-Corporation Provisions

The Act included several new provisions relating to S corporations:

For years beginning after December 31, 2004, the number of eligible shareholders has been increased from the current 75 to 100 and further provided an election, whereby a family can elect to treat up to six generations of family members as one shareholder.

In addition, for years beginning after December 31, 2004, unused losses due to basis limitations can be transferred to a spouse or former spouse in a tax-free transfer incident to divorce. Previously, these unused S corporation losses were lost forever.

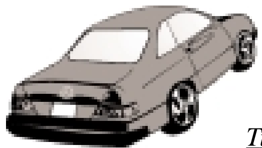
(continued on page 4)

(continued from page 3)
American Jobs Creation Act of 2004

Charitable Contributions

Charitable Donations of Vehicles

Taxpayers must obtain a contemporaneous written acknowledgement for donations of qualified vehicles, including cars, boats, and aircraft that have a claimed value of over $500. If the donee organization sells the vehicle without any significant intervening use or material improvement, the taxpayer's charitable deduction is limited to the gross proceeds received by the charitable organization upon subsequent sale of the vehicle. This is effective for contributions made after December 31, 2004.



Tip: Contributions of vehicles by December 31, 2004 are subject to the current, less restrictive rules.

Non-cash Contributions

"C" corporations that contribute non-cash property exceeding $5,000 now are required to obtain a qualified appraisal for that property. Under current law, this was already required for individuals, partnerships, "S" corporations and other entities. Also, for any contributions of non-cash property exceeding $500,000, the individual, partnership or corporation is required to attach the appraisal to their tax return. This is effective retroactively for contributions made after June 3, 2004.

Tip: It may be advisable to attach the appraisal to the taxpayer's tax return for any significant contribution, even if the attachment is not required.

Donations of Intellectual Property

For donations of patents, copyrights, trademarks and other intellectual property, the amount of the initial charitable deduction is now limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property. The taxpayer also may receive an additional deduction in the year of contribution or later tax years based on a sliding-scale percentage of the revenue received or accrued by the charitable donee in excess of the initial deduction, with respect to the contributed property. This is effective retroactively for contributions made after June 3, 2004.

Executive Compensation

The new tax act will significantly change the tax treatment of deferred compensation. These changes affect:

a. Non-qualified stock options
b. Stock appreciation rights
c. Phantom stock plans
d. Bonus plans that allow the bonus to be paid after it is earned
e. Employment contracts that allow for salary to be paid after it is earned

Tip: Most deferred compensation plans will need to be revised.

The new law will impose current taxation on deferred compensation or, if later, at the time the compensation is no longer subject to a "substantial risk of forfeiture" if the plan does not comply with the new requirements with respect to distributions, accelerated benefits and elections.

The law provides for a broad definition of deferred compensation. It eliminates the executive's ability to choose to draw the compensation (or exercise the stock option) at any time. The ability to protect assets in an offshore trust or to put assets in a trust that becomes protected upon a change in the financial condition of the company also is eliminated.

The law provides for an additional 20% tax plus interest at one plus the underpayment rate on individuals affected by the plan's failure to comply with the rules, but, most importantly, it subjects the deferred income to current taxation if the plan doesn't comply with the new law.

Tip: Contact the draftsperson of your company's plan or if you are the individual for whom income has been deferred, contact your tax adviser.

The new law applies to income earned, vested and deferred after December 31, 2004. A material modification to a plan after October 3, 2004 will cause pre-2005 deferrals to be subject to the new law. The act requires that deferred income be reported on W-2 forms even if it is not subject to current tax.

Other Changes Affecting Compensation

For payments made after December 31, 2004, withholding on bonuses or supplemental wage payments in excess of one million dollars will be subject to withholding at the top rate (35%). Taxpayers will no longer be able to use the bonus withholding amount on these payments (25%). New York State's and New York City's (resident) bonus withholding rates remains at 8.2% and 4.8% respectively.

Tax deductions attributable to the personal use of company-owned aircraft and certain goods and services will be limited to the amount included in the individual's income. An individual includes in income an amount equal to a first class ticket price when the aircraft is used for personal use. This may make the ownership of a corporate aircraft impractical for many companies.

State and Local Sales Tax Deduction

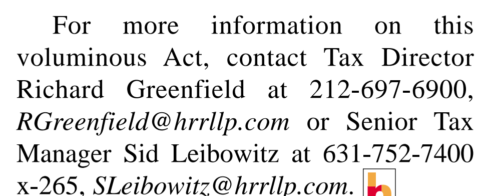
Under the Act, individual taxpayers have been given the option to deduct state and local sales tax in lieu of state and local income taxes for tax years beginning in 2004 and 2005.

Tip: If a taxpayer pays New York State income tax, he/she may be better off opting to deduct sales tax because state income taxes are not deductible on the New York State tax return but sales tax is; however, other states may not have the same benefit.

Sales taxes may not be deducted for purposes of computing the alternative minimum tax liability.

Taxpayers may deduct the actual amount of sales tax paid or use the amount from IRS tables. Taxpayers who elect to use the tables are allowed, in addition to the table amount, to include any sales tax paid on motor vehicles, boats and other items to be prescribed by the IRS.

For more information on this voluminous Act, contact Tax Director Richard Greenfield at 212-697-6900, *RGreenfield@hrrllp.com* or Senior Tax Manager Sid Leibowitz at 631-752-7400 x-265, *SLeibowitz@hrrllp.com*.



New Benefit and Contribution Ceilings in 2005

For 2005, eligible taxpayers may contribute up to a combined total of $4,000 (up from $3,000 in 2004) to all IRAs, whether traditional or Roth, or both.

Also, the 2005 employee's contribution to 401(k) plans, 403(b) annuities (for employees of public schools and 501(c)(3) organizations) section 457 plans (for employees of state or local governments or tax-exempt organizations) and SARSEPs (salary reduction simplified employee pensions) is $14,000 (up from $13,000 for 2004).

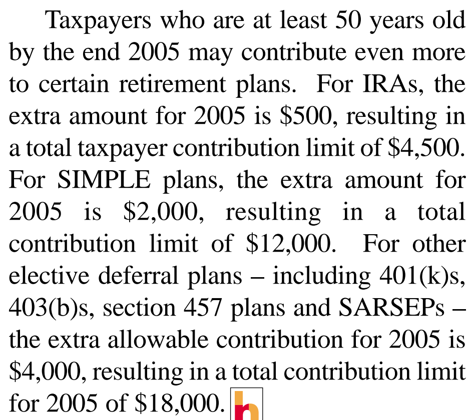
For SIMPLE (Savings Incentive Match Plan for Employees) plans, the 2005 salary reduction limit is $10,000 (up from $9,000 for 2004).

Employer plan limits have increased. For **defined contribution** plans, the annual addition may be up to 100% of an employee's compensation, but not more than $42,000 for 2005 (up from $41,000 in 2004). In defined contribution plans, contributions are based on a percentage of the participant's annual compensation.

For **defined benefit** plans, the annual benefit limit increases from $165,000 to $170,000 in 2005. Defined benefit plans are retirement plans where contributions are not fixed but actuarially determined to produce a certain benefit at retirement.

For both defined contribution and defined benefit plans, the limit on compensation that may be taken into account will increase from $205,000 to $210,000 for 2005.

Higher contribution limits for taxpayers 50 and over



Taxpayers who are at least 50 years old by the end 2005 may contribute even more to certain retirement plans. For IRAs, the extra amount for 2005 is $500, resulting in a total taxpayer contribution limit of $4,500. For SIMPLE plans, the extra amount for 2005 is $2,000, resulting in a total contribution limit of $12,000. For other elective deferral plans – including 401(k)s, 403(b)s, section 457 plans and SARSEPs – the extra allowable contribution for 2005 is $4,000, resulting in a total contribution limit for 2005 of $18,000.

A Bah Humbug Before the Holidays

The IRS has issued a memorandum putting a "Bah Humbug" in the holiday season. Many employers who reward their employees by providing some form of holiday cheer may have to withhold taxes from their gifts, depending on the type of holiday gift they provide.

Several years ago an organization provided its employees with a turkey, ham, or gift basket for the holidays. Due to certain religious or dietary constraints and after some complaints by their employees, the organization decided to change its gift to a holiday gift coupon, with a face value of $35. The coupon was redeemable at many local grocery stores.

However, although it was more convenient for the employer to provide these coupons, the organization later learned that the gift is taxable to their employees. Although $35 may be considered *de minimis* (or small) in the employer's eyes, according to the IRS, a *de minimis* fringe benefit is one that can not be readily valued, infrequent, or impractical to administer.

Beware – because cash and cash equivalent fringe benefits, such as gift certificates and the annual holiday gift coupons, have a readily ascertainable value, they do not constitute *de minimis* fringe benefits.

Social Security Update – 2005

Taxable earnings:

The Social Security Administration recently announced a $2,100 increase in 2005 taxable earnings of FICA wages and self-employment. Although the total tax rates will remain unchanged, the maximum amount of taxable earnings that are subject to the Social Security tax (at 6.2% for an employee and 12.4% for a self-employed person) will increase from $87,900 to $90,000.

As in 2004, there is no limit on earnings subject to the Medicare tax (at 1.45% for an employee and 2.9% for a self-employed person).

In summary, the combined tax rate on the first $90,000 of earnings will be 7.65% for employees (plus a matching 7.65% by the employer) and a 15.3% self-employment tax rate; however, self-employed individuals may deduct one-half of their self-employment tax, resulting in an effective rate of approximately 12%. For example, on a salary of $90,000, an employee and his employer each would pay $6,885 in Social Security and Medicare tax in 2005. For self-employed individuals, $90,000 in net earnings would result in $13,770 in Social Security and Medicare tax.

"Nanny" tax:

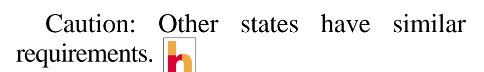
During 2004, if you paid a household employee $1,400 or more in cash wages in the calendar year, you are required to withhold and pay Social Security and Medicare taxes.

Household employees include not only "nannies," but also housekeepers, maids, babysitters, gardeners and others who work in and around your private residence. Repairmen, plumbers and contractors are not included, as they are not considered your employees. For 2005, the wage threshold for household employers to withhold these taxes will remain at $1,400. Additionally, household employers are required to pay Federal unemployment tax if they pay total cash wages of $1,000 or more in any calendar quarter of the current or preceding year to household employees.

These taxes are paid to the IRS along with your 2004 Federal income tax return. You also must provide the employee with Form W-2 by January 31, 2005 and to the IRS by February 28, 2005.

It is also important to note that the law still requires employers, who live in New York and pay wages of $500 or more in any calendar quarter, to file quarterly unemployment insurance returns.

Keep in mind that in New York, worker's compensation and disability insurance also are required for a household employee who is employed for at least 40 hours per week by any one employer.



Caution: Other states have similar requirements.

THE ADVISER CORNER

What is Your Business Worth? *Signs That You Need a Business Valuation*

By Harold Deiters, CPA

There are many ways you can benefit from having a professional business valuation. Among other things, a professional business valuation can save you hundreds of thousands of dollars, prevent you from making a bad investment, or simply give you piece of mind.

Harold Deiters

Professional business valuations can be used in a wide range of circumstances, including business merger, sales or acquisitions; estate, gift and income tax planning; bankruptcies; reorganizations and workouts; litigation and arbitration; corporate recapitalizations; buy/sell agreements; ownership successions; business/property losses and interruptions; federal/state tax controversies; stock compensation programs; partner/shareholder disputes; and trust/charitable foundation planning.

Valuing a business is a highly complex process and cannot be conducted using pre-set formulas or "rules of thumb." Each business is unique and has different qualitative, quantitative, and intangible factors contributing to its value. Reliable conclusions that stand up to regulatory and judicial scrutiny only can be drawn after a detailed study of all relevant factors involved. And such thorough analysis only can come from a knowledgeable and experienced appraiser.

A professional business valuation includes the following:

- Initial analysis to understand the scope and purpose of the valuation
- In-depth research of the business itself, including past/present financial condition, projected earnings capacity, dependencies, human resources, competitive position, and short/long-term prospects
- Examination of any external factors (i.e., the current/projected state of the economy, industry, regulatory and market environment) that impact the operations of the business
- Preparation of a formal report that documents the approach used and the results obtained in a concise manner that clearly demonstrates the merits of the opinion

In addition, other services that may be performed by a professional appraiser include providing expert testimony on any findings, if necessary; as well as transaction structuring, tax and financial planning, claim filings, and litigation support.

One of the most crucial items to any valuation is utilizing appropriate discounts or premiums. In each valuation, to arrive at a fair market value for the business one must apply the applicable discounts or premiums depending on the situation. Examples of adjustments are discounts for lack of marketability, minority interest and premiums for controlling interests.

Example: Estate of Lea K. Hillgren – In 1997, several months before her death, Ms. Hillgren formed a limited partnership. Based on a bad fact pattern (including such things as co-mingling of partnership and personal assets, not filing a partnership certificate until after death, and making partnership distributions only to Ms. Hillgren) the Tax Court disregarded the limited partnership and disallowed all discounts.

Four of the properties in the partnership also were subject to a 1994 Business Loan Agreement (BLA) between Ms. Hillgren and her brother Mark. Under the terms of the BLA, Mark had the sole right to determine if underlying property could be sold. For one of the properties, Mark was entitled to 25% of any net cash proceeds from the sale or refinancing of the property.

The IRS argued that the disregarded partnership should supersede the BLA. The estate argued that the subject matter of each agreement was separate. The Tax Court concluded that the BLA "...had apparent business purpose. Moreover, a hypothetical buyer would not disregard or ignore the BLA."

The appraiser used by the estate for preparing the return took the BLA into account in determining discounts to be applied to the partnership interest. For the single property subject to the 25% lender interest described above, the estate's trial appraiser first reduced fair market value by 25%. The appraiser then analyzed median discounts to net asset value for comparable publicly registered limited partnerships based on revenues, debt-to-equity, and distributions. After this analysis, the appraiser arrived at a 50% combined discount for lack of control and marketability. The significant discount was due in part to the high level of debt on this property.

The IRS appraiser determined a 10% discount for lack of control, referencing closed-end mutual funds and real estate investment trusts and by taking the BLA into account. The IRS appraiser also determined a 35% marketability discount based on restricted stock studies. The estate pointed out that the IRS appraisal contained incorrect assumptions about cash flow and the effect of the BLA.

The Court agreed with the estate's appraiser, agreeing that their discounts were reasonable and not contradicted by reliable evidence.

For the three other properties, the estate's appraiser arrived at combined discounts for lack of control and marketability of 35%, 35%, and 40%. The IRS appraiser arrived at discounts of 30%, 30%, and 40%. Because the difference was "insubstantial," the Tax Court adopted the estate's discount. The estate's appraiser took an additional 5% discount on all property for the lack of voting rights.

This case shows that the IRS can question discounts or premiums used in a valuation. It is important that the appraiser be able to document and support his/her approach and the manner in which he/she arrived at the discounts and premiums.

For more information on business valuations, contact Audit Manager Harold Deiters at 631-752-7400 x-226 or *HDeiters@hrrllp.com.*

Working Families Tax Relief Act of 2004

2004 was a busy year for Congress, which also enacted the Working Families Tax Relief Act of 2004.

Some of the significant provisions included in the act are as follows:

- The maximum child tax credit increases to $1,000 for tax years beginning in 2005 through 2009.

- Married taxpayers will see relief in two ways. One way is an increase in the standard deduction amount for married joint filers to double the standard deduction for single taxpayers for tax years beginning 2005 through 2008. The standard deduction for single and married filing separate taxpayers will be $5,000 and $10,000 for married filing joint taxpayers. The second way is a change in the 15% tax bracket. For the 2005 tax year, the end point of the 15% tax bracket for married joint returns increases to $59,400 or twice the end point of the 15% tax bracket for single returns of $29,700.

- The alternative minimum tax ("AMT") exemption amount for individuals remains at $58,000 for married taxpayers filing jointly, $29,000 for married filing separately, and $40,250 for unmarried taxpayers in 2005. The exemption previously would have decreased approximately $7,500-$10,000 across the board in 2005.

- Several credits available to individuals and businesses set to expire in 2004 have been extended through 2005. These credits include the research credit, work opportunity, and welfare-to-work. Additionally, the qualified electric vehicle credit is not subject to a phase down in 2004 and 2005.

- The maximum deduction of $250 available to educators such as teachers, instructors, counselors, and principals, for books, supplies, computer equipment, etc has been extended through 2005.

Limiting Scope of Qualified Dividends for Estates and Beneficiaries

When a decedent dies owning something that would have been income had he lived to collect it, that item is subject to both estate tax and to income tax on the return of the taxpayer (either the estate or a beneficiary) who ultimately receives the item. Examples of these items include balances in individual retirement accounts (IRAs) and dividends that have been declared but unpaid at the date of death (assuming that the ex-dividend date was prior to the date of death). The income is called income in respect of a decedent.

To mitigate against the imposition of both the estate tax and the income tax on the same item, the Internal Revenue Code allows a deduction for the Federal estate tax attributable to the item on the income tax return where the item is reported.

Example: John's taxable estate of $2 million includes an IRA of $100,000. Assume an estate tax rate of 50%. The estate tax liability is $1 million (50% of the $2 million taxable estate), of which $50,000 (50% of $100,000) is attributable to the IRA.

John's daughter takes a distribution of the entire $100,000 IRA balance in a single year. Although she must report the $100,000 as ordinary income, she may take a deduction of $50,000 for the estate tax attributable to the IRA. This deduction is not subject to the limitation that disallows miscellaneous itemized deductions that aggregate less than 2% of a taxpayer's adjusted gross income.

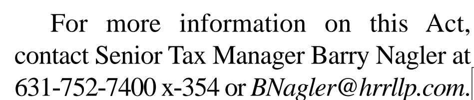
If the taxpayer was entitled to apply the same calculation above to dividends, the taxpayer would receive a potential windfall, because the dividend would be taxed at a rate of only 15%, but the deduction would offset ordinary income taxed at a rate as high as 35%. To prevent this result, the 2004 law provides that the amount of the dividend treated as a qualified dividend must be reduced by the deduction claimed for the estate tax attributable to that item of income.

Example: John's taxable estate of $2 million includes accrued dividends of $20,000. Assume an estate tax rate of 50%. The estate tax liability is $1 million (50% of the $2 million taxable estate), of which $10,000 (50% of $20,000) is attributable to the accrued dividends.

John's estate receives the $20,000, which is a qualified dividend. It also receives $180,000 of taxable income from other sources, for a total of $200,000 of taxable income. While the estate may claim a $10,000 deduction for the estate tax attributable to the dividend, it may only treat $10,000 (not the full $20,000 dividend received) of its income as qualified dividend income eligible for the 15% tax rate.

A similar rule requires taxpayers to reduce the amount of capital gains eligible for the 15% tax rate when the capital gains represent income in respect of a decedent; however, the rule applicable to capital gains had been enacted prior to 2004.

For more information on this Act, contact Senior Tax Manager Barry Nagler at 631-752-7400 x-354 or *BNagler@hrrllp.com.*



SAVE THE DATE!

What is Your Business Worth?
Avoiding Landmines in Financial Statements

On Tuesday, January 18, 2005, 8-10 a.m., Holtz Rubenstein Reminick Partners Barry Garfield and John McAteer will be leading a discussion for closely-held businesses on analyzing financial statements, as well as giving helpful hints on how to value your business.

Topics:

- Financial statement fundamentals
- Determining how much your business is worth
- Importance of cash flow
- Reading the fine print

To register, contact the Hauppauge Industrial Association (HIA) at (631) 543-5535.

Gifts to Family Members

By December 31, 2004, consider making gifts to family members, which allows you to take advantage of the $11,000 gift tax exclusion ($22,000 for gifts made by married couples) that applies for donees each year. You can make a significant reduction in your taxable estate by making use of the annual gift tax exclusion.

It is also important to note that unless the gift is made to a child under age 14, the income from the cash or other asset given away is effectively shifted from the giver to the donee.

New Jersey Limits Net Operating Loss Deductions

New legislation has passed in New Jersey limiting corporate net operating losses for 2004 and 2005 and decoupling from both the increased maximum Federal Section 179 property expensing deduction and Federal bonus depreciation.

Net operating losses for New Jersey Corporations are limited to 50% of taxable income for taxable periods beginning in calendar years 2004 and 2005. The Business Tax Reform Act of 2002 had previously suspended the application of net operating losses for periods beginning in calendar year 2002 and 2003.

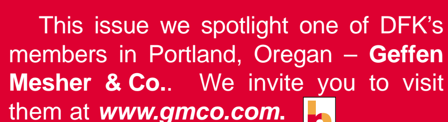
New Jersey has decoupled from the increased Federal Section 179 deduction for tax years ending after December 31, 2003. For assets placed into service on or after January 1, 2004, the maximum Section 179 deduction will be $25,000 instead of the Federal maximum of $100,000. New Jersey also has decoupled from the Federal bonus depreciation rules for assets placed into service after September 10, 2001.

Note: All of the decoupling by so many states requires additional time and recordkeeping.

DFK Firm Spotlight: Geffen Mesher & Co., 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 one of DFK's members in Portland, Oregan – **Geffen Mesher & Co.**. We invite you to visit them at ***www.gmco.com.***



Year-End Tax Strategy – Investment Timing Decisions

December 31st is just around the corner. If you haven't considered your 2004 tax situation, it's not too late to start. Year-end tax planning activities often result in substantial tax savings.

Capital gains and losses are great areas for planning because you have more control over when the income is realized than you do over any of your other income, because you decide when to sell. However, you should know the rules with respect to the deductibility of capital losses. Net capital losses are allowed to offset net capital gains. Only $3,000 ($1,500 if married filing separately) of any excess capital loss may be applied against ordinary income. The remaining loss gets carried forward indefinitely.

Knowing these rules, here are a few strategies to minimize your tax liability:

- If you already have capital losses which exceed your current capital gains plus $3,000 ($1,500 if married filing separately), consider selling capital gain property before the end of 2004 to utilize the benefit of the capital loss this year.

- If you have an excess of capital gains over capital losses, sell capital loss property before the end of the year to offset the excess capital gain and eliminate the tax on the gain.

Note: Different limitations apply for corporations.

To hear additional strategies, contact Senior Tax Manager Sid Leibowitz at 631-752-7400, x-265, or *SLeibowitz@hrrllp.com.*

(continued from page 1)

Notable and Quotable

Senders talked about health insurance basics and alternatives.

- Holtz Rubenstein Benefits Consulting Vice President **Josh Senders** discussed consumer-driven health care at a firm-sponsored seminar.

- Tax Partner **Arnie Haskell** spoke in front of both the Tax & Accounting Institute at CW Post and the tax law committee of the Nassau County Bar Association.

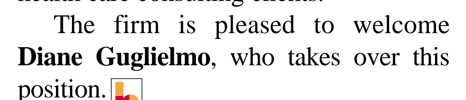
- Audit Partner **Andy Vuono** and Director **George Victor** (who was the conference co-chair) were featured speakers at a Foundation for Accounting Education conference in New York City, on paperless audit systems.
  George Victor also spoke at the National SEC Conference for Small Companies in Washington DC.

- Partner **Alan Weiner** gave a presentation on Limited Liability Companies (LLCs) to the New York State Bar Association

- Tax Manager **Joel Ackerman** reviewed the tax savings of cost segregation plans for several real estate and bank audiences.

Congratulations and good luck to Administrative Assistant **Mary Senzatimore**, who is leaving the firm after seven years to raise her second child, due in December. Mary works with our health care consulting clients.

The firm is pleased to welcome **Diane Guglielmo**, who takes over this position.



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

This publication is designed to present matters of general interest relating to accounting, taxation and business management. It is not intended to constitute accounting or tax advice. Articles were written by the staff of Holtz Rubenstein Reminick LLP. Please consult your HRR adviser before taking any specific actions. ©2004 Holtz Rubenstein Reminick LLP.