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HOLTZ RUBENSTEIN

adviser



DECEMBER, 2001

Qualified Retirement Plan Amendment Deadlines

Several tax acts in the 1990s changed provisions governing tax-qualified retirement plans. The IRS provided an amendment period, known as the "GUST remedial amendment period," giving plan sponsors time to amend their plans to comply with these provisions.

The deadline for this amendment period originally was December 31, 2001 for all plans whose plan years began on January 1, 2001. However, as seen with other deadlines since the September 11, 2001

terrorist attacks, the GUST remedial amendment period has been extended by the IRS to **February 28, 2002** for any plans not affected by the September 11, 2001 terrorist attacks. Plans directly affected by the attacks have been given an additional extension of time to June 30, 2002 for implementing amendments.

In cases where complying with the June 30, 2002 extended deadline would result in substantial hardship, an additional extension has been provided to December 31, 2002. These additional extensions will require a statement attached to the determination letter application, labeled "September 11, 2001 Terrorist Attack," describing how the attacks affected the plan.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created several provisions, similar to the importance of the GUST provisions, which will require plans to be amended again. The IRS has provided a remedial amendment period for plan sponsors to adopt any retroactive amendments required under EGTRRA by the last day of the plan years beginning January 1, 2005.

Through the issuance of several notices since the enactment of EGTRRA, the IRS has provided specific information relating to the new provisions, such as hardship distributions, effective dates for the new compensation limits, and a modification of the rules determining the top-heavy status of the plan.

The IRS has provided sample plan amendments for the changes required or permitted by EGTRRA. These amendments are designed to assist plan sponsors and adopters of pre-approved plans to comply with the requirement that they adopt good-faith EGTRRA plan amendments on a timely basis.

Notable and Quotable

Partner **John McAteer** has been elected President of the Interfaith Nutrition Network, which feeds and houses Long Island's hungry and homeless.

Partner **Gary Carpenter** has been elected Chairman of the Board of the Long Island chapter of the National Multiple Sclerosis Society. Gary has been involved with the Long Island chapter for seven years, on the Board of Trustees, as spokesperson for the chapter, and as fundraiser for the annual MS Walk and the annual Renaissance Ball, where this year he was named Man of the Year.

Partner **Alan Weiner** has been re-elected by the members of DFK International to the Board of Directors and its Executive Committee. Alan also has been elected to represent all American DFK members, as the national contact partner for DFK/USA. DFK International is the worldwide association of independent accounting and business advisory firms.

In addition, Alan recently was quoted in two Wall Street Journal articles, about the tax aspects of real estate investments and Internet tax planning tools and scams.

HR Adviser Alert:

As the end of the year approaches, if your retirement plan adviser has not been in contact with you, you should reach out to him/her to confirm that your plan has been properly amended to reflect the GUST provisions, and to discuss any changes required to be made under EGTRRA.

This Month

- ⇒ **Qualified Retirement Plan Amendment Deadlines**
- ⇒ **Social Security Update**
- ⇒ **CyberNotes – Savings Bonds**
- ⇒ **Windows 95 Is Retiring**
- ⇒ **Additional Relief from Application of Mid-Quarter Convention Depreciation Rules**
- ⇒ **The Adviser Corner: Beware of Wash Sales of Stocks or Securities**
- ⇒ **Form 1099-MISC Filers – Don't Forget Phone Number!**
- ⇒ **Tax Test: Do You Need to Pay Self-Employment Tax?**
- ⇒ **DFK Website of the Month**

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Social Security Update

Taxable earnings:

The Social Security Administration recently announced a \$4,500 increase in 2002 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 \$80,400 to \$84,900. As in 2001, 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 \$84,900 of earning will be 7.65% for employees (plus a matching 7.65% by the employer) and a 15.3% self-employment tax rate.

Nanny tax:

During 2001, if you paid a household employee \$1,300 or more in cash wages in the calendar year, you are required to withhold and pay Social Security and Medicare taxes.

Household employees include 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. The wage threshold for household employers to withhold these taxes remains at \$1,300 for 2002.

Windows 95 is Retiring

With the release of Windows XP from Microsoft it was inevitable that the oldest supported operating system, Windows 95, would be retired. It's happening on December 31, 2001.

There are many of you out there who may think, "Hey, it's still working for me. So what if they're not going to support it?"

The problem is that when Microsoft ceases support of an operating system, vendors of other products (such as accounting software, games, specialty software, etc.) also will eventually stop supporting their products running on the outdated operating system.


For example, Sage Software (soon to be known as Best Software), the manufacturers of the MAS-90 product line, will no longer support their product on Windows 95 after June 30, 2002. This can be a serious issue




if you have problems with your accounting software and it's running on an unsupported operating system.

Microsoft already has made an announcement that support for Windows 98, Windows 98 SE, and Windows NT 4.0 will stop on June 30, 2003. Windows 2000 will be entering the extended phase of support on March 31, 2003. In all probability, the non-support phase for Windows 2000 will become effective March 31, 2004.

If you would like to read more information on the Microsoft operating system life cycle, please visit www.microsoft.com/windows/lifecycle.asp.

For assistance in selecting a new operating system for your business, call Tony Romano, Director of Holtz Rubenstein Technology Services, at 631-752-7400 x-255. 


These taxes are paid and submitted to the Internal Revenue Service along with your 2001 Federal income tax return. You must also provide the employee with Form W-2 by January 31, 2002 and to the IRS by February 28, 2002. 

Additional Relief from Application of Mid-Quarter Convention Depreciation Rules

This is an update of an article that appeared in the November 2001 Holtz Rubenstein Adviser.

If the third or fourth quarter of a taxpayer's tax year includes September 11, 2001, the taxpayer may elect to apply the half-year convention to all property (except residential and nonresidential real estate) placed in service during the 2001 tax year.

The half-year convention treats property as placed in service in the middle of the year. In order to make this election, the taxpayer must write "Election Pursuant to Notice 2001-70" across the top of Form 4562, Depreciation and Amortization, for the tax year that includes September 11, 2001.


Taxpayers may rely on this notice until the regulations have been changed to include this guidance. 

CyberNotes – Savings Bonds

Lately more and more people are looking at United States Savings Bonds as an investment option. They offer safety and security as well as relatively high interest rates when compared to CDs and money market funds.

Savings bonds also are very easy to purchase. You can buy them through a bank, a payroll reduction plan, or online through Savings Bonds Direct at the website of the Bureau of the Public Debt – www.publicdebt.treas.gov/sav/sav.htm.

In addition to purchasing bonds, there are many other informative features available on the website. It explains in detail the different types of savings bonds. You can find out how much your older savings bonds are worth and see if they still are earning interest. You also can find out the current interest rates on bonds now being issued.

There are also fun calculators that help you figure out how much you should be saving in order to pay for anything from a college education to a boat. Whether you are thinking about a savings bond for yourself, or to give as a holiday gift, visit www.publicdebt.treas.gov/sav/sav.htm. 

THE ADVISER CORNER

Beware of Wash Sales of Stocks or Securities

By Joel Ackerman, CPA

As the end of the year approaches, taking losses in your security account may benefit your tax position for the year. However, if you were to purchase identical securities thirty days earlier or later, you would be unable to deduct the loss you were originally counting on, due to what is known as a “wash sale.”

A wash sale occurs if you sell and buy “substantially identical securities” within the 61-day wash sale period. This period consists of the day of the sale, the 30 calendar days before the sale and the 30 calendar days after the sale.

For example, on December 31, 2001 you sell 100 shares of ABC for \$5 a share (for a loss of \$1,000) and on January 15, 2002 you decide to purchase 100 shares of ABC at \$7. Since the purchase occurred before the end of the wash sale period, the December 31, 2001 sale is considered a wash sale and the \$1,000 loss will be postponed. In order to claim the loss, the same security cannot be purchased from December 1, 2001 (30 days prior to sale) to January 30, 2002 (30 days after the sale).

“Substantially identical securities” means that the stock sold must be the same as the stock purchased in the wash sale period. Stocks of the same class or type (such as common and common, preferred and preferred), issued by the same corporation are identical in all respects. Convertible preferred stock, which can be converted to common stock, can be considered identical to the company’s common stock.

The wash sale rule not only applies to stocks or securities purchased within the 61-day wash sale period but also if you acquire a contract or option to buy substantially identical stock or securities. This rule does not apply to losses from sales of commodity futures contracts and foreign currencies.

If you sell common stock at a loss and at the same time purchase warrants for common stock of the same corporation,

the wash sale rule also will apply. However, if you sell warrants at a loss and at the same time buy stock of the corporation, the wash sale rule applies only if the warrant is for the identical security as the purchase.

When a wash sale occurs there are several consequences to each transaction. First, and most importantly, you are not allowed to claim the loss on your sale. If you do not sell the replacement stock in the same year, as in the example above, your loss will be postponed, possibly to a year when the deduction is less valuable.

Second, your disallowed loss is added to the basis of the replacement stock. This adjustment preserves the benefit of the disallowed loss. You’ll receive that benefit on a future sale of the replacement stock. Because of this basis adjustment, a wash sale, which on the surface seems to be a disaster, will allow you to receive the same tax benefit at a later time. However, if you die before selling the replacement stock, neither you nor your heirs will benefit from the basis adjustment.

The last consequence is that the holding period for the replacement stock includes the holding period of the stock you sold. This prevents you from converting a long-term loss (which would be disallowed on the wash sale) into a short-term loss at the time of the final sale of the security.

Expanding on the earlier example, the cost basis of the replacement stock would be \$1,700 (\$700 cost plus \$1,000 wash sale postponed loss). Regarding the stock’s holding period, if the original purchase of the ABC stock occurred two years ago, then no matter when the replacement stock is sold, the gain (or loss) would be long-term. If the original stock purchase was on December 1, 2001, then the holding period would be short term if the replacement stock was sold on or before December 1, 2002.

It is possible that the IRS can take the position that the wash sale rules apply to purchases and sales by each taxpayer, spouse, and their respective IRA accounts. Securities sold by one spouse and then purchased by another could look on the surface to be two separate transactions.

Form 1099-MISC Filers – Don’t Forget Phone Number!

The IRS announced on its website that taxpayers who file the 2001 Form 1099-MISC, Miscellaneous Income, must include the telephone number of a person to contact in the “filer name and address” area even though it was inadvertently omitted from the form.



However, it could be treated as a sale between related parties – losses from such transactions are not allowed, and deemed a wash sale. IRA accounts also may be deemed as related accounts. The tax consequence of that sale would be quite severe. The loss would not only be disallowed on the original sale, but since the IRA does not report gains or losses, there is no way for the IRA to benefit from the additional basis given for the disallowed losses to the replacement shares. To date, there is no authority on the matter of IRAs.

The wash sale rule is difficult to combat if you have several security accounts. The problem is even more difficult to detect if you have accounts with more than one brokerage firm. Be aware that the losses taken on one account could be postponed or lost if the securities were subsequently purchased by another account.

If you buy and sell a significant amount of identical securities with different accounts make sure that you purchase replacement shares 31 days after (or that you did not purchase replacement shares less than 31 days before) the initial sale to avoid the problem of the wash sale.

If you have any questions regarding wash sales, please call Joel Ackerman at 631-752-7400, x-262 or JAckerman@hr CPA.com.

Tax Test: Do You Need to Pay Self-Employment Tax?

The self-employment tax (SE tax) is a Social Security and Medicare tax for individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of wage earners. It can apply even if the work is only part-time, or doesn't generate enough income to support the individual.

Who must pay. You must pay SE tax if: 1) You were self-employed and your net earnings from self-employment were \$400 or more (excluding certain income described below); or 2) you performed services for a church as an employee and received income of \$108.28 or more. The SE tax rules apply even if you are fully insured under Social Security or have started receiving benefits. For 2002, the maximum net self-employment earnings subject to the social security part of the self-employment tax will increase from \$80,400 to \$84,900.

Definition of self-employed. You are self-employed if you carry on a trade or business as a sole proprietor, an independent contractor, a member of a partnership, or are otherwise in business for yourself. The definition of a trade or business is an activity carried on for a livelihood or in good faith to make a profit. The facts and circumstances of each case determine whether or not an activity is a trade or business. The IRS will look at factors such as the regularity of activities and transactions and the production of income to determine if you have a trade or business. You don't need to actually make a profit to be considered in trade or business, but you do need to have a profit motive, and make ongoing efforts to further your business.

Sole proprietors, partners, and spouses

If you own your own business as a sole proprietor, the income from your business

is SE income. If only one spouse has an interest in a business, then it is a sole proprietorship.

If you are a member of a partnership that carries on a trade or business, the general rule for SE tax is that your distributive share of the income or loss from the trade or business is included in the calculation of your SE income.

If a husband and wife are partners (that is, they both have an interest in the business), then the partnership must report the business income and expenses on a separate return, and the spouses must file a Schedule K-1 with their regular tax return, showing each partner's share of the net income or loss, and file separate Schedules SE to report each partner's individual SE tax.

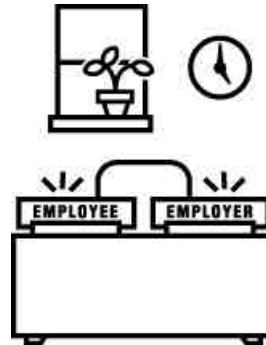
Note: If your spouse is your employee and not your partner, then you must pay Social Security and Medicare taxes for him or her as the employer.

Independent contractors

Independent contractors are generally not employees and therefore usually pay SE tax. (This assumes the independent contractor is not incorporated. If he or she is, then no SE tax is paid.) Such persons have an independent trade, business, or profession in which they offer their services to the general public. However, whether someone is an employee or independent contractor depends on the facts of each case. The general rule is that an individual is an independent contractor if the payer has the right to control or direct only the result of the work, and not what will be done and how it will be done.

You are not an independent contractor if you perform services that can be

controlled by an employer (what will be done and how it will be done). This applies even if you are given freedom of action. What matters is that the employer has the legal right to control the details of how the services are performed. If an employer-employee relationship exists (no matter what the relationship is called), you are not an independent contractor.



What is SE income?

Different types of income can be SE income. The source of your income and your involvement in the activity from which your income is derived will determine whether it is SE income.

Gains and losses. A gain or loss from the disposition of property that is neither stock in trade nor held primarily for sale to customers

is not SE income. It does not matter whether it was a sale, exchange, or involuntary conversion.

Interest. Interest is not SE income unless you receive it in your trade or business. This includes interest on accounts receivable, bonds, notes or other debt, unless you are a dealer in stock or securities.

Real estate rent. Rent from real estate and personal property leased with real estate is not SE income, unless either of the following applies: 1) You are a real estate dealer, or 2) You provide services for your tenants. You are a real estate dealer if you are engaged in the business of selling real estate to customers with the purpose of making profits from those sales. Rents received for using or occupying a hotel or apartment house are SE income if services are provided for the occupants. Something is a service if it is provided for the convenience of the occupants, such as maid service. But heat, light, cleaning of stairways and lobbies, and the collection of trash are not services primarily for the occupants' convenience.

If you have any questions regarding SE tax, contact Tax Manager Sid Leibowitz at 631-752-7400 x-265.

DFK Website of the Month

DFK International is the worldwide association of independent accounting and business advisory firms in which Holtz Rubenstein 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 month we spotlight one of DFK's newest members – Bennett Thrasher PC in Atlanta, Georgia. Visit them at www.bennett-thrasher.com.