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Annual Business Tax Newsletter
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Business Update: Tax Planning Tips & New Tax Laws - Fall 2004

Last Year for 30% & 50% Bonus Depreciation - As of 12/31/04, the extra bonus depreciation will not be available. If you were considering large asset purchases in 2005, it is advisable to purchase and place in service the assets no later than December 31, 2004. The bonus depreciation is in addition to the regular depreciation taken. This tax break is only available on the federal level as Virginia does not honor it, so it will be necessary to add it back into Virginia income.

New Section 179 Depreciation - The limit for taking the Section 179 depreciation expense for assets placed in service for 2004 has increased from \$100,000 to \$102,000.
Tax Tip - Place assets in service by 12/31/04 to take advantage of Section 179 if there is a profit in the company.

Vehicle Depreciation Secret - Most passenger vehicles have limited depreciation for the first year they are placed into service **unless** they have a 6,000 lbs. loaded gross vehicle weight. This includes many heavy sport vehicles (SUVs). What does this mean to the business owner who uses his or her vehicle more than 50% of the time for business? You can purchase one of these vehicles and use the new Section 179 deduction or the new bonus depreciation or regular depreciation. **Tax loop closed** - This write off is still available but the Sec 179 amount has decreased from \$100,000 to \$25,000 as of 10/22/04. Please note that there are some down sides to using this tax break.....1) All of the depreciation would be used up in the first year whereas it might be better tax wise to spread it out over the 5-year class life of the vehicle, 2) If the business use falls below 50% or the vehicle is disposed of, there will be a recapture of income for the amount of depreciation that was taken for years it is not in service.

Please see my Web site at www.lascpa.com (click on the 'Information Center' button) for a detailed list of vehicles that qualify as having a gross vehicle weight of 6,000 pounds or more.

Mileage rate - The standard mileage rate is 37.5 cents/mile for 2004 and **goes up starting January 1, 2005 to 40.5 cents/mile**. All business owners with vehicles should record their odometer readings as of 12/31/04 and record business miles for the year. The IRS requires written records if either the standard mileage rate method or the actual

expense method is used. If you have employees, see both Travel Expenses and Automobiles below.

Automobiles - An automobile must be used more than 50% in the taxpayer's trade or business to be considered qualified business use, and to be eligible for accelerated depreciation. If you purchased, sold or traded a vehicle during the year, you need to provide us with the documentation of the transaction so we can properly record it for tax purposes. Written documentation should be kept recording your business vehicle usage. Reimbursements for personal use of vehicles owned by employees or owners can be made under the standard mileage rate or actual cost method if you have an accountable plan as noted under Travel Expenses.

Travel Expenses - Most employers cover their employee's business expenses by reimbursing them. The expenses can be a deduction for the company and non-taxable income to the employee if the reimbursements are made in accordance with an accountable plan that requires employees to substantiate all expenses and return any advances in excess of the expenses incurred. **If an accountable plan is not followed, the employer is responsible for adding the reimbursements to the employees wages as compensation.** This also hurts the employer because the employer now has to match the social security and medicare on the additional compensation. If you are in need of a written accountable plan to be in compliance, please contact our offices.

Meals - The deduction for meals & entertainment remains at 50% for 2004. Occasional meals provided to your employees may be 100% deductible as long as they are on an occasional and infrequent basis such as a holiday party, or when they are provided for the employer's convenience (for emergency work or during a particularly busy time when employees are required to stay on the job during mealtimes). As discussed in the travel section, a plan should be in place to cover meal reimbursements paid to your employees. You should choose between an actual cost reimbursement or a pre-diem rate based on federal guidelines.

Important Reminders

W-2s - If you mail off a W-2 to an employee's last known address and it is returned, you are required to keep that W-2 on file for four years.

W-4s & I-9s - Employees should fill out new W-4s in January. Employee names and social security numbers must match their social security cards exactly. Employers will be penalized if numbers are incorrect or missing. The IRS has adopted a zero tolerance for incorrect filings of the W-2s. As an employer, you can call the Social Security Administration to verify your employee's social security number for accuracy at 800-772-6270. W-4s can be found at the following Web site: www.irs.gov. Once on the IRS Web site, search Forms & Publications for: "W-4." We can provide copies of the W-4 if you do not have Internet access. It is very important to stay current with employees' changes of addresses.

All employees should also have filled out an I-9, which verifies an employee's citizenship. The employer penalty for not having the I-9 form on file starts at \$100.00 per employee and can go as high as \$1,000 per employee. The I-9 form must be on file by the end of the third business day after the employment date; and must be retained for the longer of 3 years or 12 months after termination. I-9s can be found at the following

Web site: www.ins.usdoj.gov/graphics/formsfee/forms/i-9.htm. Our office can provide copies of the I-9 if you do not have Internet access.

Personal Property Taxes & Business Licenses - All businesses must file annual personal property tax returns. These are filed with the county where both your business & assets are located and in the county where you perform work & maintain assets. The due dates of these returns vary from jurisdiction to jurisdiction. Charges for personal property tax are based on the year of purchase of the assets and should match the assets that are depreciated on the business income tax returns. All businesses should be registered for a business license. In Prince William County, there are no taxes due for the BPOL (Business & Professional Occupational License) tax until a business grosses more than \$100,000 annually. The BPOL form is due March 1st. Please be aware that as a business owner, you are responsible for filing these annual forms. Our offices can help you handle these filings at your request.

Estimated payments - Estimated payments for corporations are due 12/15/04. Estimated payments for taxpayers who are self employed are due 1/15/05. Please contact our offices before the end of the year if you have concerns regarding increasing or decreasing your estimated payments.

Independent Contractors - If you are paying an individual as an independent contractor instead of an employee, be sure to have a written agreement that spells out all conditions along with the individual's address & social security number for reporting purposes. **Important** - All independent contractors should fill out IRS form W-9 (Request for Taxpayers Identification Number & Certification) and submit it to you. If the subcontractor does not pay taxes on his or her earnings, the IRS can come back and **charge you the 30% backup withholding taxes!!** Let us know if you need any blank Form W-9s. Go to my Web site at www.lascpa.com for a generic copy of the Independent Contractor's agreement. The business owner is required to issue a 1099-Misc to any individual or attorney that is paid more than \$600 annually.

Minimum Wage - Minimum wage is currently \$5.15 per hour.

Leases - If a corporation rents or leases property owned by the shareholder, the lease should be in writing and the rent charged must be at fair market value for the area.

Business Gifts - The maximum deduction for a business gift is \$25.00 per gift. Any amount greater than \$25.00 for the purchase of a gift is considered to be nondeductible.

Home Office - To qualify for a home office deduction, you must exclusively use a portion of your home to carry on a trade or business. If you are unable to permanently segregate a room, you should at least use some sort of screen or dividers to establish exclusive use of one section. Also bear in mind that to obtain a home office deduction under the exclusive use rules, you must use your home office computer 100% of the time for business. Even using it occasionally for personal purposes can cause your home office to be non-deductible.

Shareholder Loans - Closely held corporations are regularly subjected to IRS scrutiny because of loans made to stockholders. The IRS often takes the position that the loans are really disguised dividends - especially in the case of loans that remain on the books year after year. This results in the loan being included in the recipient's income. This

can be avoided by having a more formal loan agreement or promissory note in place. S Corporation shareholder loans must be put in writing with set repayment dates in order to justify basis in the company - this ultimately could allow for the deduction of losses on the shareholder's personal income tax return. Each loan should have a separate agreement. Contact us to make sure your loans are properly documented to avoid this problem.

Corporate Minutes - Keeping complete and accurate minutes of your shareholder's meetings may seem like a bothersome task. But, the time spent now can save your corporation a great deal of money later on. Please take a few minutes to update your corporate books before year-end.

Health Insurance Premiums & Medical Reimbursement Plans - Health insurance premiums for the self employed and S Corporation shareholders are 100% deductible as a reduction to adjusted gross income.

Tax Tip - If a spouse works in the business of a sole proprietor and receives W-2 earnings, the premiums can be deductible on the Schedule C reducing social security and Medicare taxes. In addition, if the spouse is a legitimate employee, the company can set up a medical reimbursement plan. This would not be advantageous if the sole proprietor had other employees as the medical plan would have to be non-discriminatory.

Employing Your Spouse & Children - If you are operating as a sole proprietorship, it can be beneficial to employ your spouse and children. You do not have to withhold social security and Medicare taxes if your child is under the age of 18. Both the spouse and the children are exempt from federal and state unemployment taxes. Since family members are earning income, they can contribute to IRA accounts on their own behalf. Even better, a retirement plan can be set up which would reduce the federal tax liability of the sole proprietor and defer income of the employees (the spouse and children). Having a spouse as an employee can also provide deductions for health insurance premiums and other medical expenses through a medical reimbursement plan.

Even if you are incorporated, you may want to consider employing your children for minimal clean-up work so that they can earn at least \$3,000 per year to put away into a Roth IRA. If they have no other earnings, there should be no federal or state tax liabilities; and when the money is withdrawn, it will be tax-free. Money that is earned will never be taxed!!!

Retirement - Retirement funds are an excellent way to defer or reduce taxes. Contribution limits for every type of retirement fund have increased. There are some types of retirement plans that can be set up and funded until the extension date of the return. The tax return can be prepared with a retirement contribution recorded, but the taxpayer does not have the funds available so an extension is filed and the return is mailed on the date the taxpayer makes the contribution (up until the due date of the extension).

In order to take advantage of the tax breaks associated with retirement funds, it is necessary to have the fund set up properly within IRS compliance. Meeting with a financial advisor may be helpful so that your specific needs can be addressed. There are severe penalties if you have set up a retirement plan, and it is not being funded, maintained, or deducted on your income tax return properly.

Insurance - The cost of insurance has escalated dramatically since 9/11/01. See my Web site at www.lascpa.com for web addresses to do comparison-shopping for insurance quotes.

Privacy Statement

Federal law requires that once a year I inform you of our Privacy Policy. As you know, we collect certain personal information about you in order to prepare your tax returns. The information is either provided by you or obtained by our office with your permission. No personal information will ever be disclosed about you to anyone except that which is already public or permitted by law.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here. The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account.

Procedural, physical, and electronic safeguards will be maintained in compliance with federal standards regarding non-public personal information. We are committed to retaining your confidence, and want to assure you that any information you give us remains safe and confidential.