ANNUAL NEWSLETTER

12904 Harbor Drive
Fairfield Office Park
Woodbridge, VA 22192

November 1999

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Web Site http://www.LASCPA.com

The millennium and the 1999 tax season are just around the corner! Many tax law changes were enacted in 1998 - this update will review some of the changes that may apply to your 1999 tax returns. Please use this update to assist in your year-end tax planning strategies and to help in the gathering of information for the preparation of your 1999 tax return.

Be sure to check out our new Website at www.LASCPA.com if you have not had the opportunity to do so yet.

REMINDERS for 1999:

1) A tax return should be filed for children who have unearned income of more than $700.
2) Your name on the tax return must match exactly as it appears on your social security card. Be sure to inform the social security administration if your name has changed.
3) A written acknowledgment from charities for donations of $250 or more are required. A written appraisal is required for any donated item that has a fair market value of $5,000 or more. Please find attached to this update a valuation sheet for noncash contributions for your use. Our office will not assign a value greater than $50 per bag for donated items; so take a few minutes to value any items to ensure you get a proper deduction.
4) A non-working spouse may qualify for deductible IRA contribution up to $2,000. A phase-out limitation begins when the couple's adjusted gross income reaches $150,000.

UPDATE #1 (Child Credit)

The child credit has increased to $500 for each qualifying dependent child who is under the age of 17 at the end of the 1999 tax year. The child credit is limited for high income earners. It begins to phase-out with adjusted gross income of $110,000 (Married Filing Jointly) and $75,000 (Single).

UPDATE #2 (Mileage Rates)

There are 2 standard mileage rates for 1999: .325/mile for the period 1/1/99-3/31/99 and .31/mile for the period 4/1/99-12/31/99. So don't be surprised when we ask for your annual milage broken down between these two periods. The rate does go back up to .325/mile on January 1, 2000.

UPDATE #3 (Capital Gains)

Before the end of the year is the time to make decisions about buying and selling your investments in order to net gains against losses. The most favorable tax treatment is given to capital assets that have been held for more than one year. The maximum tax rate on net capital gains is now generally 20% and reduced all the way to 10% for taxpayers in the 15% bracket.

UPDATE #4 (Paying Tax by Credit Cards)

Taxpayers who file electronically will be able to pay their federal income taxes using a credit card. A charge for this service will be made by the credit card companies based on the amount of the tax owed.

UPDATE #5 (Refunds Taken)

A federal income tax refund can now be taken away from the taxpayer to cover a tax debt the taxpayer has with a state income tax return.

UPDATE #6 (Educational Incentives)

Hope Scholarship Credit - The Hope Credit is available for the 1st two years of secondary education for students who attend school at least half-time. This credit is available per student with a maximum credit of $1,500 per qualifying student. The education expenses must be paid in the 1999 year and only cover tuition and fees (not books, room, or board). These expenses can be paid from the student's earnings, a loan, a gift, or an inheritance. The taxpayer, spouse, or dependent can qualify for the Hope Credit. This credit also phases out for higher income earners. It is not available to taxpayers with adjusted gross income higher than $100,000 (Married Filing Jointly) and $50,000 (Single). Since school years usually run from September to June, a student could have up to 3 different calendar years that qualify as first & second years of secondary education. Since the Hope Credit can only be taken for 2 tax years, proper tax planning to optimize the credit is important.

Lifetime Learning Credit - The Lifetime Learning Credit is based on 20% of the qualifying expenses paid. Maximum eligible expenses are $5,000 annually with a maximum credit available of $1,000 through the year 2002. The annual limit will increase beginning in the year 2003 to $10,000 - increasing the maximum available credit to $2,000. The Lifetime Credit is per taxpayer unlike the Hope Credit which is per student. Each student can only be used for either the Hope or Lifetime credit each year. The Lifetime Credit has the same phase out limitation for higher income earners ($100,000 - Married Filing Jointly and $50,000 - Single). There are no limits on the number of years that this credit may be claimed. The Lifetime Credit applies to tuition and fees (no books, room, or board) for undergraduates, graduate students, and anyone improving their job skills through a training program. The student does not have to attend full-time or half-time to qualify for this credit.

Deduction for Student Loan Interest

A deduction for interest paid on secondary educational loans is available. In order to claim this deduction, the taxpayer does not have to itemize. The maximum deduction is $1,000. Once again, there are phase-out limitations due to adjusted gross income starting at $60,000 for Married Filing Jointly and $40,000 for Single. The loan must have been incurred to pay qualifying expenses (tuition, fees, books, room, and board) for the taxpayer, spouse, or dependent. The deduction is only for interest payments paid during the first 60 months that the payments are required to be made.

UPDATE #7 (IRAs)

Individual Retirement Accounts are generally hit with a 10% penalty tax if the withdrawal is made before age 59 1/2. There are some exceptions to that rule. Here are two important exceptions:

1) The penalty does not apply for withdrawals up to a lifetime cap of $10,000 that are used to purchase a principal residence for a "qualified first-time buyer." In order to be a qualified first-time buyer, you need only to **not** have owned a principal residence within the two-year period before the purchase of the new home! The qualified first-time buyer does not have to be the IRA owner.

2) Distributions from IRAs to pay higher education expenses will not incur the 10% penalty. These expenses include tuition, room, board, fees, books, supplies, and equipment required for post-secondary education. Qualified expenses can be incurred by the taxpayer, spouse, or any child or grandchild.

Educational IRA

Oddly enough this account has nothing to do with retirement. Contributions to an Educational IRA do not affect a taxpayer’s eligibility to contribute to a regular or Roth IRA. Contributions can not exceed $500 annually per beneficiary and the beneficiary has to be under the age of 18. Anyone can make the contributions on behalf of the child but it must be made by the end of the year and there are income limitations. If you exceed adjusted gross income limitations starting at $150,000 (Married) and $95,000 (Single) for a contribution, you can “gift” the money to the beneficiary who can then set up the IRA themselves. The Educational IRA is nondeductible but is tax-free upon withdrawal if the money is used to cover qualified higher educational expenses. (The money may not be used for elementary or high school expenses.) If the Educational IRA is not used by the beneficiary, it can be rolled into another educational IRA for a member of the beneficiary’s family within 60 days of distribution. If the child does not go to college and does not have a family member to roll the IRA over to, the funds must be withdrawn by age 30. The earnings are then taxed and subject to the 10% penalty.

Roth IRA

The new Roth IRA basically allows the taxpayer to set up an IRA account that is nondeductible going in but tax-free coming out. In order for the distribution of accumulated earnings to be tax-free, it must be made 5 years after the initial contribution and after the taxpayer is older than 59 1/2, or becomes disabled, or is used for qualifying first-time home buyer or education expenses. Early withdrawals are tax-free if the taxpayer is withdrawing original contributions (not accumulated earnings). The annual contribution limit for the Roth is $2,000, but not more than the taxpayer's earned income.

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Contributions can be made to the Roth IRA after age 70 1/2 and the minimum required distribution rules do not apply. A taxpayer can contribute to a Roth IRA even if covered by another retirement plan. The phase-out limits for a Roth contribution are reached at adjusted gross income of $160,000 for Married Filing Jointly and $110,000 for Single filers.

BUSINESS OWNER'S UPDATE - Fall 1999

Estimated payments - Estimated payments for corporations are due 12/15/99. Estimated payments for taxpayers who are self employed are due 1/15/00. Please contact our offices before the end of the year if you have concerns regarding increasing or decreasing your estimated payments.

Vehicle Mileage Rate - The standard mileage rate for 1999 is split into separate time periods as follows: .325/mile from 1/1/99 to 3/31/99 and .31/mile from 4/1/99 to 12/31/99. The rate goes back up to .325/mile on January 1, 2000. Remember to record your odometer reading on 12/31/99 for ending and beginning mileage documentation. Any personal use of a business owned vehicle should be reported to our offices by 12/31/99.

W-4s & I-9s - It's a good idea to have employees fill out new W-4s in January. Starting this year, employee names and social security numbers must match their social security cards exactly. There will be a penalty of $50 for filing incorrect W-2s.

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.

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. We advise having the independent contractor fill out IRS form W-9 (Request for Taxpayers Identification Number & Certification).

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

Health Insurance - Health insurance for the self employed is 60% deductible for 1999 as an adjustment to the taxpayer's total income.

Personal Property Taxes & Business Licenses - Any business located in Prince William County must register with the county for personal property taxes and business licenses. Personal property taxes are filed annually and charges are based on the year of purchase of the assets. Even though it is necessary to register for a business license, there are no taxes due until the business grosses more than $100,000 annually. Most counties have similar taxes - be sure to check with your local jurisdiction regarding these requirements.

Buying Equipment & Assets Before 12/31/99 - One of the best ways to reduce your profit before year-end is to buy assets. As long as the company is in a profit situation and has not placed more than $219,000 in assets into service during 1999, the company may expense off the total amount of the purchased assets up to $19,000.

Employing Your Spouse & Children - If you are operating 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. Please contact our office for more information.

Retirement Plans -Just a reminder that retirement funds are an excellent way to defer/reduce taxes. 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.

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.

Meals - The deduction for meals & entertainment remains at 50% for 1999. Occasional meals provided to your employees may be 100% deductible as long as they are on an occasional and infrequent basis, 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 below 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.

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 office.

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.

Business Gifts - The maximum deduction for a business gift is $25.00. Any amount greater than $25.00 for the purchase price 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. Using a portion of your home for personal and business use will not qualify. 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. If necessary, locate your computer outside of your home office so it does not interfere with the exclusive use rules.

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. Contact us to make sure your loans are properly documented to avoid this problem.

Corporate Minutes - Keeping complete and accurate minutes of your shareholders' 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.

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If you need any forms to fulfill any of the requirements we have mentioned in this update newsletter, please contact our offices.