JENNIFER A. JONES, CPA, LTD.
A Quarterly Newsletter

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YEAR-END TAX PLANNING STARTS NOW

Now is the best time to start looking at your financial and tax picture to determine what actions you should take before December 31st.

Your review should look at the following areas:

Has your filing status changed?
What is your top marginal tax bracket?
Are you subject to AMT?
Can you time your income and deductions to achieve any savings?
Can you transfer assets to family members to save on taxes?
Are you taking advantage of the retirement savings opportunities available?
Is there a better retirement plan available to you?
How are your investments being taxed?
What can you do to reduce the tax on your investments?
Can you/should you do a like-kind exchange when you sell property?
How can you take advantage of the education savings plans available to you?

If you own a business,
Which business structure is best for you?
Can you hire your family members and save on taxes?
Are you taking advantage of the new Sec 179 limits and bonus depreciation?
Have you reviewed your choice of retirement plans recently?
Should you take a salary or a dividend?

The due date to set up a Safe-Harbor 401(k) or SIMPLE is October 1st!

For more information and a detailed list of actions you can take to help minimize your tax liabilities, check out "Start Your Year-End Tax Planning Now"

Check 21 Legislation

As you may know, effective October 28, 2004, banks and other financial institutions will have the option of creating, processing, and exchanging digital pictures of checks rather than moving the original paper check. The main goal of the Check 21 legislation is to improve the overall efficiency and security of the payment system. The Check 21 legislation makes the digital copy a legal "substitute check" which can be used for proof of payment or for any other reason that might require an original cancelled check. If you currently get your cancelled checks with your monthly statement, beginning October 28th, some or all of the checks returned to you may actually be substitute checks.

For more information about Check 21 legislation and how it will affect you, visit the Federal Reserve Board at http://www.federalreserve.gov or your bank's website.

New Overtime Rules

Effective August 23, 2004, the Department of Labor has made extensive revisions to the rules dealing with overtime pay. The key provisions include:

1) Overtime pay exemptions do not apply to manual laborers or other "blue collar" workers.
2) Exemptions do not apply to police officers, firefighters, and other public safety personnel.
3) The prior $155 a week minimum salary level for exemption increases to $455 a week., so employees earning less that $23,660 a year must generally be paid overtime.
4) Those earning at least $100,000 a year will be exempt from overtime pay if they "customarily and regularly" perform at least one of the duties of an executive, administrator, or professional employee.
5) Definitions of the exemption categories are simplified, and computer professional are made a separate category.

For more information, see http://www.dol.gov/dol/topic/wages/overtimepay.htm

Dividend or Year-End Bonus?

As a corporate owner, should I take a bonus or a dividend check? It depends. There can be substantial tax savings based on your facts and circumstances, so you need to carefully review your situation to determine the answer. Click here for more information for Sub-Chapter S owners & click here for C-Corporation Owners.

The Cost-of-Living Dollar Limits for 2004 Tax Year

IRA Contribution Limit $3,000
50 & Over Catch-up Contribution $500
401(k) deferral limit $13,000
50 & Over Catch-up Contribution $3,000
Annual compensation limit $205,000
Defined contribution IRC Sec 415 limit $41,000
Compensation limit for SEP eligibility $450
Deferral limit for SIMPLE $9,000
IRC Section 179 $102,000
Unified Credit Exclusion $1,500,000 in 2004
Self-employed health ins. AGI deduction 100%
Business mileage rate $0.375/mile
Medical mileage rate $0.14/mile
Charitable mileage rate $0.14/mile

1st Year Depreciation Limits:
Passenger Autos
New $10,610 Used $2,960

Trucks & Vans under 6,000 unloaded GVW
New $10,910 Used $3,260

Social Security

Wage Base for 2004 $87,900

Retirees under 65 may earn up to $11,640 ($970 a month). For each $2 earned over the amount for the year, the retiree loses $1 in benefits. Retirees turning 65 in 2004 can earn up to $31,080 in the year without losing benefits, counting only earnings before the month they turn 65. For each $3 earned over this limit, the retiree loses $1 in benefits. No limit on earnings if 65 or over.

As you work and pay Social Security taxes, you earn "Credits", up to a maximum of 4 for each year. The amount of earnings it takes to earn a credit changes each year. In 2004, you earn one credit for each $900 of your earnings. So if you have earned at least $3,600 during the year, you get the maximum 4 credits. You need 40 credits for minimum coverage.

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DEADLINES

October

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, quarterly and monthly filers

Maryland income tax withheld return and payment due, monthly filers

Federal, DC and Maryland Individual Income Tax Returns final due date, if Form 2688 or additional extension was filed

20

Virginia and Maryland sales tax return and payment due, quarterly and monthly filers

DC income tax withheld return and payment due, quarterly and monthly filers

31

Form 941 due

Virginia income tax withheld return and payment due, quarterly and monthly filers

Maryland income tax withheld return and payment due, quarterly and monthly filers

State unemployment tax returns and payment due

Form 940 federal tax deposit due

November

1

Virginia Individual Income Tax Return, final due date if second Form 760-E was filed

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, monthly filers

Maryland income tax withheld return and payment due, monthly filers

20

Virginia income tax withheld return and payment due, monthly filers

DC income tax withheld payment return and payment due, monthly filers

Virginia and Maryland sales tax return and payment due, monthly filers

December

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, monthly filers

Maryland income tax withheld return and payment due, monthly filers

20

Virginia income tax withheld return and payment due, monthly filers

DC income tax withheld payment return and payment due, monthly filers

Virginia and Maryland sales tax return and payment due, monthly filers

31

Virginia, DC, and Maryland individual estimated tax payment #4, if you itemize your deductions

Contributions to Coverdell Education Savings Account (Education IRA) are now due by April 15th

Last chance for making donations and other tax-deductible payments

Nursing Home Costs - A Real Threat to Individuals: Medicaid Planning Needed

Faced with escalating nursing home costs and medical expenses, individuals have three options in paying for care. First, they can self-pay. Second, they can purchase long-term care insurance. Third, they can do Medicaid planning to qualify for benefits. For a complete article by Craig Riffle, go to
https://www.nsacct.org/uploadedFiles/LongTermCare-Craig+Riffel.doc
Also check out how you can use a private annuity in Medicaid planning at:
https://www.cpa2biz.com/News/Journal+of+Accountancy/July+2004/From+The+Tax+Adviser.htm

Retirement Plan Sponsors and Administrators

If you are an employer who has a retirement plan for your employees, you should check out and subscribe to the new IRS quarterly publication "Retirement News for Employers" at www.irs.gov/ep Go to Newsletters under Related Topics.

Protect your Retirement Distributions

Because retirement plan distributions are the most valuable asset in many estates, particular care must be exercised to protect these assets. Unlike most other estate assets, income tax planning is vital. This article outlines 10 common pitfalls and how to avoid them.
https://www.cpa2biz.com/News/Selected+Features/Estate+Planning+Pitfalls+of+Retirement+Plan+Distributions

For Free Answers to Your Business and Tax Questions

Do you have outstanding paychecks or other outstanding checks? Then you are a holder of unclaimed property. To see reporting requirements effective 7/1/04:
(Cut & paste the MD and DC URL into your Browser's address box to go to these sites.) Maryland: compnet.comp.state.md.us/compliance
Virginia: http://www.trs.virginia.gov/ucp/ucp.asp
DC: http://cfo.dc.gov/cfo/cwp/view,a,1326,q,590614,cfoNav,|33208|.asp

Worker classification is **a top audit target of the IRS** since there are billions of tax dollars at stake. Criteria you can use to check your classification of workers can be found at http://www.irs.gov/businesses/small/article/0,,id=99921,00.html or see http://www.irs.gov/pub/irs-utl/emporind.pdf (Cut & paste the URL for the article.)

You can cover employee travel expenses by reimbursing them for their actual costs or at a standard per diem rate. Using the per diem rate eliminates the need for employees to substantiate to the company their actual costs. To find the rates, go to Publication 1542 at www.irs.gov or www.policyworks.gov

To donate used computer equipment, try www.recycles.org/byte For suggestions on the valuation of property, see Pub 561 at www.irs.gov or www.usedcomputer.com or for a list of suggested values of used items go to http://www.salvationarmy-usaeast.org/help/valuation_guide.htm

GoToMyPC & Xdrive

GoToMyPC is a fast, easy and secure way to access your PC from any Web browser in real time. You, your employees, your accountant, your computer tech staff or anyone you authorize can remotely access your PC from any-Web-enabled computer. You can start working at your computer just as if you were sitting in front of it. You can access files, programs, email, and your network.

This software allows you to make your accounting records available to us without the headaches and delays of backing up and restoring files, bringing those files to us, and the possibility of losing data. It also can save you from paying for travel time for tech support. This is a great product, well worth your evaluation, and very inexpensive!

For more info, see www.gotomypc.com or read Greg Alwang's review at http://www.pcmag.com/article2/0,1759,12010,00.asp (Cut & paste this article's URL into your browser's address box.)

Xdrive: For easy, reliable and inexpensive off-site backup and storage of computer data, see http://www.xdrive.com

Websites of Interest

Small Business Sites

National Federation of Independent Business's tools and tips for small business owners at www.nfibonline.com

Current and archived versions of *Entrepreneur*, *BizStartups* and *HomeOfficemag* magazines www.entrepreneurmag.com

Free articles on buying, selling, or determining the value of your business at www.businessbookpress.com

Help for small businesses with sample business plans, employment and other legal forms, articles and guidance on various topics www.businessknowhow.com

To keep informed on tax related issues quickly and easily, visit Small Business and Self-Employed Community at http://www.irs.gov/businesses/small/index.html

The Center for Business Planning offers sample business plans, analyses of business strategies, info on evaluating business and marketing plans www.businessplans.org

Want to know what IRS examiners will look for, and how, when auditing certain industries? http://www.irs.gov/businesses/small/article/0,,id=108149,00.html (cut & paste this URL in your browser's address box)

Tools for evaluating the lease vs. purchase of a new vehicle: www.leaseguide.com/index2.htm

How do your employee benefits compare with the federal government's? http://www.opm.gov/oca/leave/HTML/factindx.asp

College Savings

College Savings and 529 Plans: www.collegesavings.org www.savingforcollege.com
www.dccollegesavings.com www.collegesavingsmd.org www.vpep.state.va.us
College savings and 529 Plan rebates www.upromise.com

Retirement Savings and Retirement Plan Information

To determine your required minimum distribution: http://www.newrmd.com/
Roth IRA information: www.rothira.com
Retirement Plan comparison: www.selectaretirementplan.org
Retirement Plan options http://www.dol.gov/ebsa/pdf/choosing.pdf
Retirement Plan Dollar Limitations (COLA): www.irs.gov/ep go to Published Guidance & Cost of Living Increases
or http://www.irs.gov/pub/irs-tege/cola_table.pdf
Small Business 401(k) Plans: http://www.dol.gov/ebsa/publications/401kplans.html

General Interest

Product reviews www.consumerreview.com

Missing Records and Unclaimed Property

To track down missing records, locate lost assets, or discover property you didn't know you had:
Birth, marriage, and death certificates www.cdc.gov/nchs/howto/w2w/w2welcom.htm
Military records www.nara.gov/regional/mprsf180.html
Passport records www.travel.state.gov/passport_records.html
Missing a pension from a previous employer www.pbgc.gov
Holders of abandoned or unclaimed property reporting requirements (new rules effective 7/1/04):
Maryland: compnet.comp.state.md.us/compliance Virginia: http://www.trs.virginia.gov/ucp/ucp.asp
DC: http://cfo.dc.gov/cfo/cwp/view,a,1326,q,590614,cfoNav,|33208|.asp

Estate Planning

To assist in various aspects of estate planning: http://www.learnestateplanning.com/index.html

Dividends or Salary? How to Get Cash Out Of Your S-Corp

(back)

Self-employment and payroll taxes are just a couple of the many factors people consider when choosing the form of business entity they will operate under. All the earnings from a general partnership, along with LLC's treated as partnerships, are, in most cases, income subject to self-employment taxes. On the other hand, distributions from an S-Corporation, in the form of dividends, not as a salary, avoid payment of payroll taxes. So, why take a salary at all from your S-Corp? Because the Law, the IRS, and the Courts say you have to.

So you have to take a salary instead of taking all dividends - what's the difference? Unlike dividends, salaries are subject to payroll taxes. Here is the dilemma. The FICA hit keeps getting larger every year. In 2004, you would pay 7.65% for both the employee and employer share on the first $87,900, or $13,448.70 in FICA tax (the Medicare portion of 2.9% is unlimited and continues above the $87,900 FICA wage base). So, as you can see, the more dividends you can legally take, the less payroll taxes you have to pay. The problem: there is a fine line between what is too much in the way of dividends versus salary.

So, how much salary should you take? That will depend on a number of factors and circumstances.

- Do you do significant work for the corporation?
- Do you have employees generating revenues for the company?
- Are you an officer?
- What is the profitability of the company?
- Are you selling a product or service?
- What would you pay to hire someone else to do the job?
- Is the business in the start-up mode and reinvesting cash?
- Is the business capital intensive? In other words, did you invest a large amount of cash, allowing you to receive a reasonable return on your investment?
- What are similar people being paid in your business or industry?

If you are going to try and justify a lower salary, while taking out higher dividends, keep good records and document all your contracts while taking into consideration those points noted above. The same factors used in determining "reasonable compensation" issues with highly paid shareholders are used to justify, or refute, lower salaries paid out of a S-Corp. Since the proper determination is subjective, documentation is critical. While the payroll savings from lower salaries can be substantial, distributed dividends reclassified as salary can create substantial taxes, penalties and interest. So, proceed with caution. Feel free to contact us to discuss these factors in more detail.

Dividends or Salary? How to Get Cash Out Of Your C-Corp

(back)

Dividends sound nice. You buy a stock, it pays dividends, and you're a happy investor. In fact, if you own a C corporation and it owns some GM or Disney or IBM, a whopping 70 percent of the dividends your company receives from those great investments are *excluded* from taxation (as long as your company owns less than 50 percent of GM, Disney or IBM, that is).

But for a privately held company, dividends are usually an expensive pain in the neck and definitely not a cause for celebration. How is this possible, you ask? Well, when your closely held company pays dividends to you and your fellow shareholders, you must pay income tax on them but your company does not enjoy a deduction for them. But that's double taxation, you say! And you're right, it is!

If you own a C corporation and you pay yourself "excess compensation" in salary or bonus in order to distribute profits from your business, the IRS can recharacterize some or all of it as a constructive dividend and render it non-deductible to your company. And, adding insult to injury, they'll likely tack on a non-deductible penalty as well.

An exception to this is a Personal Service Corporation (PSC). Businesses organized as a personal service corporation derive substantially all of their income from the labors of the service provider-owner, therefore virtually everything may be paid out as salary without risk of being reclassified as non-deductible dividends.

Another consideration is that your salary is subject to FICA taxes — Social Security tax of 6.2 percent must be paid on a salary up to $87,900 in 2004 (this amount increases annually due to inflation); and Medicare tax of 1.45 percent must be paid on ALL salary — whereas dividends are not.

So, if your corporation's tax rate is 15 percent, it might be worth it to pay at least some dividends in lieu of salary. An amount paid as dividends may be taxed twice (at the corporate tax rate, and then again at the individual tax rate) but your salary is essentially taxed twice also (at the combined FICA tax rate of 7.65 percent and again at the individual tax rate.) But the minute your company makes more than $50,000 it gets into the 25 percent federal corporate bracket; or if your corporation is a Personal Service Corporation it is subject to the 35 percent federal corporate tax bracket on all of its taxable income, then the payroll taxes look cheap by comparison.

Then there's the rule that if you don't pay your profits out, your company could get socked with an "accumulated earnings tax" which will make you wish you'd just paid it out in dividends and swallowed the double taxation in the first place. A C corporation can usually retain up to $250,000 without adverse consequences but a personal service corporation can only retain $150,000. Both types of entities may be permitted to retain amounts in excess of these limits if it can be demonstrated that the additional working capital meets the reasonable needs of the business; for example, if you need to retain cash to buy a new plant and equipment.

There is a happy medium to be struck in your dividend policy. If your firm is profitable, it's usually wise to declare a modest but regular dividend. Think of it as an insurance premium against future audits.

Start Your Year-End Tax Planning Now

(return to newsletter)

You have a unique window of opportunity to control the amount of total tax you pay for this year and next. By this time of year, you should have a good picture of what your income and deductions will be for this year. This knowledge can allow you to accelerate or defer some income, or accelerate or defer deductions, between 2004 and 2005, to end up with a lower overall total tax liability.

Income can often be deferred by delaying year-end billings, postponing year-end bonuses, arranging deferred compensation, and increasing deductible retirement contributions. Similarly, deductions may be accelerated by paying outstanding medical, interest, business, other deductible expenses, or by making charitable contributions by December 31st.

Year-end tax planning is more important than ever before for individuals and small business owners. It should begin immediately to take advantage of the 2004 and 2005 tax benefits. Please contact our office for assistance with your year-end tax planning strategy.

Year-end tax planning for individuals

Here are some things to consider when determining the timing of income and deductions:

Life events. Changes in personal circumstances, such as the birth of a child, marriage, divorce or retirement during 2004, or anticipated in 2005, may also require year-end income and deduction shifting to even out taxable income.

Adjusted gross income (AGI) limits. Adjusted gross income (AGI) levels should be reviewed at year-end to determine whether benefits from certain deductions will be maximized. For example, medical expenses are deductible only to the extent that they exceed 7.5% of your AGI, while miscellaneous itemized deductions must exceed 2% AGI to be useful. Timing these and other deductions, however, may not necessarily mean that you should even them out over 2004 and 2005. You may find that after doing the math that it would mean less tax for you if you took the standard deduction for one year and bunched all itemized deductions into the other year.

Planning the level of your AGI between 2004 and 2005 also may make a difference in the amount of total itemized deductions that must be reduced (required of those with more than $142.700 in 2004) or the level beyond which personal exemptions, Roth IRAs contributions, child credits, or education tax credits must either be limited or denied.

Alternative minimum tax (AMT). You also need to keep your eye on the alternative minimum tax (AMT). High real estate and/or state income taxes have turned the AMT into a problem for even the "average" taxpayer. By shifting certain items of income and deductions at year-end, AMT sometimes can be avoided, or loaded to your benefit into only one year. "Crunching the numbers" at year-end often will indicate the AMT strategy that's best for you.

Capital asset transactions. Year-end tax selling of stock and other capital assets frequently can save the active investor a significant sum. The first step to realizing these savings is to add up all short-term and long-term capital gains and losses realized so far this year. Then determine which of those gains and losses arise from 15% capital gain property and which arise from 25%

depreciable and 28% collectible property. With this information, you should realize more short-term gains if you have net short-term losses, more long-term gains to offset long-term losses, more short-term losses to offset short-term gains, and so forth.

Gifts. Gifting is frequently overlooked as a tax-planning tool. For 2004, you can make tax-free gifts up to $11,000 ($22,000 for married couples). Immediately in January, you also will be eligible to make another round of gifts up to $11,000 and $22,000.

Year-end tax planning for small businesses

If you own a small business, tax planning should be a year-round event, but many people don't start thinking about taxes until the year comes to a close. For the small businessperson, tax planning is often a combination of personal and business planning, because the two are very closely linked. However, sole proprietors have very different tax considerations than owners of C corporations or partners in a partnership so a careful review is needed to determine what tax planning techniques will best maximize your savings.

Overview

Let's take a look at some general year-end tax strategies for small business people:

Accelerating or deferring income. Corporations can elect to accelerate or defer income and potentially lessen harsh tax consequences. Billing for services or products can be accelerated and payment received before the end of the year. Dividends can be paid before the end of the year or delayed until the next year. Self-employed, cash-basis businesses can delay billing until late in the year so payments will not be received until next year. Year-end bonuses can be delayed. Special accounting rules also can help you defer recognition of gain, such as an employee's taxable fringe benefits. Research expenditures, charitable contributions, and casualty losses also can help you shift income.

Reviewing your operating status. Sole proprietors should consider the liability protection available to a one-member limited liability company. This change in status can be done without changing your tax reporting status. S corporations are increasingly attractive, especially after some very tax-friendly court decisions. Start thinking if your small business needs would be met by operating as an S corporation. Conversion from C to S status can open the door to some favorable tax treatment. On the other hand, operating as a "traditional" corporation still has many tax-friendly considerations so you need to carefully weigh which status best fits your needs. Review whether your corporation Is considered a Personal Service Corporation and, if so, whether it is in compliance with the required fiscal year rules. Review the method of accounting rules to see if your corporation can elect to change to the cash basis of accounting, or if your corporation has grown to the level where it is required to use the accrual basis of accounting for tax purposes.

Using net operating losses. The slowing economy is evident in the growing number of businesses reporting net operating losses. Remember, the tax rules allow you to carry back and carry forward net operating losses, thereby mitigating some of the pain. Congress made the carry back rules more generous and now allow you to carry back losses five years.

Purchasing equipment. Timing business purchases has very important tax consequences. Depreciation generally runs on half-year conventions and you'll need to decide whether to make your purchase in the last months of this year or if deferring these purchases until 2005 will generate more favorable tax treatment. Small businesses also can "write-off" (expense) up to

$102,000 for property placed in service during 2004. Congress introduced a special bonus depreciation allowance of 30% of the cost for equipment purchased after September 10, 2001 and 50% of the cost for equipment purchased after May 5, 2004. This bonus depreciation allowance is not available for state tax purposes.

Retirement planning. For the small businessperson, retirement planning also plays an important role in year-end tax planning. The 2001 Tax Relief Act opened the door for greater participation in more tax-free savings vehicles for many small business owners. Contribution limits have been raised and with aggressive planning techniques, which meld the benefits available to employees and employers, you can maximize your retirement savings. If you do not have a retirement plan in place, a new tax credit is available.

Specific Action Points to Consider

Individuals

Withholdings

1. Make sure that the withholding on your salary or estimated tax payments are sufficient to meet your expected income tax liabilities. If not, consider whether you are subject to an underpayment of estimated tax payment penalty. If liable for the penalty, you will minimize the penalty most effectively by increasing your withholdings. If unable to change withholdings, then make/increase your final estimated tax payment.

Investors

1. Consider selling stock or mutual funds that have declined in value before December 31st in order to realize capital losses that can offset capital gains reportable for the current year. If you want to hold a particular investment, consider selling by December 31st and re-purchasing the security after 30 days (wash-sale rules) or purchasing a similar security.
2. Review your investment income and any margin interest paid. If your interest expense exceeds your investment income, review your investment strategy and financing options.
3. Review your taxable bond and tax-exempt bond portfolio. Consider the after-tax yields.

Deductions

1. Accelerate your mortgage interest deductions by prepaying your home mortgage payment due January 1st.
2. Accelerate your state income tax deductions by paying any state estimated income tax payments due in January before December 31st. If you are an employee and you anticipate a balance on your state return, increase your withholding on your paychecks before December 31st.
3. Convert any non-deductible interest on personal loans into fully deductible interest by paying off the debt using a home equity line of credit or consolidating loans as part of

a home mortgage refinance to take advantage of record low home mortgage rates. Be careful of limitations and alternative minimum tax considerations.

4. Increase your charitable contribution deductions by making gifts of property, such as stocks, that have gone up in value, in lieu of cash donations. If the property has been held for at least 12 months, the full fair market value is tax-deductible and the gain is not subject to regular or alternative minimum taxes.

Individual Retirement Accounts

1. If you are eligible, consider converting your traditional IRAs to Roth IRAs. While you will owe current federal and state income taxes on the amount converted, the amounts transferred into the Roth IRA will grow tax-free and avoid income taxes when withdrawn in the future.
2. Contribute the maximum "catch up" contribution to your IRA. For 2004 and 2005, the amount is $500. For 2006, the "catch up" amount will increase to $1,000 if age 50 or older by December 31, 2006.
3. If eligible, establish Roth IRAs, otherwise, establish traditional non-deductible IRAs for each spouse. Fund these accounts to the maximum ($3,000 per individual in 2004 and $4,000 per individual in 2005) on January 1st of each year.
4. Establish a Roth IRA for each employed child earning at least $3,000 in 2004 and $4,000 in 2005. Contribute $3,000 for 2004 and $4,000 for 2005. While these contributions are not tax deductible, all future earnings will be tax-free when withdrawn after age 59½. Maximize tax-free income by making the contribution on January 1st each year.
5. Convert each child's traditional IRA to a Roth IRA as they reach age 14. While the conversion will be subject to current taxes, all future earnings will be tax-free when withdrawn at age 59½.

Retirement Planning

1. Contribute the maximum contribution to your 401(k) plan; $13,000 for 2004 and $14,000 for 2005.
2. Contribute the maximum "catch up" contribution to your 401(k) plan if age 50 or older by December 31st: $3,000 for 2004 and $4,000 for 2005.

Retirement Income

1. On April 17, 2002, IRS finalized the Minimum Distribution Rules for Retirement Plans. A new life expectancy table was issued. The new table is effective for all distributions in 2004.

Education Related

1. Consider funding an IRC Sec. 529 college savings plan in order to shelter additional investment earnings for future tax-free payouts to cover college and/or private school costs. The definition of member of the family has been expended for purposes of inter-family changes of designated beneficiaries to include first cousins of the original beneficiary.
2. Establish and fund the maximum annual contribution ($2000 in 2004) to a Coverdell Education Savings Account (ESA) (formerly named Education IRA) for each child in order to shelter investment earnings for future tax-free payouts to cover college

and/or private school costs. If your AGI exceeds the limitations, consider others who may be eligible to make the contribution, including the child. The deadline for the ESA contribution is April 15th following the year-end.

3. Consider not claiming college age children as dependents on your federal or state income tax returns. Instead, have them pay for their college education and living expenses from their own funds or custodial accounts. They may be eligible for the HOPE education tax credit ($1,500 a year for the first two years) or the Lifetime Learning Credit ($2,000 a year after the first two years).

Family Tax Planning

1. Reduce overall income taxes by shifting appreciated stock/real estate or income producing property to a family limited partnership (FLP), Sub-chapter S corporation (Sub-S), or limited liability company (LLC) set up on behalf of your children ages 14 or older.
2. Increase the income shifted to lower tax bracket children by having the FLP, LLC or Sub-S begin operating a business that supports your small business.
3. Have the FLP, LLC, or Sub-S purchase all new equipment needed for your business and lease this equipment back to your business at an annual rate equal to 25-33% of its fair market value purchase price.
4. Increase the rent charged to your business for use of the office building or equipment to the highest reasonable rate, in order to withdraw funds free of payroll taxes, and to increase the income shifted to lower tax bracket children where the property is owned by a FLP, LLC or Sub-S on behalf of your children.
5. Employ children age 6 or older through your business where feasible, in order to fund college savings arrangements or IRAs. Each child can earn $4,750 in 2004, federal income tax-free, in exchange for services actually rendered.
6. Have the FLP loan funds to your business for working capital or capital improvements at a high interest rate in order to shift funds from the business to your children on a tax-favored basis.

Small Business Owners

Entity Selection

1. Review the tax savings available by electing Subchapter S corporate status, effective January 1, 2005. You may be able to reduce your payroll taxes by taking a lower salary, with the remaining profit distributed as a dividend (subject only to income taxes); reduce the income taxes on the sale of the business; enjoy the flow-through of tax credits; reduce audit risk and exposure.
2. If a sole proprietor, review with your attorney the liability protection available to a one-member limited liability company without changing your tax reporting status.

Income

1. Defer income into 2005 by slowing billing and collection activities in December.
2. Corporate business owners may want to consider borrowing funds from the corporation, properly documented by a promissory note, then converting the shareholder loans to salary during 2005 to shift income into next year.
3. Be sure to take advantage of any existing net operating losses.

Business Expenses

1. Accelerate your deductions by paying all business expenses on or before December 31st. You may even want to contact your vendors to get an updated billing. Remember that amounts charged on all-purpose credit cards count as a current year deduction, even if the bill is not paid until next year.
2. Have your business reimburse you for all business expenses paid personally during 2004, e.g., travel and entertainment, business car expenses, dues and subscriptions, continuing education, safe deposit box fees, tax return preparation fees, tax planning fees, etc.
3. Make sure the business is paying all medical insurance premiums for you and your family.
4. Make sure that all travel is business related (continuing education meetings, consultation with colleagues, etc.) in order to eliminate non-deductible personal travel costs. In order to document consultations with colleagues, send a letter to the colleague confirming your visit, as well as a follow-up letter to thank him for the opportunity, outlining the discussion from the four-hour in-office visit.
5. Pay for all business related dues and subscriptions through the business account. If your business has a waiting area, purchase all magazines, newspapers and other periodicals through business and display these in the waiting area.
6. Pay all business related miscellaneous itemized deduction expenses, such as safe deposit box fees, tax return preparation fees, dues and subscriptions, etc. through the business account in order to insure deduction.
7. Separate fully deductible travel, lodging, and continuing education expenses from meal and entertainment expenses for tax reporting purposes. In addition, make sure all meal expenses for staff meetings, functions and outings are classified properly since these are 100% deductible under IRC Sec. 274(n).

Property and Equipment

1. Make maximum use of the annual $102,000 expensing deduction under IRC Sec. 179 to immediately write-off new or used equipment purchases made during the current year.
2. Consider if you should take the special 30% depreciation allowance for qualified property you place into service or the special 50% depreciation allowance for qualified property you place into service after 5/5/03. (Some states are not permitting this deduction, e.g. Virginia does not permit this deduction.)
3. Take advantage of the final quarter equipment purchases requirements for “half-year” and “mid-quarter” depreciation conventions to maximize or defer depreciation deductions.
4. Take advantage of the Disabled Access tax credit of up to $5,000 annually for the cost of building improvements such as the expansion of hallways, repaving parking areas, installing ramps, bathroom modifications, carpeting and floor covering costs incurred to make your facility more accessible to the handicapped.
5. Also take advantage of the $15,000 expensing election for the expenditures to remove architectural and transportation barriers to provide services to the handicapped and elderly.
6. If you have business vehicles, consider buying a sport utility vehicle (SUV) rated at 6,000 lbs. or more, fully loaded, in order to get the 6-year depreciation write-off, be eligible for the Sec. 179 $102,000 expense election, and to avoid the luxury auto tax. SUVs that qualify include the Lincoln Navigator, Chevrolet Suburban, GMC Yukon, Ford Expedition and Excursion, Range Rover, Land Rover, and the Lexus LX 470.
7. Pay all operating expenses for your business vehicles through the business account and deduct the actual cost of operation, rather than the standard mileage rate. Keep a log to document your business vs. personal use. If incorporated, show any personal usage as income on your W-2.

Employment of Spouse and Children

1. Pay your spouse an annual salary of $3,600 in 2004 in order to qualify for the minimum Social Security benefits.
2. If child care is required, the spouse's earned income needs to be at least what is paid to the child care provider, up to $4,800, to maximize the child care tax credit.
3. As an employee, the spouse will be entitled to tax deductible travel and fringe benefits.
4. If the business is unincorporated, consider having your spouse covered as the "named insured" under the medical insurance policy in order to convert this to a 100% deductible business expense. Self-employed health insurance deduction finally has reached 100% deductible as an AGI adjustment, but does not affect the self-employment tax computation.
5. If your business has a SIMPLE-IRA retirement plan, increase the spouse's salary to $9,000 in order to qualify for the maximum SIMPLE-IRA deferral.
6. If your business has a 401(k) profit sharing plan, increase your spouse's salary in 2004 to $14,100 to qualify for the maximum deferral of $13,000. If the spouse is over age 50, increase the salary to $17,350 to take advantage of the maximum deferral of $16,000 in 2004.
7. Employ children age 6 or older through your business where feasible, in order to fund college savings arrangements or IRAs. Each child can earn $4,850 in 2004, federal income tax-free, in exchange for services actually rendered.
7. If the business is a proprietorship, wages paid to your children who are under 18 years old are not subject to FICA and unemployment taxes.

Retirement Plans

1. If you do not have a retirement plan, you should review what is available and what fits your circumstances best. **Certain plans must be set up by October 1st and others must be set up by December 31st to qualify for a 2004 tax deduction.** You have until April 15th to set up an SEP Plan and still take a deduction on your 2004 return. You have until the due date of your return to fund these retirement plans.
2. Contribute the maximum amount to your retirement plan as long as at least 60% of the amounts are allocated to you or your spouse. If you are not receiving at least 60% of the total amounts allocated, you need to review other options, such as a cross-tested plan or safe-harbor 401(k) profit sharing plan to maximize your retirement benefits and make your plan more cost-effective.
3. If you have a 401(k) profit sharing plan, provide the required notice to your employees by December 1st, if you plan to use the safe-harbor provisions effective January 1, in order to limit staff funding requirements. Contact the plan provider to determine the amendment requirements to adopt the safe harbor provisions.
4. If your have a money purchase pension plan and a profit sharing plan, consider merging these plans into a single plan, in order to maximize the annual contribution while eliminating the additional legal, accounting, and administrative fees incurred in operating two plans. If merging your plans, notify the employees by November 30th so that the merger can be effective January 1st.
5. There are some "sunset" provisions that may influence your decision to merge your plans. An alternative option is to freeze the money purchase pension plan. This requires an amendment to reduce the contribution requirement to zero.
6. If you are age 45 or older and your employees are younger, consider establishing a defined benefit plan. This may substantially increase your tax-deductible retirement plan contributions. As a result of the repeal of IRC Sec. 415(e), contributions to a defined benefit plan can now be made without regard to amounts contributed or accumulated under prior defined contribution plans.

7. If you currently have a defined benefit plan, have your actuary compute how much your 2004 contribution can be increased due to investment losses and how much the 2005 contribution can be increased to take advantage of the higher funding limits.
8. If your spouse operates a separate business, consider establishing a separate retirement plan for that business.

C Corporations

1. Consider establishing a Medical Reimbursement Plan to have the corporation pay for medical expenses incurred not covered by medical insurance and a Dependent Care Assistance Program to cover up to $5,000 of child care costs.
2. Make sure that you are reimbursed for all eligible unreimbursed medical expenses and child care costs incurred during the year.
3. Pay disability insurance premiums on a personal basis and have your corporation reimburse you following the close of the policy year, provided you are not disabled. If you become disabled, no reimbursement should be made. You can take the position that the disability proceeds received should be tax-free since in the year of the disability, the premiums were paid personally.
4. Reduce your Personal Service Corporation's (PSC) taxable income to zero by paying year-end bonuses and making retirement plan contributions. Retaining earnings in a PSC only makes sense to the extent the earnings fully utilize net operating losses and tax credits.
5. Pay all charitable contributions and donations personally to insure a full deduction.
6. If you operate a PSC on a fiscal year rather than the calendar year, make sure you have complied with IRC Sec 280H in regards to minimum distribution and compensation requirements.

Sources:

Blair/McGill Advisory, "Top 50 Year-End Tax Planning Strategies" October 2001

2001 Tax Law Summary, PCPS Newkirk Products, Inc.

2004 Year-End Tax Planning Guide, PCPS Newkirk Products, Inc.