

JULY 2004

Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for OUR CLIENTS and FRIENDS*

Is It Time to Update Your Will?

Preparing a will is the best way to be certain your property is distributed according to your wishes, but keeping that will up-to-date is essential. You should review your will periodically, especially when there are changes to personal circumstances, your financial situation, or the tax laws. Here are some situations that should trigger an immediate review of your will:

- **Marriage, divorce, or remarriage.** These life events can have a major impact on financial planning documents. For example, if a widow or widower remarries, it is important that the will is updated to show how the children from the previous marriage and the new spouse should be provided for.
- **A new heir.** Updating a will is especially important when you have a child, because your will allows you to name a guardian to care for your child in the event that something happens to both you and your spouse. If you don't name a guardian for your child, the courts will appoint one.
- **Death of someone named in the will.** The death of a named executor, guardian, beneficiary, or trustee signals a need to make changes to those provisions in your will.

SPECIAL TAX ISSUE

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Did You Know?

Around the 10th century, Italian bankers began conducting their business in big open areas, each banker working from his own bench or table. "Banca," the Italian word for bench, has since been altered slightly to give us the word "bank."



- **Substantial increase or decrease in net worth.** If you get a large personal injury settlement, or receive a large inheritance or other unexpected windfall, additional tax planning might be necessary to minimize the tax bill on your estate. On the other hand, a significant decline in your financial assets might dictate altering your specific bequests or making other modifications.
- **Relocation to another state.** If you relocate, you should have an attorney in the state of your new residence review your will. This is especially important if you move to or from a community property state. Although all states recognize a will that was properly created in another state, there may be nuances that need to be addressed.

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CPA Client Bulletin

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- **Tax law changes.** Updating your will allows you to take advantage of recent developments and new techniques in estate planning. With the estate tax exemption scheduled to change a number of times between now and 2011, and the prospect of future changes, it's more important than ever to review your will on a regular basis.
- **Changes to your intentions.** Whether you want to add a new beneficiary or charitable donation, or you've had second thoughts about your executor or the guardian

of your children, be sure to implement these changes on a timely basis. If your revised intentions do not make it into print, they will have no legal effect.

How to change your will

You can't just make changes on your will. While every change doesn't necessitate redrafting, marking your will up invalidates it completely. In the past, changes were made by creating an amendment called a "codicil," which, to be valid, has to be signed and witnessed like a will. A codicil supplements your will and can modify, further explain, or add to, delete, or amend provisions in

qualifying separate plan for prescription drug benefits.

How do HSAs work?

HSAs allow you and your employer to make contributions each year that can be used to pay for qualified health expenses for you, your spouse, and dependents.

The money you contribute to an HSA is tax-deductible up to the amount of the policy deductible, even if you don't itemize. Next, the interest and investment earnings are not taxable, so the money in your HSA grows tax-free. Finally, you can take tax-free distributions to pay for qualified medical expenses.

How much can I contribute to an HSA?

The annual deposit limit is equal to the amount of the health insurance deductible. (HSA owners born before 1950 can contribute an additional \$500.) The tax write-off cannot exceed \$2,600 for individuals and \$5,150 for families. Contributions must be made in cash, not with stocks or other property and, like IRAs, contributions may be made through April 15 for the previous tax year.

the existing document. However, in the age of word processing, it is much better to redraft, sign, and witness a new will.

Keep it safe and current

Once you have signed your will, keep it in a safe place, such as a safe deposit box, and be sure that your family members know where to find it. You should keep a duplicate unsigned copy handy and review it periodically to see if any changes are needed.

Reviewing your will is an important part of the estate planning process, and a process that will ensure that it is in alignment with your financial and estate planning objectives.

What expenses are qualified?

HSAs can be used to cover IRS-approved medical expenses not covered by insurance, including doctor visits, prescription drugs, over-the-counter remedies, and long-term care insurance. Funds can also be used to pay for the health insurance deductible, COBRA benefits, health insurance premiums you pay while you are unemployed, and for Medicare premiums in certain situations.

To deter the use of HSAs for non-medical purposes, funds withdrawn before age 65 for nonmedical purposes are subject to a 10 percent penalty, as well as taxes on the amount withdrawn. Taxpayers who are age 65 or over are exempt from the penalty, but must pay taxes on amounts not used for medical purposes.

Are there special rules for preventive-type medical expenses?

To qualify for an HSA, you must have medical insurance with a high annual deductible. However, even these high-deductible plans may have no deductible for preventive-type expenses, such as periodic exams, immunizations,

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Help for High Medical Insurance Deductibles

"HSA" is the newest acronym in health insurance savings. The Health Savings Account, created by the 2003 Medicare Prescription Drug, Improvement and Modernization Act, is a tax-favored savings plan that can be used to pay for qualified medical expenses. Here are some answers to questions that will help you determine if you can benefit from an HSA.

Who is eligible to open an HSA?

Effective January 1, 2004, anyone who is covered by a high-deductible health insurance policy and is not eligible for Medicare can open an HSA. To qualify, you cannot be claimed as a dependent by another person. A high-deductible plan is defined as one with an annual deductible of at least \$1,000 for individual coverage and at least \$2,000 for family coverage. In general, the high-deductible policy must be your only health insurance, although there are exceptions if you participate in certain flexible or reimbursement arrangements (see below) or if you have a

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or certain screening services. Earlier this year, the IRS specified that you may still establish an HSA even if the plan has no annual deductible for preventive-type expenses.

If I participate in my employer's flexible health spending account (FSA) and health reimbursement arrangement (HRA), am I still eligible?

The general rule to qualify for an HSA is that the high-deductible insurance

must be your only health coverage. However, under Revenue Ruling 2004-45, you may be eligible if you are covered under certain restrictive FSAs or HRAs, such as limited purpose FSAs and HRAs that restrict reimbursement to certain permitted benefits such as vision, dental, or preventive care benefits. There are other unusual situations which may also allow you to participate in both types of plans.

Should I open an HSA?

If you have a medical insurance plan

with a high annual deductible, you should consider the pros and cons of an HSA. Whether an HSA will work for you depends on a number of factors, including the amount of your other medical expenses and your adjusted gross income, among others. In addition, if you have any other type of health care insurance or reimbursement arrangement, it may be especially difficult to navigate the rules. Please call us to discuss whether an HSA can help you ease the pain of high medical insurance deductibles.

Midyear Tax Checkup

You've filed your tax return, and now you're ready to kick back and forget about taxes for a while. Not so fast—tax savings requires more than a year-end scramble to defer income and accelerate expenses. The most effective way to lower your tax bill is to treat tax planning not as an annual event but rather as a year-round process. Here are some strategies that will help you keep more of what you earn.

Start with your recently filed return

The best tax planning begins with an examination of where you stand right now. Did you end up writing a large check to Uncle Sam that included an underpayment penalty? Or did you receive a large refund check? Each of these scenarios represents a tax-planning opportunity.

If you're concerned that you'll owe more taxes this year, adjust the number of allowances on your W-4 or pay more in estimated taxes. To rectify an overpayment situation, consider increasing the number of allowances claimed. By making these corrections early in the year you get the full benefit of the adjustment.

Make retirement planning a priority

Arrange to make retirement plan contributions early in the year. You can make your 2004 IRA contribution as late as April 15, 2005. For Simplified Employee Pension (SEP) plans or

Keoghs, you have until April 15, 2005, or your tax-extension due date. But why wait? The sooner you set aside the funds, the more you will maximize the benefits received from the tax-deferred compounding of investment returns with retirement plans. And if you're not funding your 401(k) plan at work to the maximum, take some time now to figure out how you can cut expenses and increase your contributions.



Plan your charitable giving

Creating a charitable giving plan in advance provides you with the opportunity to make tax-wise contributions. For example, if you have held securities for over a year and they have increased in value, consider giving those to charity. When you contribute appreciated property that you have held over a year, you not only can deduct the property's full appreciated

value, but you also avoid paying capital gains tax on the profit.

Maximize deductions

Certain deductions, such as medical expenses and miscellaneous deductions, have "floors"—minimum amounts you have to exceed before a deduction is allowed.

With time on your side, you can work toward the concept of bunching deductions—the practice of accelerating expenses into this year if it appears you might reach the floor, or deferring expenses into next year if you don't expect to exceed the floor in 2004. The same strategy applies to your miscellaneous itemized deductions, including unreimbursed employee business, job-hunting, investment, and tax-preparation expenses.

Shift income

Another strategy you might consider now for reducing your 2004 taxable income is to shift income to other family members. Under current tax law, you can gift to your children, or anyone else, up to \$11,000 each annually (\$22,000 if your spouse joins you in the gift), without being subject to the gift tax. Income generated by the gift is taxed to the new owner.

Don't wait until year end

Remember, when it comes to saving tax dollars, timing can be everything. Don't wait until the last minute to take the steps that can minimize your tax bill for 2004 and beyond.

IRS Eases Burden on Certain Meal and Entertainment Expenses

The Internal Revenue Service recently issued a new procedure that allows the use of statistical sampling methods to establish the amount of certain fully deductible meal and entertainment (M&E) expenses (those that are not subject to the usual 50% deduction disallowance rule). The new rule, effective for years ending after May 3, 2004, is intended to ease the reporting burden of taxpayers, but, because of the administrative cost involved and the limited types of expenses that qualify, is most likely to benefit large businesses that frequently incur these types of expenses.

Which expenses qualify?

Only M&E expenses that are fully deductible are eligible for the new procedure. While there are several categories of fully deductible expenses, the most common is food and beverages excludable from the income of a recipient because they are considered de minimis fringe benefits (too small to be reasonably accounted for). Such expenses may include supper money provided occasionally so that an employee can work overtime or meals excluded from income because they are provided on the employer's premises for the employer's convenience.

Will the new rule benefit your business?

If you have large numbers of transactions involving the fully deductible meal and entertainment expenses described above, the new procedure may allow you to cut down on documentation for those types of expenses. However, for the vast majority of small businesses, the rule will be of minimal assistance. If you feel your business may benefit from the new procedure, please call us to discuss its possible application to your business.

Tax Calendar

JULY 2004

July 12

Employees who work for tips. If you received \$20 or more in tips during June, report them to your employer. You can use Form 4070.

July 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

Partnerships. File a 2003 calendar year return (Form 1065). This due date applies only if you were given an automatic three-month extension. Provide each partner with a copy of Schedule K-1 or a substitute K-1. If you need an additional three-month extension, file Form 8800.

Electing large partnerships. File a 2003 calendar year return (Form 1065-B). This due date applies only if you were given an automatic three-month extension. If you need an additional three-month extension, file Form 8800.

AUGUST 2004

August 2

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2004. Deposit any undeposited tax. (If your tax liability is less than \$2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until August 10 to file the return.

For federal unemployment tax, deposit the tax owed through July if more than \$100.

If you maintain an employee benefit plan with a calendar year end, file Form 5500 or 5500EZ for calendar year 2003.

August 10

Employees who work for tips. If you received \$20 or more in tips during July, report them to your employer. You can use Form 4070.

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2004 only if you deposited the tax for the quarter in full and on time. Otherwise, Form 941 was due on August 2.

August 16

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in July if the monthly rule applies.

Individuals. If you have an automatic four-month extension to file your income tax return for 2003, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, and penalties due. If you need an additional two-month extension, file Form 2688.



The CPA. Never Underestimate The Value.