

# CPA CLIENT

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## What Kind of Retirement Plan Is Right for Your Business?

Many small business owners do not think of retirement plans when thinking about deductions and their yearly tax bill, although retirement plans are often one of the best tax breaks available to small business owners. Retirement plans have a double-pronged benefit—you save taxes now and help build a secure future retirement for participants.

There are a number of retirement plan options for small business owners, each with its own advantages and limitations. The plan you choose depends on the form and size of your business, the amount you wish to contribute, the amount of flexibility you desire, and many other factors. But regardless of the your particular circumstances, you will almost certainly find a plan that suits your situation.

In general, there are three basic types of plans: (1) IRA-based plans, (2) defined contribution plans, and (3) defined benefit plans. Each has its own rules for annual contribution limits, filing requirements, and participant rules that are beyond the scope of this article. However, knowing the basics will help you proceed to the next step.

### IRA-based plans

IRA-based plans include payroll deduction IRAs, simplified employee pension (SEP) plans, and savings incentive match plan for employees IRAs (SIMPLE-IRAs).

*Payroll deduction IRA.* The payroll deduction IRA is probably the simplest retirement arrangement for a business, although it does not provide a deduction for your business. Under a payroll deduc-

tion IRA, an employee establishes an IRA (either a traditional IRA or a Roth IRA) with a financial institution. The employee then authorizes a payroll deduction for the IRA. Your responsibility as an employer is simply to transmit the employee's authorized deduction to the financial institution.

*SEP.* A SEP is basically an IRA you set up for yourself and your employees. SEP administrative costs should be lower than for some other plans. By establishing a SEP,



you the employer have adopted a plan that has a trust for the plan assets, and each of your employees (including yourself) has a separate account within the trust. A SEP is funded only by employer contributions. Each employee is always 100% vested in

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(or has total ownership of) the contributions to his or her SEP. If you set up a SEP for yourself, you generally must cover all employees who meet an age and service test.

**SIMPLE-IRA.** SIMPLE-IRAs are available only for a small business with 100 or fewer employees. If you opt for a SIMPLE-IRA plan, your employees can elect to defer part of their salary. Each employee is always 100% vested in all contributions to their SIMPLE.

**Defined contribution plans**

With a defined contribution plan, you as the employer make a stated ("defined") contribution to the plan. Each participating employee has a separate account and his or her retirement benefit results from the contributions made to his or her account and the earnings on those amounts. Examples of defined contribution plans include 401(k) plans, including SIMPLE 401(k)s, profit-sharing plans, and money purchase plans.

**401(k) plans.** With a 401(k) plan, employees can choose to defer some of their salary. So instead of receiving that amount in their paycheck, the employee defers, or delays, getting that money. In this case, their deferred money is going into a 401(k) plan sponsored by their employer. This deferred money generally does not get taxed by the federal government or by most state governments until it is distributed.

You can make a 401(k) plan as simple or as complex as you want. A preapproved 401(k) plan cuts down on administrative headaches and expenses. While 401(k) plans provide some popular advantages, the administrative costs often make them too expensive for small businesses.

**SIMPLE 401(k) plans.** A new subset of the 401(k) plan is the SIMPLE 401(k) plan. Like the SIMPLE-IRA, this plan is for the small business with 100 or fewer employees. Under a SIMPLE 401(k) plan, an employee can elect to defer some compensation. But unlike a regular 401(k) plan, the employer must make either:

1. A matching contribution up to 3% of each employee's pay depending on the amount each employee contributes; or
2. A nonelective contribution of 2% of each eligible employee's pay, regardless of whether the employees make contributions.

The employees are totally vested in any and all contributions.

**Profit-sharing plans.** Contributions to a profit-sharing plan are discretionary. If you do make contributions, you will need to have a set formula for determining how the

contributions are divided. This money goes into a separate account for each employee. As with 401(k) plans, you can make a profit-sharing plan as simple or as complex as you want. Preapproved profit-sharing plans are available to cut down on administrative headaches. However, you will still need to test the plan to assure that benefits do not discriminate in favor of the highly compensated employees.

**Money purchase plans.** Money purchase plans have required contribution percentages, which are stated upfront in the plan. Preapproved money purchase plans are available to cut down on administrative requirements. Money purchase plans are subject to more generous limits; therefore it is possible to grow larger account balances than under some other arrangements. However, administrative costs may be higher, and an excise tax applies if the minimum contribution requirement is not satisfied each and every year.

**Defined benefit plans**

With a defined benefit plan, the participant is promised a stated "defined" benefit. There are no separate accounts, only one general trust. Usually the benefit is stated as a percentage of pay or a specific dollar amount multiplied by the participant's years of service. Trust earnings have no impact on the participant's promised benefit.

Sometimes, you might hear defined benefit plans described as:

- Career Average Earnings Plans
- Final Average Earnings Plans

While there are often higher costs and more complexity with these plans, defined benefit plans can provide significant benefits in a relatively short period of time, and, often, employers can contribute (and deduct) more than under other retirement plans. Another advantage is that the plan provides a predictable benefit. However, such plans are the most costly and most administratively complex.

**Many choices to make**

Is one of these plans for you? Please call us if you would like to consider the many possibilities for establishing a retirement plan for your business or to discuss whether your current plan still fits your needs and expectations. Because of the significant tax advantages available now, and the important future benefits a retirement plan can provide, establishing a retirement plan is one of the most important steps you can take for both yourself and your business.

## Making Business Tax Deposits Electronically

In 1997, the IRS began requiring certain taxpayers to pay their federal taxes electronically, using a system called EFTPS (Electronic Federal Tax Payment System). The system allows taxpayers to use the phone, personal computer (PC) software (for businesses only), or the Internet to initiate tax payment reports to EFTPS directly.

While this requirement improved the government's cash flow by creating an immediate transfer of funds from taxpayers, you as the taxpayer can also reap benefits from filing electronically. Do you know if you are required to file? This article explains both the filing requirements and the benefits to enrolling in the program voluntarily.

### Is your business required to use EFTPS?

While any business taxpayer can use EFTPS, some business taxpayers are required to use EFTPS because they have met certain criteria—specifically, if your total deposits of designated federal taxes (including employment taxes, income taxes, Railroad Retirement taxes, Social Security taxes, and various other types of non-payroll withholding) during a calendar year exceed \$200,000, you are

required to use EFTPS beginning in the second succeeding calendar year. For example: if you had more than \$200,000 in deposits of designated taxes in calendar year 2002, you are required to use EFTPS beginning January 2004. Once you are required



to use EFTPS, you must continue to pay using EFTPS in subsequent years, even if your annual tax deposits fall below \$200,000.

### How does EFTPS work?

With EFTPS-Direct, you make your tax payment report at least one calendar day before the tax due date. Based on your tax payment report, EFTPS initiates a debit against your bank account

and your tax records are updated with the IRS.

With EFTPS-Through a Financial Institution (available only to businesses), you initiate your tax payment through a service offered by your financial institution. Your financial institution debits your account and sends the tax payment electronically to EFTPS.

There is no cost to you for using EFTPS. However, if you choose to use EFTPS-Through a Financial Institution for your business, you may incur a fee from your financial institution.

### The benefits of using EFTPS

The obvious drawback of paying electronically is you lose the "float" you would have received if you had paid by check. However, there are advantages as well:

- It's fast. You can make a tax payment in minutes. You can avoid the need to run out to the bank if you are busy with other matters.
- It's convenient. EFTPS is available by phone, PC software, or Internet—24 hours a day, 7 days a week.
- It's simple. No more frantic searching at the last minute for a deposit coupon.

Even if you are not yet required to use EFTPS, it may be an idea to consider. Please call our office if you would like more information.

## Tax Tips for Traveling Teachers

While students look forward to a summer without books, many teachers and professors will use at least part of their summer to expand their knowledge. This knowledge often comes in the form of travel, sometimes to attend a course, other times as a trip in which the travel experience itself is educational. Are these travel expenses deductible for tax purposes?

### Travel as an educational experience

If the education comes from the travel experience itself, the expenses are not deductible, even if the travel is directly related to the subject you teach.

Example: You are a French language teacher. While on sabbatical leave granted for travel, you traveled through France to improve your knowledge of the French language. You chose your itinerary and most of your activities to improve your French language skills. You cannot deduct your travel expenses as educational expenses. This is true even if you spent most of your time learning French by visiting French schools and families, attending movies or plays, and engaging in similar activities.

### Deduction for courses taken

A course that is related to your job as a teacher or professor is deductible, as

long as it meets at least one of the following two tests:

1. The education is required by your employer or the law to keep your present salary, status, or job; or
2. The education maintains or improves skills needed in your present work.

However, even if the above requirements are met, a class will not be deductible if:

1. It is needed to meet the minimum requirements to be a teacher; or
2. It is part of a program of study that will qualify you for a new trade or business.

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# CPA CLIENT TAXLETTER

## NEW IRS WEB SITE FOR MILITARY PERSONNEL

If you have a friend or family member serving in the military, you can do your part to help them by making sure they have access to information about their tax benefits. The Internal Revenue Service Web site contains a special section devoted to helping members of the U.S. Armed Forces serving in a combat zone get all of the tax benefits available to them, including special exclusions from income and special extensions of time for filing returns. You can find this information at [www.irs.gov/newsroom/article/0,,id=107467,00.html](http://www.irs.gov/newsroom/article/0,,id=107467,00.html). The Web site includes:

- Questions and answers on exclusions, extensions, and other tax benefits available to members of the U.S. Armed Forces serving in a combat zone.
- Publication 3, Armed Forces' Tax Guide, which covers the special tax situations of active members of the U.S. Armed Forces.
- Several recent news releases and notices.
- A special e-mail address that members of the U.S. Armed Forces, their spouses, authorized agents, or representatives can use to notify the IRS about someone serving in a combat zone.

## The Do's and Don'ts of IRA Investing

Investors today have almost an infinite number of investment options available to choose from, ranging from the stock, bond and mutual fund offerings of Wall Street to gold coins, real estate and derivatives. However, your investment decisions can be even more complicated when deciding where to invest your IRA funds, because the law restricts the types of investment vehicles you can use for an IRA.

Deciding how to invest your IRA assets can be a landmine. You need to steer clear of prohibited investments completely, while making choices that will enhance the growth of your retirement funds. Although deciding how to invest your IRA assets is one that is best done with professional advice, it is helpful to know the basics.

### What works; what doesn't

Following are some of the rules that apply to specific investments you might use in IRAs, as well as some important limitations.

*"Traditional" investments.* These include of the most commonly-used assets for IRA investments: publicly traded stocks, mutual funds, bonds, Treasury instruments, and certificates of deposit.

*Life insurance.* IRAs cannot invest in life insurance.

*Collectibles.* Collectibles are not allowed within an IRA. Collectibles include the following items: art works, rugs or antiques, metals or gems, stamps and coins, and any alcoholic beverage. However, certain silver and gold (such as American Eagle) coins and any coins issued by a state are allowed.

*Foreign investments.* In general, an IRA cannot be used to transfer funds overseas. However, American Depository Receipts (ADRs) and domestically sponsored mutual funds that make overseas investments are allowed.

*Real estate.* Subject to certain restrictions, IRA funds can be invested in real estate. For instance, rental property may be permissible as long as the properties involved are not used by either the IRA owner or certain family members. However, for many real estate transactions, it may be advisable to obtain an advance ruling from the IRS.

### Nontraditional investments may have risks and complications

While you are not restricted to "traditional" assets within an IRA account, making other choices will be more complicated, and can also put your IRA at risk if

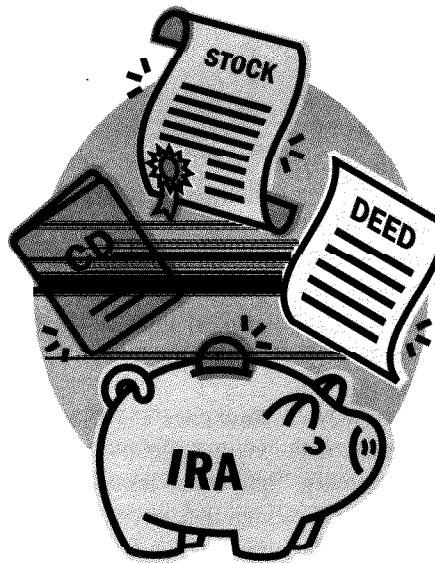
you are not careful.

If you choose to invest in nontraditional assets, you may find that many traditional IRA custodians (banks, brokerage houses, and mutual funds) will not act as custodians for non-traditional investments. This means that you must locate an independent trustee (to, for example, hold title to the real estate or to collect rent).

In all IRA investing, it is crucial to avoid "self-dealing"—when the IRA owner uses the account for personal enrichment or to satisfy financial objectives in a way that goes beyond the intent of the tax law. Here are just a few examples of what may be considered self-dealing with IRA funds:

- Purchasing stock in a closely held corporation in which the IRA owner is an officer or has a controlling equity position.

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## Special Tax Reporting for "Money Service Businesses"

As part of a strategy to prevent money laundering and terrorist financing, certain businesses called money services businesses (MSBs) must comply with a federal law known as the Bank Secrecy Act (BSA). Under BSA requirements, certain MSBs must register with the Department of the Treasury and report certain "suspicious transactions."

### Are you an MSB?

A business may be an MSB if it offers any of the following services:

- Money orders
- Check cashing
- Traveler's checks
- Currency exchange

- Money transmission

If your business does not conduct \$1,000 or more in business with any one person on any one day, it may not be classified as an MSB. No threshold, however, applies to money transmission. Special rules apply to businesses that serve only as an agent for another MSB—for example, a business that sells money orders issued by another company. With few exceptions, each MSB must register with the Department of the Treasury. However, if your business serves only as an agent for another MSB—for example, a business that sells money orders issued by another company—your business is not required to be registered.

If you think you may be subject to these rules, you can call our office for further information. Details are also available by visiting [www.msb.gov](http://www.msb.gov) or by calling (800) 800-2877.

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### Tax Tips: *continued from page 3*

State or school districts usually set the minimum educational requirements for teachers. The requirement is the college degree or the minimum number of college hours usually required of a person hired for that position.

Once you have met the minimum educational requirements for teachers for your state, you are considered to have met the minimum educational requirements in all states. This is true even if you must get additional education to be certified in another state.

All teaching and related duties are considered the same general kind of work. A change in duties in any of the following ways is not considered a change to a new business:

1. Elementary school teacher to secondary school teacher.
2. Teacher of one subject, such as biology, to teacher of another subject, such as art.
3. Classroom teacher to guidance counselor.
4. Classroom teacher to school administrator.

to certain limits), and lodging. If the main purpose of your travel is personal, you can deduct only your expenses for the lodging and 50% of your expenses for meals during the time you attend the qualified educational activities.

Whether a trip's purpose is mainly personal or educational depends upon the facts and circumstances. An important factor is the comparison of time spent on personal activities with time spent on educational activities. If you spend more time on personal activities, the trip is considered mainly educational only if you can show a substantial nonpersonal reason for traveling to a particular location. Regardless of the main purpose of the trip, you cannot deduct expenses for personal activities such as sightseeing, visiting, or entertaining.

### An educational summer

As a teacher or professor, chances are you chose your summer educational activities for nontax reasons. But knowing the tax rules will help you to take advantage of available deductions and will encourage you to gather the information now that will help you next April.

### Travel expenses

If the main purpose of a trip is to attend a work-related course or seminar, you can deduct expenses for travel, meals (subject

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### Do's and Don'ts: *continued from page 3*

- Using IRA funds to buy a vacation home the IRA owner or his or her family will use.
- Purchasing restricted stock from a relative.

If a taxpayer violates the IRA rules, he or she jeopardizes the IRA's tax-free status. The entire IRA may even become taxable. A 10% early withdrawal penalty also may apply. With certain investments, IRA owners face other risks as well. For example, a special tax on "unrelated business income" may apply in certain real estate arrangements.

### Sensible investing

The intent of the IRA rules is clear: the government wants IRA money to be used for retirement and invested sensibly so it will be there when it is needed. Your goals should be the same. To circumvent this reasoning is inviting trouble as well as jeopardizing your retirement security. Many taxpayers find that sticking to traditional investments is the best course to follow. However, if you are considering other options, ensure that you are steering clear of problems before you make a decision.

# CPACLIENT TAXLETTER

## New Tax Law Means Extra Cash for Some Families This Summer

This summer your kids could be the reason you get a special check from Uncle Sam. The just-signed Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the Child Tax Credit to a maximum of \$1,000 per child from \$600 per child, beginning in 2003. The Act also provided for immediate tax relief by directing the Treasury to send this increase to taxpayers this year. An estimated 25 million eligible taxpayers could receive up to \$400 for each child claimed on their 2002 returns as an advance payment of their 2003 Child Tax Credit.

### No action required

Taxpayers do not need to do anything to receive the advance payment. The IRS automatically will send notices to eligible taxpayers. The IRS notice will be followed a few days later by the advance payment check. The IRS will mail both the notice and the check to the address listed on the taxpayer's 2002 tax return. Anyone who has moved since

filing the 2002 return should notify the U.S. Postal Service of the new address, so that the notice and check may be forwarded.

The Treasury will mail advance payment checks on July 25, August 1, and August 8 to taxpayers who filed their returns by April 15. The checks will be issued based on the last two digits of the Social Security number listed first on the 2002 tax return. Taxpayers whose last two digits are the lowest will receive their checks first.

Taxpayers who have received filing extensions will still get the advance payment checks if they are eligible. They should have their advance payment checks about four to six weeks after the IRS receives their 2002 tax return.

### Advance payment guidelines

The IRS will use 2002 tax year data to determine who will receive the automatic advance payment. Generally:

- Taxpayers must have claimed the Child Tax Credit on the 2002 tax return.
- Taxpayers must have used Form 1040 or Form 1040A, or filed electronically.
- The child must have been born after 1986.

## New Tax Act Delays Due Date of Corporate Estimated Tax

If your corporation has an estimated tax installment payment of its corporation income tax due on September 15, please take note. The Jobs and Growth Tax Relief Reconciliation Act of 2003 has made a one-time delay for a **portion** of your September 15, 2003, payment.

### The general rule

Subject to certain exceptions, corporations must generally pay a portion of their current year's estimated tax liability on the fifteenth day of the fourth, sixth, ninth, and twelfth month of the corporation's fiscal year. Thus, corporations who normally would have a payment due on September 15, 2003, are those with a year ending:

- December 31, 2003 (third quarter payment)
- March 31, 2004 (second quarter payment)
- May 31, 2004 (first quarter payment), and
- September 30, 2004 (fourth quarter payment).

For taxpayers with the above year-end dates, the newly signed law delays the due date of part of your September 15,

2003, payment until October 1, 2003. The Act does not affect taxpayers with other year ends, and it does not affect the due date of any future payment.

### How the change affects the amount due

For an estimated tax payment due on September 15, 2003, only 75% of the required amount is due on that date. The remaining 25% is due on October 1, 2003. For example, if your corporation was scheduled to make an estimated tax installment payment of \$10,000 on September 15, 2003, you are now required to pay \$7,500 (75% of \$10,000) by that date. The remaining \$2,500 will be due on October 1, 2003.

If you are scheduled to make a corporate estimated tax payment on September 15, 2003, please call us to verify the amounts that will be due on September 15 and October 15 to be sure you avoid any penalties.



The CPA. Never Underestimate The Value.

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