

May/June 2004

TAX IMPACT

IN THIS ISSUE

HOW YOUR BUSINESS CAN CONTROL HEALTH CARE COSTS

COVERDELL ESAs VS. 529 SAVINGS PLANS

MARRIED WITH CHILDREN?

Bypass and QTIP trusts can help you benefit your spouse and then your kids

TAX TIPS

Employee investment education, corporate splits, and more...



MORRISON, BROWN, ARGIZ & FARRA, LLP

Certified Public Accountants

1001 Brickell Bay Drive, 9th Floor, Miami, FL 33131
(305) 373-5500 • Fax (305) 373-0056

301 E. Las Olas Boulevard, 5th Floor, Fort Lauderdale, FL 33301
(954) 760-9000 • Fax (954) 760-4465

1113 Spruce Street, Suite 301, Boulder, CO 80302
(303) 381-2550 • Fax (303) 381-2551

Website: www.mba-cpa.com

HOW YOUR BUSINESS CAN CONTROL HEALTH CARE COSTS

Look at the financial statements of most companies, including your own, and you'll probably see that one of the largest expense items is payroll and benefits. With health care costs continuing to increase, your business may have a difficult time trying to balance your employees' needs with your bottom line. By considering alternatives to traditional health insurance plans, you can cut expenses and reap tax advantages.

TRIM COSTS

Before you begin cutting some of the health care benefits you offer workers, look for ways to reduce these expenses. For starters, shop around. You may be able to reduce costs by buying from an insurance carrier new in your area. Or if you are a small company, see whether you can buy health insurance through a trade association or other organization that caters to your industry. By becoming part of a larger group, you might be able to obtain health insurance for your staff at a more attractive rate.

Another option is to switch your plan type. Instead of a traditional indemnity plan, offer an HMO or a PPO. These are typically more limited, but also less expensive, than indemnity plans. By switching, you could save from 10% to 50% per worker, depending on plan types and coverage.

If you have a young and healthy work force, you may want to forgo traditional insurance and self insure. Why? By paying health care costs as they arise, you could spend less than you would on medical insurance premiums. Also, you may be able to deduct these expenses if bills are paid in a nondiscriminatory plan. To protect your business in case health insurance claims exceed the set threshold, buy "stop-loss" insurance.

Helping your employees improve their health or stay in shape also can keep health care costs in check while reducing your tax bite. Wellness programs such as smoking cessation and weight loss clinics are deductible. Plus, workers will appreciate your interest in their well-being.

CONSIDER HEALTH CARE OPTIONS

Although your health insurance costs for employees are generally 100% deductible, the tax break may not be enough to help your bottom line. So consider alternatives to traditional health insurance plans, such as a cafeteria plan (otherwise known as a 125 plan).

By establishing one, you save taxes on the funds earmarked for health care costs and your workers can both save taxes and choose their health and dental

THE INS AND OUTS OF HEALTH SAVINGS ACCOUNTS

Although some business owners have had little choice, they may feel guilty about having to offer only high-deductible health insurance coverage to their employees. Well, one hopes the new Health Savings Account (HSA), effective this year, will help set their minds at ease.

To open an HSA, participants must have a relatively inexpensive but high-deductible health plan. (An example of a high-deductible plan is when coverage begins after you pay the first \$1,000 for individual coverage or the first \$2,000 for family coverage.) They can use funds to cover the deductible and other health-related expenses for themselves and their spouses and dependents.

HSAs are flexible: You or your workers could set one up and make contributions to it, participants need no earned income to create one and, unlike flexible spending accounts, account balances roll over from year to year. When participants reach age 65, they can use any remaining funds to supplement their income — the assets will be subject to income tax, but no penalties.

But there are drawbacks. For example, you and your workers can contribute only up to the amount of the health plan deductible (in 2004, up to \$2,600 for individuals and \$5,150 for families) and employees can't be covered under another medical plan. And HSA funds used for nonqualified medical purposes are taxable and subject to a 10% penalty.

coverage and other benefits from a menu of options. They pay for only those they select, and you can discontinue any that employees don't value. Here are the two types of cafeteria plans:

1. Premium-only plans (POPs). One way to cushion the financial impact on your workers' wallets is to offer a POP, which allows employees to pay for insurance premiums with pretax dollars. Employees save income tax and Social Security (FICA), and your company reduces FICA and unemployment taxes (federal and usually state).

Let's look at an example. Suppose you have 20 employees, each contributing \$1,500 in pretax premium contributions to a POP. Just on FICA taxes alone, you'll save \$2,295 ($\$30,000 \times .0765$).

2. Flexible spending accounts (FSAs). These plans provide a tax-free means of paying for out-of-pocket expenses such as health and dental insurance deductibles and co-payments, optical care and medications (including prescriptions and over-the-counter drugs).

With an FSA, employees contribute pretax dollars into an account. Throughout the year, when they incur expenses, they can receive reimbursements. But funds left unused by year end are lost to the employee; the employer keeps the assets, which it may use to benefit all workers, depending on plan regulations.



A new option for employers and workers is the Health Savings Accounts that were created under the Medicare legislation in late 2003. For more on this vehicle, see "The ins and outs of Health Savings Accounts" on page 2.

TALK TO EMPLOYEES

Health care expenses will likely continue to be a concern for at least the next few years. But be careful that, in your quest to cut your tax bill, you don't alienate workers. Ask them which benefits are attractive and those they can live without. Although your staff probably won't be pleased with a change in their health insurance plan type, they will appreciate the opportunity to give feedback. 📄

COVERDELL ESAs VS. 529 SAVINGS PLANS

The cost of a higher education continues to increase. In 2003-2004, four-year public institutions raised tuition and fees to \$4,694, on average (a 14.1% increase over the previous year), while four-year private institutions increased tuition and fees to \$19,710 (a 6% increase), according to the College Board.

But by contributing to an education savings program, you can provide the necessary financial support so your children or grandchildren can reach their goals and reduce your tax bite. Let's take a look at two popular plans: Coverdell Education Savings Accounts (ESAs) and Section 529 savings plans.

SIMILARITIES AND DIFFERENCES

Although there are many differences between ESAs and 529 plans, they share the same purpose: to grow money for education expenses tax free. You can make contributions to both plans on behalf of the same individual each year. Here's a closer look at the advantages and disadvantages of ESAs and 529 plans in these areas:

Distributions. Under both plans, distributions are tax free for federal purposes if used to pay qualified education expenses at any accredited college or university, including most community colleges and technical training schools. Two key differences: You also may use ESA distributions for elementary and

EXTRA, EXTRA: INDEPENDENT 529 PLANS

Are you worried that a child or grandchild won't be able to attend a private college because of the costs? (This year, tuition at a private four-year college was approximately \$20,000 on average, according to the College Board.)

If so, consider an Independent 529 plan, introduced just last year, which allows you to lock in tuition rates and fees at participating private institutions at today's prices. And this prepaid tuition plan offers tax-deferred growth and tax-free withdrawals until 2010. (But don't get this program confused with state-sponsored prepaid 529 plans, which also can allow you to lock in future tuition rates at today's prices.)

Here's how it works: You buy a tuition certificate that you can use at member colleges. (Currently more than 220 participate.) Let's say that your child plans to begin college in a decade. Assuming tuition continues to increase at about 7% per year, your tuition bill will be about \$50,000. But by creating an Independent 529 plan and buying a tuition certificate for \$20,000 (the current cost of attending a private college), you'll save about \$30,000.

Keep in mind that participating in an Independent 529 plan offers no guarantees that your child will be accepted to the college. If your child does not attend a private college operating in this plan, you can roll over the assets into another family member's account or into a state-sponsored 529 plan. You may opt for a refund, but there is a 10% penalty.

Just like other education savings plans, your child's or grandchild's financial aid package may be affected by an Independent 529 plan. Aid eligibility may be reduced dollar for dollar.

secondary education costs, including academic tutoring, and the tax-free provision for 529 plans will expire in 2010 unless Congress extends it.



Contribution limits. Although there is an annual contribution limit for ESAs (\$2,000 per child), there is none for 529 plans. (Each state and 529 plan sponsor sets its own limits.) Another contribution drawback to ESAs is the income limit. In 2004, the adjusted gross income phase-out range for making contributions is \$95,000 to \$110,000 if you are single and \$190,000 to \$220,000 if you are married filing jointly. However, a family member can still contribute to an ESA benefiting your child. Meanwhile, there are no income limits for contributing to 529 plans.

Control over investments. If you would like more control over how your money is invested, then an ESA may be more appealing. Unlike some 529 plans that require you to invest in a managed portfolio based on your child's age, you choose the investments that you'll hold in an ESA.

Federal and state income tax deductions. You cannot deduct contributions for either plan for federal tax purposes. But if you contribute to a 529 plan sponsored by your state, it may allow you to deduct the contributions for state income tax purposes.

Although no states allow you to deduct ESA contributions, you may benefit from other tax breaks. If you qualify, you can claim the Hope or Lifetime Learning credit and still exclude ESA distributions from your gross income. Just don't use the ESA funds to pay the same expenses for which you're claiming the credit.



Estate planning. 529 plans offer a key estate planning benefit: Contributions are considered gifts for gift tax purposes so you can immediately remove the assets from your estate. Plus, you can use up to five years' worth of the annual gift tax exclusion at once. So, you may give up to \$55,000 (\$110,000 if you and your spouse both make gifts) without biting into your

\$1 million lifetime gift tax exemption. But if you die before the end of the five-year period, the remaining years' gifts will be included in your estate.

Account transfers. 529 plan owners retain control over account transfers. For instance, they can switch the beneficiary to certain other family members, including themselves, for any reason. But there may be gift tax consequences. You can do the same with an ESA, but transfers are limited to fewer types of family members, who also must be under age 30.

MEETING YOUR GOALS

When it comes to saving for a child's or grandchild's education, the process may be overwhelming. After all, college is much more expensive than even a few years ago. Fortunately, there are a number of ways you can help your loved ones get the education they deserve and reduce your tax bill. And by starting to save today, you will have more time for the assets to grow. 📖

MARRIED WITH CHILDREN?

Bypass and QTIP trusts can help you benefit your spouse and then your kids

The estate tax's impact is gradually decreasing until the tax is eliminated in 2010. So it may seem that estate planning is no longer critical — but that is not the case. And unless Congress passes further legislation, the estate tax will return with gusto in 2011.

Even with the benefit of increased exemption amounts over the next five years, you and your spouse may quickly meet the exemption limits if you own a home that has significantly appreciated, have life insurance policies whose proceeds will be includable in your estate at your death or have a securities portfolio. But reducing taxes isn't the only concern. You'll also want to ensure your assets are distributed according to your wishes, such as first to your spouse and then to your children. A bypass trust and a qualified terminable interest property (QTIP) trust can help you achieve your estate planning goals.

1. BYPASS TRUSTS

A married individual may leave an unlimited amount of assets to his or her U.S. citizen spouse estate-tax free. But if the surviving spouse dies with an estate



worth more than the estate tax exemption amount (\$1.5 million in 2004), the excess assets will be taxable — wasting the first estate tax exemption.

That's where the bypass trust (also known as a credit-shelter trust or exemption equivalent trust) can help. This vehicle allows both you and your spouse to take advantage of the federal estate tax exemption, thereby reducing your estate taxes, without having to give assets to your children or other loved ones on the first spouse's death.

Bypass trusts can provide for the surviving spouse to have almost unlimited access to the funds.

Bypass trusts can provide for the surviving spouse to have almost unlimited access to the funds. Flexibility is key to ensuring the surviving spouse has funds for health care or education or to maintain a standard of living. But if the surviving spouse has other assets he or she can use, it may be best to use the funds in the trust only as a last resort. Why? Because bypass trust funds will pass estate-tax free at the surviving spouse's death.

Let's look at an example. Suppose Jack's estate is \$5 million, Jackie's estate is \$300,000, and, at Jack's death this year, his estate can take full advantage of the available lifetime exemption amount. If Jack has funded a bypass trust up to the lifetime exemption

limit (\$1.5 million in 2004), the remainder of his estate (\$3.5 million) will pass to his wife estate-tax free. To reduce the tax bill on Jackie's estate, which is now \$3.8 million, she should spend the bypass trust assets last because they can pass estate-tax free at her death. Keep in mind that you must also consider the income tax impact, but generally the estate tax benefits will outweigh any income tax cost associated with the strategy.

2. QTIP TRUSTS

If your assets are greater than your spouse's (or vice versa) and you'd like to ensure they are distributed according to your wishes while benefiting your spouse after you are gone, consider using the QTIP trust instead of, or in addition to, a bypass trust. (Using both trusts together is often called an A-B arrangement.) It allows you to provide your surviving spouse with income from the trust for the remainder of his or her lifetime.

QTIP trust assets qualify for the marital deduction (and therefore pass estate-tax free) but are included in the survivor's estate. To qualify, the surviving spouse must receive all trust income throughout his or her life.

The difference between using a QTIP trust and simply giving the assets to the surviving spouse is that, with a trust, the surviving spouse has virtually no control over how assets are distributed at his or her death.

PROTECTION FOR YOUR FAMILY

There are a number of steps you can take to care for your spouse and children after you're gone. Bypass and QTIP trusts are just two strategies you can use. Just be sure to plan carefully for your and your loved ones' needs before taking action. 📄

TRANSFER TAX RATES AND EXEMPTIONS

Year	Gift, estate and GST tax rates	Gift tax exemption	Estate tax exemption	GST tax exemption
2004	48%	\$1.0 million	\$1.5 million	\$1.5 million
2005	47%	\$1.0 million	\$1.5 million	\$1.5 million
2006	46%	\$1.0 million	\$2.0 million	\$2.0 million
2007	45%	\$1.0 million	\$2.0 million	\$2.0 million
2008	45%	\$1.0 million	\$2.0 million	\$2.0 million
2009	45%	\$1.0 million	\$3.5 million	\$3.5 million
2010	35%*	\$1.0 million	Repealed	Repealed
2011**	55%***	\$1.0 million	\$1.0 million	Indexed

* For gift tax only.

** If the repeal is not extended.


***Excluding 5% surtax.

TAX TIPS

GIVE WORKERS INVESTMENT EDUCATION, NOT ADVICE

With some employees forgoing contributions to their 401(k) plans, you may wonder why your business should continue to provide this benefit. By offering workers investment education, you can improve participation levels. But how do you provide this information without giving advice, which can result in penalties for your company? Here are three tips:


1. Provide details about asset types, but avoid references to specific investments available in your plan.
2. Discuss plan information, such as the benefits of contributing and disadvantages of preretirement withdrawals.
3. Give resources, including software and assessments, to help workers determine their nest egg needs.

Information that references the investment options must be general in nature. For example, you can explain financial and investment terms such as diversification and compounding. 


MAKING THE MOST OF BUSINESS AND LEISURE TRAVEL

Like many company owners, you may combine business trips with vacations. After all, you can reap tax benefits from this practice. To qualify, the primary reason for your travel must be for work. The IRS will focus on how much time you spend at the business meeting or convention as opposed to on the beach.

So what can you write off? You can fully deduct your transportation expenses — but

not your family's travel costs. Additionally, you may be able to write off some of your meal (50% of the expenses) and lodging costs, but only if it would be more expensive to return immediately after the meeting. For example, if after a convention you were to stay over on a Saturday night, your airfare would likely be much less expensive than if you flew home earlier. This savings would probably pay for your additional hotel stay and leave you with extra. 


LOWER DIVIDEND TAX RATES APPEAL TO FAMILY BUSINESS SHAREHOLDERS

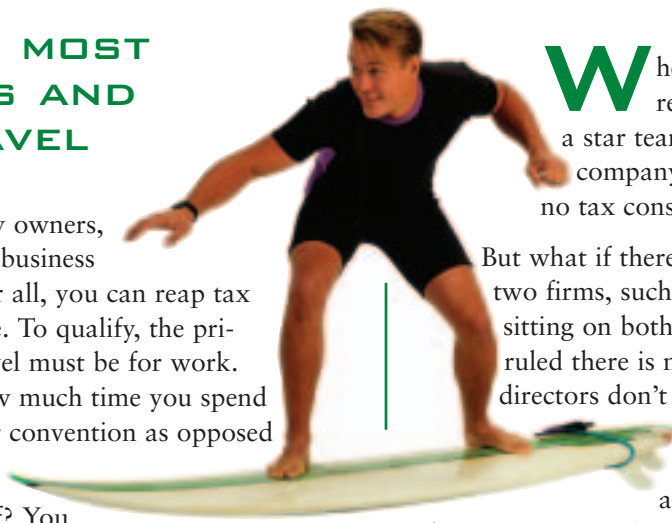
Until last year, if you wanted to sell your family business shares to relatives, you couldn't keep any interest in the company or work for it for at least a decade (complete redemption). Otherwise, your proceeds were taxed as dividends — up to 38.6%. But with lower dividend tax rates (5% and 15% in 2004), you no longer face a high tax bill. Plus, though there are certain restrictions, you can stay active in the company. 

WHEN ARE CORPORATE SPLITS TAX-FREE?

When there's a legitimate business reason — for instance, to reward a star team member with part of the company — business split-offs have no tax consequences.

But what if there is a relationship between the two firms, such as some of the same directors sitting on both boards? Last year, the IRS ruled there is no tax bite if the double-duty directors don't control the new entity's board.

The split-off also can, for a limited time, share data, benefits and accounting systems with its former parent without triggering tax. 



MORRISON, BROWN, ARGIZ & FARRA, LLP
Certified Public Accountants

301 E. Las Olas Boulevard, 5th Floor
Fort Lauderdale, FL 33301-2245

PRSR STD
U.S. POSTAGE
PAID
Permit No. 1997
Ft. Lauderdale, FL