

# Tax Tips

For Small Business

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## New Retirement Savings Option for Employers

### A Roth 401(k) may be for you

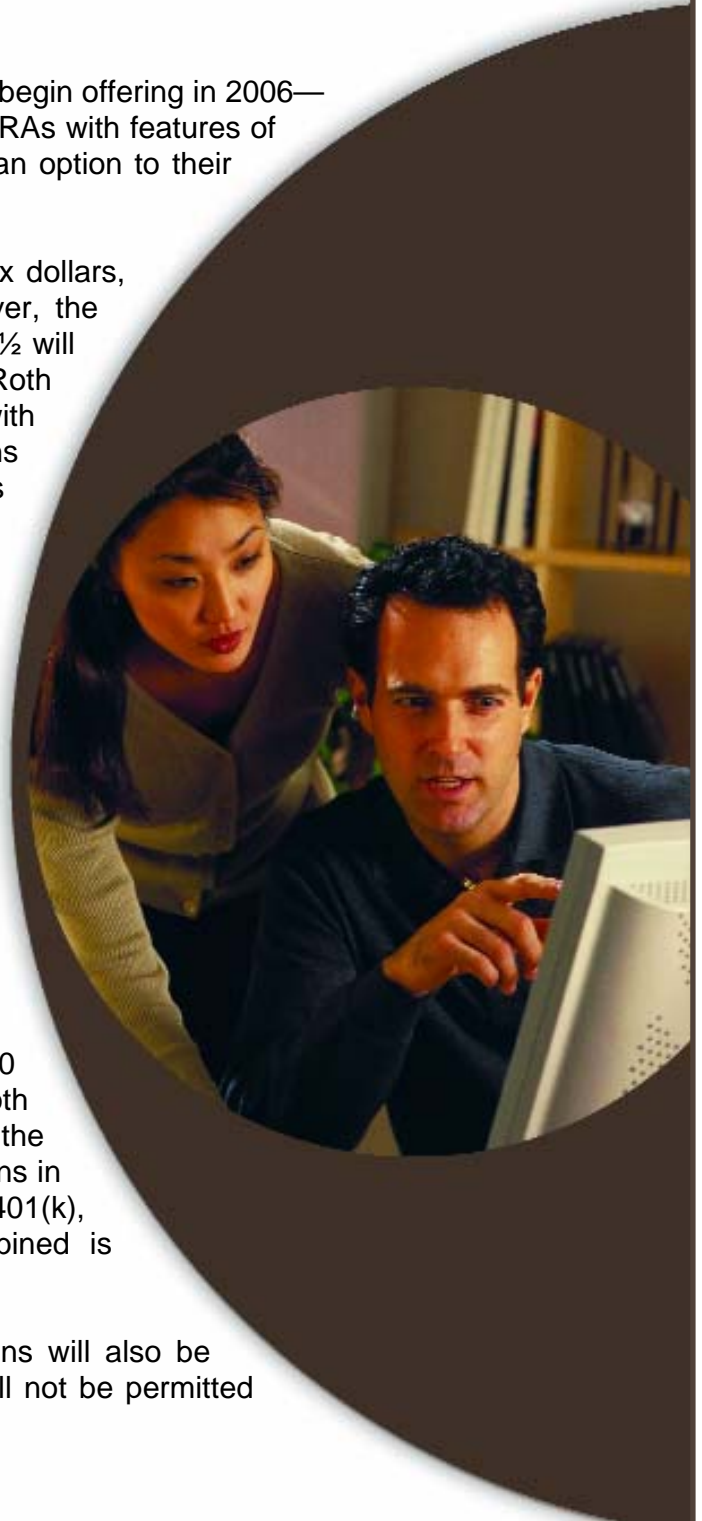
There is a new type of retirement account employers may begin offering in 2006—the Roth 401(k). The account combines features of Roth IRAs with features of 401(k) plans. Employers can offer the new accounts as an option to their regular 401(k).

Contributions to a Roth 401(k) will be made with after-tax dollars, so initially they won't reduce a worker's tax bill. However, the money will grow tax-free, and all withdrawals after age 59½ will be tax-free. In these respects, they are like self-directed Roth IRAs. In a regular 401(k) plan, contributions are made with before-tax dollars. The money is not taxed while it remains in the account, but every dollar taken out is taxed as ordinary income. A regular 401(k) plan gives you a tax break on the front end; the Roth 401(k) gives it to you on the back end.

Employees will be able to contribute to one or both accounts, but they can't switch money from one plan to the other after it goes in. Nor can they double their contribution by having both types of 401(k) accounts. The same contribution limit will apply to either account, or both combined. If an employer provides a matching contribution, the match must be put into a regular 401(k) account, subject to the regular 401(k) rules, even if the employee is directing all of his or her contributions into a Roth 401(k).

The most you can put into a Roth IRA is \$4,000 (or \$5,000 if you are 50 or older). The most you can put into a Roth 401(k) is \$15,000 (or \$20,000 if you are 50 or older), the same contribution limit that will apply to regular 401(k) plans in 2006. If you put money into a Roth 401(k) and a regular 401(k), your total allowed contribution to both accounts combined is \$15,000.

Education and nonprofit employers that offer 403(b) plans will also be able to add Roth accounts. However, the Roth option will not be permitted with 457 plans, offered by government employers.



## Are You a Home-Builder?

Home construction contractors may qualify for new tax credit

The Energy Incentives Act of 2005 contains a provision for home contractors. Beginning next year, a new tax credit is available to home construction contractors for qualified new energy-efficient homes acquired after December 31, 2005 and before January 1, 2008. If you are an eligible contractor, you might be allowed either a \$2,000 or \$1,000 tax credit for each qualified new energy-efficient home that you build and sell to an individual for use as a principal residence.



An eligible contractor is a person who constructs a new energy-efficient home, or a manufacturer that produces a qualified new energy-efficient manufactured home. To be a qualified new energy-efficient home:

- The home must be located in the United States;
- Its construction must be substantially completed after the date that the statute creating this credit was enacted; and
- It must meet the energy saving requirements.

The term “construction” includes substantial reconstruction and rehabilitation.

The \$2,000 credit is available if the home meets the following energy-saving requirements:

- 1) The home must be certified to have a level of annual heating and cooling energy consumption that is at least 50 percent below the annual heating and cooling energy consumption of a comparable dwelling unit, and



- 2) The home must be certified to have building envelope component improvements that account for at least one-fifth of that 50 percent improvement in heating and cooling energy consumption.

A manufactured home can also qualify for the \$2,000 credit if it meets these same tests and conforms to the Federal Manufactured Home Construction and Safety Standards. A manufactured home that does not meet these tests can nevertheless qualify for a \$1,000 credit if it conforms to the Federal Manufactured Home Construction and Safety Standards, and:

- 1) It is certified to have a level of annual heating and cooling energy consumption at least 30 percent below the annual heating and cooling energy consumption of a comparable dwelling unit, and to have building envelope component improvements that account for at least one-third of that 30 percent improvement; or
- 2) It meets the requirements established by the Environmental Protection Agency under the Energy Star Labeled Homes Program.

## Need an Economical Option for Employee Health Benefits?

Health reimbursement arrangements may be the answer

Are you looking for a way to reduce your employee benefit costs? You may wish to consider using a health reimbursement arrangement (HRA). An HRA is an employer-funded health benefit account for individual employees that may be used to pay their medical expenses and health insurance premiums. This type of plan is generally more economical, more flexible, and has additional features that a traditional health benefit plan does not have and, at the same time, provides favorable treatment for federal income tax purposes.

Under an HRA, the contributions you make and the amounts received by your employees are generally excluded from the employee's income. In addition, any excess amounts at the end of the year can be carried over to future years without being lost.

In order to receive favorable tax treatment, an HRA must meet the following requirements:

- 1) The plan is paid for only by you and is not provided by an employee salary-reduction election or under an employee-benefit cafeteria plan;
- 2) The plan reimburses the covered person for medical care expenses of the person, the person's spouse, and the person's dependents; and
- 3) The plan reimburses a covered person up to a maximum dollar amount for any period of coverage. Any unused portion of the maximum dollar amount at the end of that period is carried forward to increase the maximum reimbursement amount in subsequent coverage periods.



## QUICK TIPS

**1** Even though Section 179 allows you to expense up to \$105,000 of the cost of qualifying property placed in service in your business in 2005, you may only deduct up to \$25,000 if you purchased and placed an SUV in service.

**2** From January 1 through August 31, 2005, the optional standard mileage rate for the business use of a vehicle is 40.5 cents per mile. From September 1 through December 31, 2005, the standard mileage rate increases to 48.5 cents per mile.

**3** If you have employees, you are responsible for verifying their eligibility to work in the United States. This is done by filling out Form I-9, *Employment Eligibility Verification*, for each of your employees. Form I-9 is not filed with the IRS or the Social Security Administration; instead, you must keep this form in your files for at least three years after the employee is hired. In addition, employees must fill out an employee tax withholding form, Form W-4, *Employee's Withholding Allowance Certificate*.

**4** You must obtain an employer identification number (EIN) if you do any of the following:

- Form a C or S corporation or partnership.
- Pay wages to one or more employees.
- File pension or excise tax returns.

If you are the sole employee of your business and none of the above apply, getting an EIN is not required as long as you report the financial results of your business on Form 1040, Schedule C. In that case, the IRS and the Social Security Administration use your social security number to track income tax and self-employment tax, and to maintain your earnings record.

**5** The maximum number of shareholders allowed for an S corporation increased from 75 to 100 beginning in 2005. Certain family members can elect to be treated as one shareholder.

**6** As a self-employed taxpayer, you may contribute to a sole-owner 401(k) retirement plan as both an employer and as an employee. As an employer, you may contribute up to 25 percent of your total income to your retirement plan. As an employee, you may also contribute up to an additional \$14,000 in 2005 (\$18,000 if age 50 or over).

Your maximum contribution to an individual 401(k) plan is the lesser of \$42,000 or the sum of the employer and employee maximums. This provides you with an additional opportunity to maximize your yearly retirement plan contribution. Unlike other retirement plans such as SEPs and SIMPLEs, an individual 401(k) plan allows you to take out loans from plan assets.

## Hiring New Employees?

Verify their social security numbers online

Incorrect identification numbers for employees continues to be the number one problem faced by employers, according to the IRS. An incorrect identification number may result in a notice to you from the IRS requiring you to do back-up withholding.

The Social Security Administration has a website that allows you to verify that a new employee's social security number (SSN) is correct. You can verify up to 10 names and SSNs online and receive immediate results. This option is ideal for new hires.



You can also upload batch files of up to 250,000 names and SSNs and receive results the next government business day. This option is ideal if you want to verify an entire payroll database or if you hire a large number of workers at a time.

While the service is available to all employers, it can only be used to verify current or former employees and only for wage reporting (Form W-2) purposes. Check out this feature on the Social Security Administration's website at [www.socialsecurity.gov/employer/ssnv.htm](http://www.socialsecurity.gov/employer/ssnv.htm).

## Year-End Tax Strategies

What can you still do before the year ends?

Another tax year is drawing to a close and you need to know what you can do to save a few tax dollars. The most common strategy is to increase your expenses. If you are a cash basis taxpayer, you can accomplish this by simply paying all the expenses that you already owe before the year closes. If you can, stock up on incidental supplies and increase your inventory. Generally, as a cash basis taxpayer, you are not allowed to prepay your expenses for certain things such as rent, interest, and salaries. You must prorate these expenses over the period of use. For example, you cannot pay for the next year's rent and deduct it in full in the year of payment. It must be prorated over each month.

Accrual basis taxpayers have a bit more flexibility. Unlike cash basis taxpayers, accrual basis taxpayers are not governed by time of payment when they deduct expenses. An accrual basis taxpayer is allowed a deduction for an expense when the amount can be determined with reasonable accuracy, the liability to pay the expense is in effect, and economic performance has occurred.



Another common strategy is to defer income into the following year. If you can, delay your billing until the end of the year. If you use cash basis accounting and your customers or clients do not pay you until after the close of the year, you are not required to include the payment until the year you actually receive the income.

Are you thinking about making an equipment purchase? If you haven't already done so, consider taking the §179 expense deduction. For 2005, you can write off up to \$105,000 regardless of when the equipment is purchased during the year.