August 2001

# THE PENNSYLVANIA ACCOUNTANT

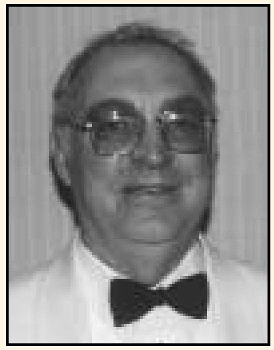
Serving the Public Accounting Profession for over 50 years • P.S.P.A.

The Newsletter Of The Pennsylvania Society Of Public Accountants

THE PENNSYLVANIA
ACCOUNTANT



# *A Message From The President*



After fifteen years as State Treasurer and three years as a line officer, I have finally ascended to the prestigious position of President of the Pennsylvania Society of Public Accountants. I have been a member of the Society for twenty-five years and feel it has been a very worthwhile and rewarding experience.

As President, I plan to continue many of the programs initiated by Bill Graham. I applaud his commitment and productivity throughout the past year. I will continue the work of the Technology Committee in redesigning and launching a new PSPA website. We hope to go live with our site in the next couple of months. Once finished, our website will be a valuable reference tool for our membership with updated legislative information, the latest headline articles pertaining to the tax and accounting industry, and direct links to many state and federal agencies. We hope to utilize the website as another value added membership benefit with a database mechanism that will enable a potential client to find YOU in their search for a tax or accounting professional. We are very excited and are eagerly anticipating its completion. Information will be forthcoming so that you can check it out for yourself.

We will explore additional member benefits and programs that have been requested by our membership such as a long term care insurance program. Monitoring the Pennsylvania State Legislature and the Pennsylvania State Board of Accountancy for regulatory and statutory changes that are proposed in our profession will continue to be a priority.

In order to be a viable and growing organization, we must recruit as many young people in our accounting profession as we can. I will strive to increase our membership through an aggressive recruitment program and I encourage all of you to help us in this effort. Bring a colleague to a Chapter meeting, or become a more active participant at your chapter programs.

I ask for your assistance and solicit your feedback as we look ahead to the challenges and accomplishments that this new year will bring to the Pennsylvania Society of Public Accountants. I will be open minded to all ideas that are presented to me and will bring them before the Board of Directors for action.

Thank you for the opportunity to serve you as President.

Respectfully Submitted,

Bernard A. Deverson, CPA

# TIME IS RUNNING OUT!!

PSPA membership dues were due on June 30, 2001. If you have not paid your membership dues please contact the PSPA Executive Office to arrange payment. Your name will be omitted from the PSPA membership directory and website listing if your dues are not received by September 1, 2001. With the seminar season fast approaching don't forget that only PSPA members in good standing are eligible to attend any PSPA sponsored seminar or chapter meeting at the reduced rate that is offered to our members.

# IMPORTANT NOTICE

## *Regarding Program Sponsor Verification*

Effective May 1, 2001, Licensees must ensure that credits they receive to satisfy the biennial CPE requirement are obtained through an approved sponsor of the Pennsylvania State Board of Accountancy, or the National Association of State Boards of Accountancy's (NASBA) National Registry of Continuing Education Professional Sponsors.

The Pennsylvania Society of Public Accountants is an approved sponsor of the PA State Board of Accountancy. The attendance certificates you receive at all PSPA seminars will include the PSPA program sponsor number. If you attend seminars that are offered through other organizations, law offices, financial institutions etc. it is advisable and necessary to obtain the sponsor number from the sponsoring organization. You may confirm whether a program sponsor is Board approved by contacting the Board's administration offices at 717-783-1404.

In the case of a CPE audit, the State Board of Accountancy will accept only credits that are obtained through an approved program sponsor. If you have any questions regarding this regulatory requirement please contact the PSPA Executive Office.

## In this Issue....

# QUICKFINDER® HANDBOOKS — 2001 Edition

***Discover what countless tax professionals find to be the handiest tax information resource available.***

- Both ***Quickfinder® Handbooks*** are current through 2000 tax law changes, and contain valuable WORKSHEETS and solution oriented ARTICLES for use in your tax practice.
- ***Quickfinder® Handbooks*** are an indispensable resource for tax professionals that will save you many hours of reading and research and provide QUICK ANSWERS to commonly asked questions.
- Locate reference and news items by SKIMMING the tabs.
- Concise, no nonsense FORMAT eliminates armloads of reference materials and other tax publications.

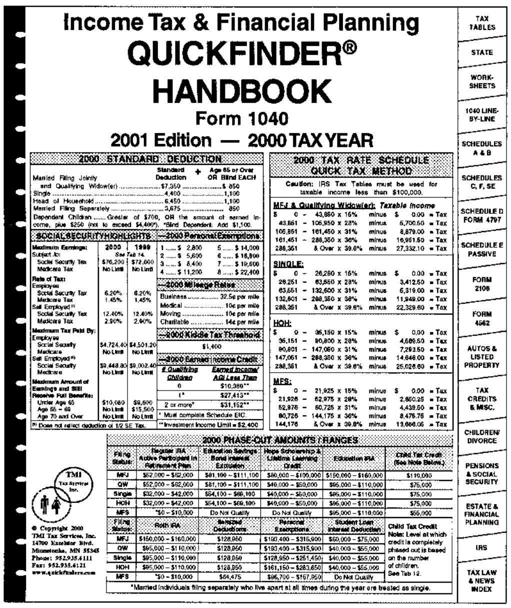
FREE

**Satisfaction Guaranteed**

***Our 29th Year***

→ ***Personal Income Tax Organizer and Deduction Finder*** **with purchase of the *Form 1040 Quickfinder® Handbook.***

*Both books are 300+ pages and are available mid-December 2000.*



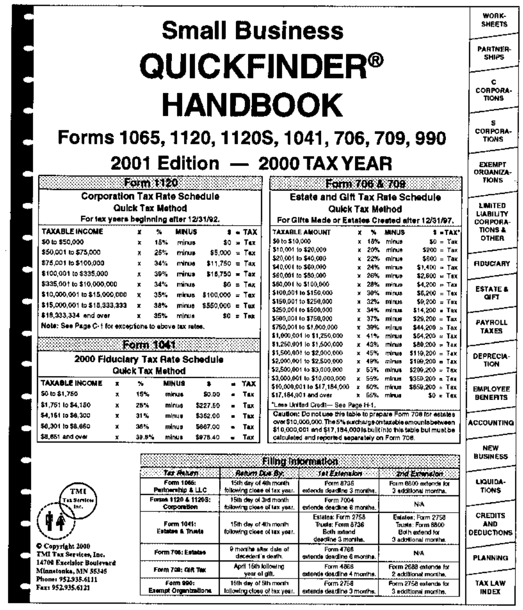

**Visit our *Newly Updated* Website:**
**www.quickfinders.com**
**Includes Important Links, *Quickfinder®* Updates, Tax Law Changes & More!**

***New Website Feature*** ***Discussion Board for Posting Tax Questions***

***Dear Staff Members of TMI—***

Best investment I ever made!
The format is excellent! You have literally condensed the Internal Revenue Code into a readable, logical outline.
**Mark E. Motluck, Palos Heights, Illinois**

This was the best resource I've found in 10 years of practice! In one of my most difficult years, TMI had answers when no one else did. Thanks. **Beth H. Waguespack, Baton Rouge, Louisiana**




## *Quickfinder® CD Rom!*

Easy-to-use CD with powerful search feature provides instant access to a wealth of useful tax information. Quick-Links jump instantly from *Quickfinder®* text to related IRS Forms and Publications.

***Quickfinder® CD Rom Contains—***

- *Income Tax & Financial Planning Quickfinder® Handbook (Form 1040)*
- *Small Business Quickfinder® Handbook*
- IRS Forms
- IRS Instructions
- IRS Publications

***One-Touch Printing!***

***—Line 4: Quickfinder® CD Rom Unit Price:***

1 CD … $84.95; 2 or more CDs … $74.95 each.

***SPECIAL!*** *Bundle Package for All Three Products:*

For each purchase of 1 Book #1 ***and*** 1 Book #2, the CD Rom is only $64.95.

***—Line 7: Shipping & Handling Per Shipping Address:***

- 1st Book $6, PLUS $1 for each additional book.
- CD ROM shipping included in price of CD.
- Alaska & Hawaii — 1st Book $7, PLUS $3 for each additional book.
- International orders billed for S&H separately.

**—USE THIS ORDER FORM AND SEND DIRECTLY TO TMI—**

***760 - Pennsylvania Society of Public Accountants***

TMI Tax Services will donate $2.50 to PSPA's Scholarship Fund and $2.50 to NSA's General Fund for each book and/or CD Rom ordered.
*To qualify for the donation, this order form must be used and sent directly to TMI. Phone/fax orders do not qualify.*

• Books shipped UPS beginning mid-December 2000. • CD ROM shipped separately mid-January 2001. • Prices valid only for 2001 Editions.

Company Name ____________________

Name ____________________

Address ____________________
(If P.O. Box, please include physical address for UPS.)

City, State, Zip ____________________

E-Mail ____________________

Day Phone (_______) ____________________

**Check payable to:** TMI Tax Services, Inc.
**Mail to:** 14700 Excelsior Boulevard, Minnetonka, MN 55345-6637
• **Phone:** 952.935.6111 • **Website:** www.quickfinders.com

***Quickfinder® Unit Price Based on Line 3 Total:***

| | |
|---|---|
| 1 Book ..... = $37.95 | 5 Books .................... = $32.95 per book |
| 2 Books ... = $35.95 per book | 6 through 12 Books .. = $31.95 per book |
| 3 Books ... = $34.95 per book | 13 or more Books ...... = $30.95 per book |
| 4 Books ... = $33.95 per book | |

| Line | Product | Qty. | x Unit Price | = Total |
|---|---|---|---|---|
| 1 | **Book #1:** *Income Tax & Financial Planning Quickfinder® Handbook (Form 1040)* | | | |
| 2 | **Book #2:** *Small Business Quickfinder® Handbook* + | | | |
| 3 | **Total: Add Lines 1 & 2.** = | | x $ | = $ |
| 4 | ***Quickfinder® CD Rom:*** *See Above* | | x $ | = $ |
| 5 | **Sub Total: Add lines 3 and 4.** | | | $ |
| 6 | **Minnesota Residents Add Sales Tax:** | | | $ |
| 7 | **Add Shipping & Handling:** *See Above* | | | $ |
| 8 | **GRAND TOTAL: Add lines 5 through 7.** | | | $ |

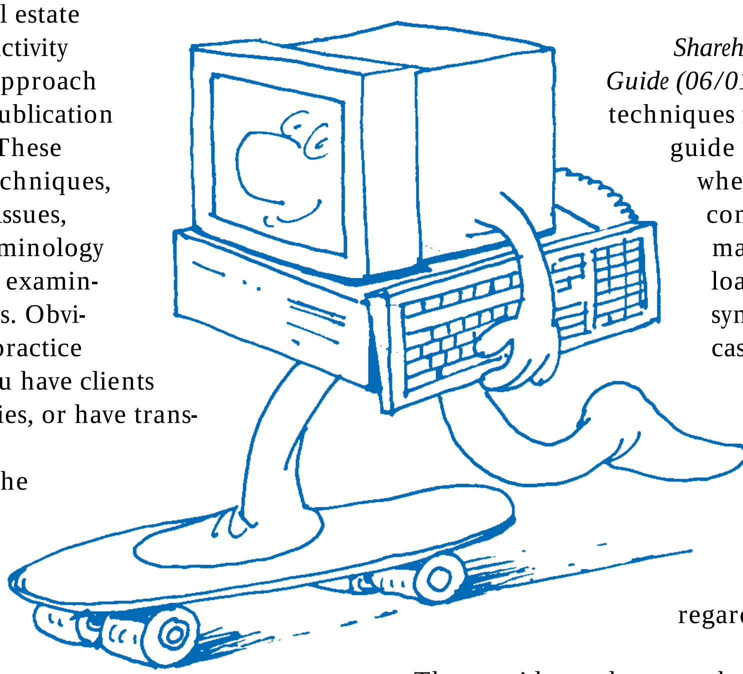
**Shipping and Handling must be included to process your order.**

# USING THE INTERNET IN YOUR PRACTICE

## The IRS Market Segment Specialization Program Audit Techniques Guides: A Useful Practice Tool

*By Mary Lew Kehm, CPA*

The IRS Market Segment Specialization Program (MSSP) focuses on developing highly trained examiners for a particular market segment. A market segment may be an industry such as construction or entertainment, a profession like attorneys or real estate agents or an issue like passive activity losses. An integral part of the approach used is the development and publication of Audit Techniques Guides. These Guides contain examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist examiners in performing examinations. Obviously, they are very important practice tools for the tax preparer. If you have clients who are in the covered industries, or have transactions covered by the guides, having the MSSP guide gives you the IRS's take on that area of practice. You can structure your client's business or transaction to minimize conflict with the IRS if you know the areas in which they are most interested.



Several manuals have been released in 2001 that are of interest to the small practitioner:

*Audit Technique Guide on Lawsuit Awards and Settlements (01/01)* focuses on taxability of law suit awards and settlements.

*Audit Technique Guide on Farm Hobby Losses (03/01)* contains examination techniques for farm hobby losses with cattle operations and horse activities pursuant to Code Section 183.

*Audit Technique Guide for Business Consultants (04/01)* contains examination techniques for business consultants. This guide is of special interest due to the number of consultants of all types that have gone into business in recent years. Coverage of the hobby rules and independent contractor rules is of particular importance.

*Shareholder Loan Audit Technique Guide (06/01)* contains examination techniques for shareholder loans. The guide explains how to determine whether a debt is bona fide and contains examples of below market term and demand loans. The guide also contains synopses of relevant court cases. This guide has been developed to provide guidance in addressing arm's length concerns, the timing of interest recognition, and the allocation of interest and principal. This guide addresses only issues regarding loans to shareholders.

These guides and many others that have been issued over the last few years have been posted on the Internet in Adobe Acrobat format (pdf) and available for download at:

http://www.irs.gov/prod/bus_info/mssp/

A few of the most popular guides are available as hypertext files for direct reading on the Internet. The guides not available on the Internet are for sale by the Superintendent of Documents. Before paying for a guide, however, here's a tip: use an Internet search engine to see whether the document may be posted somewhere else on the Internet. For example, the Attorneys Audit Guide was not listed on the IRS site when I was looking for it. I typed "MSSP Attorneys" into Google, a search engine, and found it posted on another web site. It is worth trying.


## New Audit and Review Thresholds for Charitable Organizations

Legislation that changes audit and review requirements for charitable organization has been signed by Governor Ridge. Act 45 of 2001 (HB 672) will increase the audit and review thresholds found in current law. Specifically, the law will require the following:

Financial statements of charitable organizations that receive annual contributions of $125,000 (an increase from the current threshold of $100,000) or more must be audited by a CPA or PA.

Financial statements of charitable organizations that receive annual contributions of at least $50,000 (an increase from the current $25,000) but less than $125,000 (increased from $100,000) would be required to have their financial statements reviewed or audited by a CPA or PA.

The bill was signed by the Governor on June 22, 2001, and will become effective sixty days after the date of the signing.

A copy of HB 672 is available at:
http://www.legis.state.pa.us/WU01/LI/BI/BT/2001/0/HB0672P2099.HTM

## Registry of Licensed Professionals - License PA

Secretary of the Commonwealth Kim Pizzingrilli announced the launch of a state-of-the-art licensing system that provides consumers with access to information on nearly 1 million business, health and real estate professionals licensed in Pennsylvania. Individuals can verify the licensure status of professionals, including accountants and businesses regulated by the department's 27 boards and commissions. The site can be accessed at www.state.pa.us.

## High Tech Tax Credits

State Representatives Steve Stetler introduced legislation intended to expand PA's R&D tax credit for high-tech companies. HB 1848 would increase total tax credits (in a fiscal year) from $15 million to $60 million and would also allocate $20 million in tax credits exclusively for emerging tech an bio-tech companies. The bill would extend the time limit for application for the tax credits from 2004 to 2010.

## Pennsylvania Responds to GLB Act

On June 21, 2001, Representative Armstrong and others, introduced House Bill 1822. This "privacy legislation" would be known as the Protection of Personal Information Act. It is Pennsylvania's response to the federal Gramm-Leach-Bliley Act. Many believe that the issue of "privacy" will be the principal issue to be addressed by the Legislature this fall (and perhaps into the beginning of 2002). Chairman of the Committee on Intergovernmental Affairs, State Representative Ron Raymond, may hold one or more public hearings some time in the next couple of weeks. We will keep you updated on any latest developments.

# NSA State Director's Message

*PSPA Officers, Board of Directors and Members:*

Summer is here and so is the hot weather. August 15th is just around the corner and I hope you don't have too many extensions so you can enjoy the nice weather.

Everyone who attended the 54th Annual Meeting had a great time touring our State Capitol in Harrisburg. I had the privilege of installing our new officers for the coming year.

NSA offers three Leadership Networking Conferences for newly elected officers to get together to learn the operation of NSA and other ASO's. NSA has three Leadership Networking Conferences to select from. One was held in Chicago, IL July 21-23; Virginia Beach, VA September 22-23; and San Diego, CA, October 20-21. You will earn 12 CPE credits. Contact your State Director, or NSA for more information.

NSA's 56th Annual Convention will be held in Minneapolis, MN from August 22-29, 2001. You will have 90 CPE credits to choose from for a maximum of 56 CPE's during this year's convention. I hope to see you there.

Respectfully submitted,

Margaret A. Romain-Johnson
PA State Director, District II

# Chapter Meeting Dates

## Buxmont Chapter

**September 25, 2001**
Williamson's Restaurant, Willow Grove
TOPIC: VEBA's & 412(I) Plans
SPEAKER: Lance Wallach, CLU ChFC, CIMC
CPE: 2 Hours Other

**October 23, 2001**
Williamson's Restaurant, Willow Grove
TOPIC: SSARS 8
SPEAKER: Mary Lew Kehm, CPA
CPE: 2 Hours A&A

**November 20, 2001 (Third Tuesday)**
Williamson's Restaurant, Willow Grove
TOPIC: TBA

## Central Chapter

**September 20, 2001**
Inn at Reading
TOPIC: Legislator Appreciation Night
FREE TO MEMBERS

**October 16, 2001**
Inn at Reading
TOPIC: TBA

**November 20, 2001**
Inn at Reading
TOPIC: TBA

## Lehigh Valley Chapter

**August 21, 2001**
Holiday Inn East, Bethlehem
ANNUAL LEGISLATOR APPRECIATION NIGHT

**September 18, 2001**
Holiday Inn East, Bethlehem
TOPIC: Risk Management for Accountants
SPEAKER: John Resparte, CPA
CPE: 2 Hours Other

**October 16, 2001**
Holiday Inn East, Bethlehem
TOPIC: New Tax Law
CPE: 4 Hours Tax

**November 20, 2001**
Holiday Inn East, Bethlehem
TOPIC: Peer Review
CPE: 2 Hours A&A

## Philadelphia Chapter

**August 20, 2001**
Williamson's Restaurant, City Line Avenue
TOPIC: Elder Care
Medicare/Medicaid Qualification
SPEAKER: Dana Breslin

**September 24, 2001**
Williamson's Restaurant, City Line Avenue
TOPIC: Offers in Compromise
SPEAKER: George Meyers, EA
CPE: 2 Hours Tax

**October 15, 2001**
Williamson's Restaurant, City Line Avenue
TOPIC: PA Mini Tax Seminar
Inheritance & Income
SPEAKER: PA Department of Revenue Representatives
CPE: 5 Hours Tax

**November 19, 2001**
TOPIC: Annual Meeting with the IRS
SPEAKER: IRS Representatives
CPE: 2 Hours Tax

## Southeast Chapter

**August 15, 2001**
Townhouse Restaurant
TOPIC: TBA
COST: $25.00

**September 19, 2001**
Townhouse Restaurant
TOPIC: TBA
COST: $25.00

**October 17, 2001**
Townhouse Restaurant
TOPIC: TBA
COST: $25.00

**November 21, 2001**
Townhouse Restaurant
TOPIC: TBA
COST: $25.00

## South Central Chapter

**September 26, 2001**
Mechanicsburg Officers Club, Mechanicsburg
TOPIC: Medicaid Planning,
New IRA Minimum Distribution Rules, New Federal
Inheritance Tax Rules, and Roundtable Tax Topics
SPEAKER: John Donnelly, CPA
CPE: 4 Hours Tax

*Continued on page 9*

## South Central Chapter cont.

**October 17, 2001**
Best Western Hotel, Harrisburg
TOPIC: SSARS 8 & New Tax Law
SPEAKER: Mary Lew Kehm, CPA
CPE: 2 A&A, 2 Tax

**November 21, 2001**
Mechanicsburg Officers Club, Mechanicsburg
TOPIC: November 21, 2001

# Seminar Dates

## Gear Up Estates & Trust Seminar

**September 25, 2001**
Radison Hotel, Monroeville
CPE: 8 Hours Tax
Sponsored By: Pittsburgh Chapter

**October 17, 2001**
Holiday Inn, Dunmore
CPE: 8 Hours Tax
Sponsored By: NorthEast Chapter

**October 18, 2001**
Radisson Hotel, Monroeville
CPE: 8 Hours Tax
Sponsored By: Pittsburgh Chapter

**October 25 & 26, 2001**
Radisson Hotel, Trevose
CPE: 16 Hours Tax
Sponsored By: Buxmont Chapter

## Gear Up Accounting Seminar

**September 19 & 20, 2001**
Holiday Inn Bethlehem
CPE: 16 Hours Accounting
Sponsored By: Lehigh Valley Chapter

**September 21, 2001**
Radisson Hotel, Trevose
CPE: 8 Hours Accounting
Sponsored By: Buxmont Chapter

**December 17, 2001**
Springfield Country Club, Springfield, PA (Del. County)
CPE: 8 Hours Accounting
Sponsored By: Philadelphia Chapter

## Gear Up Business Entities Seminar

**September 12, 2001**
Holiday Inn, Dunmore
CPE: 8 Hours Tax
Sponsored By: NorthEast Chapter

**October 1 & 2, 2001**
Radisson Penn Harris Hotel & Convention Center
CPE: 16 Hours Tax
Sponsored By: Central/South Central Chapter
Joint Education Committee

## Gear Up 1040 Seminar

**November 7 & 8, 2001**
Woodlands Inn & Resort, Wilkes-Barre
CPE: 16 Hours Tax
Sponsored By: NorthEast Chapter

**November 13 & 14, 2001**
Springfield Country Club, Springfield, PA (Del. County)
CPE: 16 Hours Taxes
Sponsored By: Philadelphia Chapter & Southeast Chapter

**November 26 & 27, 2001**
Radisson Hotel, Trevose
CPE: 16 Hours Tax
Sponsored By: Buxmont Chapter

**December 3 & 4, 2001**
Holiday Inn Bethlehem
CPE: 16 Hours Tax
Sponsored By: Lehigh Valley Chapter

**December 13 & 14, 2001**
Radisson Hotel, Monroeville
CPE: 16 Hours Tax
Sponsored By: Pittsburgh Chapter

**December 3 & 4, 2001/December 17 & 18, 2001**
*Seating is limited. Please register early to get your choice of dates.*
Harrisburg Marriott
CPE: 16 Hours Tax
Sponsored By: Central/South Central Chapter
Joint Education Committee

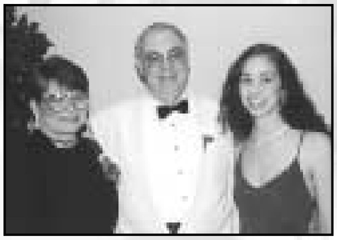
# Highlights of the 54TH


George & Christine Fieo, and children Theresa, Carmen and Nicholas (Philadelphia Chapter)


National Civil War Museum


PSPA members and families board the "Pride of the Susquehanna"


PSPA members gather at Allenberry Playhouse to see the "Wizard of Oz"


Incoming President Bernie Deverson, with wife Marion and daughter Tracey

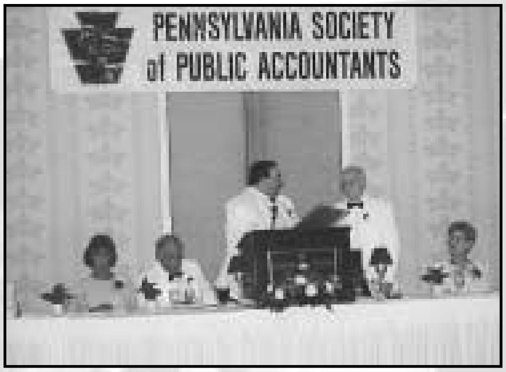

NSA Governor District II, Ezra P. Smith and Past President William C. Graham


Sherry L. DeAgostino, PSPA Executive Director & husband Steve Wickenheiser.


John & Betty Rhine (SOC Chapter). Betty is currently President of the SOC Chapter, hosts of the 54th Annual Meeting.


Toni & Harriet Emmi (Northeast Chapter)

# ANNUAL MEETING




PSPA Secretary Richard Brasch presents a lifetime PSPA membership certificate to outgoing president, William C. Graham at the Installation Ceremony on Saturday, June 23, 2001

PSPA Past Presidents
We had the unique opportunity of having eleven PSPA Presidents (Past & Present) attend the 54th Annual Meeting. They are (left to right): Robert T. Zaleski, PA (served 1983-85), Marvin R. Huttman, CPA (served 1987-89), John P. Hassler, PA (served 1992-93), H. Richard Neidermyer, CPA (served 1993-94), David E. Fleck, PA (served 1994-95), Joyce P. Huttman, PA (served 1996-97), Anthony P. Theofilis, CPA (served 1997-98), Neil C. Trama, Jr., PA (served 1998-99), Mary Lew Kehm, CPA (served 1999-2000), William C. Graham, PA (served 2000-01), and Bernard A. Deverson, CPA (serving 2000-01). All of these individuals have devoted countless hours to the PSPA and are largely responsible for its success.

Membership Co-Chairperson, Joyce Huttman presents a membership award to Jim Frederick, President of the West Central Chapter for the Highest Membership Retention for the 2000-2001 membership year. Other membership awards were presented to Buxmont Chapter for the largest number of new members, and Lehigh Valley Chapter for the Largest Percentage Membership Increase. Congratulations!

Fred A. McKillop, PSPA Governmental Consultant, and wife Jolly

Colleen Brannon, Administrative Assistant, PSPA Executive Office

2001-2002 PSPA Officers (left to right)
Richard Brasch, Jr., CPA, Second Vice President, Timothy J. Sundstrom, CPA, First Vice President, W. Raymond Bucks, CPA, President-Elect, Bernard A. Deverson, CPA, President, Paul C. Cannataro, CPA, State Treasurer, Gerald L. Brenneman, CPA, State Secretary

John Hassler (Past President) and wife Jan. John served as Master of Ceremonies at the Installation Dinner.

PHOTOS COURTESTY OF STEVEN M. WICKENHEISER

## *PSPA Members...*

Discover a valuable benefit program.

PSPA Members... *"Nationwide Is On Your Side.®"*

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**Harrisburg, PA 17112-1115**
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*Nationwide is on your side!®*

**Your Life Is Constantly In Motion.** Always changing. Always moving forward. And it's important to know that your insurance coverages are doing the same. If you haven't checked out the reduced rate auto insurance plan provided to PSPA members, you might be letting a great benefit slip by. Choose Nationwide, and you'll receive local agency service, multiple discounts, guaranteed claims repairs and convenient payment options. Call today for a no-obligation quote and find out how good it feels when "Nationwide Is On Your Side.®"

THE PENNSYLVANIA ACCOUNTANT

# 2001-2002 Pennsylvania Tax Changes
# Law Offices of McNees, Wallace & Nurick

**By Sharon R. Paxton, Esq.**

On June 22, 2001, Governor Ridge signed Act No. 23 of 2001 (H.B. 334), an omnibus bill including state tax changes for fiscal year 2001-2002. All of the changes discussed below are contained in H.B. 334, with the exception of the provisions relating to Educational Improvement Tax Credits (Act No. 4 of 2001; H.B. 996) and the Spiritous and Vinous Liquor Tax (Act No. 50 of 2001; S.B. 243). The changes include the following:

## SALES & USE TAX

**Sales Tax Bad Debts** – The portion of bad debt that a retailer may recover has been increased from two-thirds to 100% of the bad debt written off on Federal Income Tax Returns required to be filed after January 1, 2001.

**Local Sales & Use Tax/Road Construction Materials** – For purposes of Philadelphia Local Sales Tax, the situs for the sale of road construction materials has been changed from the location of the vendor selling the materials to the location to which the materials are delivered, effective for sales made after June 30, 2001.

**PC Tax Holiday** – For fiscal year 2001-2002, the Sales Tax holiday for personal computers has been expanded to cover PC peripherals and Internet access devices for non-business use. The tax holiday will be in effect for two one-week periods: August 5, 2001 through August 12, 2001, and February 17, 2002 through February 24, 2002.

**Wood Pellet Fuel** – Effective July 1, 2001, wood pellets used as fuel for cooking, hot water production or to heat residential dwellings are exempt from Sales & Use Tax.

**Airline Food & Beverages** – Effective July 1, 2001, food (and nonalcoholic beverages) served by airlines to passengers in connection with airline service is exempt from Sales & Use Tax.

**Production of Ice** – Effective July 1, 2001, the Sales & Use Tax "processing" exemption has been expanded to include the production, processing and production of ice for wholesale distribution.

**Saw Mills** – The Sales & Use Tax "processing" exemption for saw mills and planing mills has been expanded. Effective July 1, 2001, the operation of a saw mill or planing mill for the production of lumber or lumber products for sale is deemed to commence with the unloading, by the operator of the mill, of logs, timber, pulpwood or other forms of wood material.

## CORPORATE TAXES

**Retroactive Repeal of Statutory Nonbusiness Income** - The definitions of "business income" and "nonbusiness income" have been retroactively amended, effective for taxable years beginning after December 31, 1998. The definition of "business income" has been expanded to include "all income which is apportionable under the Constitution of the United States." "Nonbusiness income" is thus limited to income which is not apportionable under the United States Consti-

*Continued on page 15*

tution. As amended, the statute characterizes gain from the partial or complete liquidation of business assets as "business income," and legislatively overrules the holding of the Pennsylvania Supreme Court in *Laurel Pipe Line v. Commonwealth*. Notwithstanding this change, tax relief may be available to many multistate corporations not only under the Due Process and Commerce Clauses of the United States Constitution, but also under Pennsylvania's Multiformity and Unrelated Assets doctrines and through the equitable apportionment or "subparagraph 18" provision (which provides relief where standard apportionment does not fairly attribute income to Pennsylvania).

**Continued Phase-Out of Capital Stock/Franchise Tax** – Under legislation enacted last year, the Capital Stock and Franchise Tax rate for tax year 2001 is 7.49 mills. The tax will continue to be phased out through a series of 1-mill rate reductions, until the tax is eliminated for tax year 2009.

**Unincorporated Entities Electing to be Taxed as Corporations** – Effective for taxable years beginning after December 31, 2000, any unincorporated entity classified as a corporation for Federal Income Tax purposes is considered a corporation for Pennsylvania Corporate Net Income and Capital Stock/Franchise Tax purposes. Single-owner unincorporated entities, other than entities electing to be taxed as a corporation for Federal Income Tax purposes, will be disregarded as an entity separate from the owner for Pennsylvania Income Tax purposes. These changes effectively close a tax loophole through which an unincorporated entity taxable as a corporation at the federal level could escape corporate taxation, while the owners of the entity did not pay Pennsylvania Income Tax on the entity's earnings.

**Production of Ice** – For tax years beginning after December 31, 2000, the Capital Stock/Franchise Tax "processing" exemption has been expanded to include the production, processing and packaging of ice for wholesale distribution.

**Saw Mills** – For tax years beginning after December 31, 2000, the Capital Stock/Franchise Tax "processing" exemption for saw mills and planing mills explicitly includes operations beginning with the unloading of logs, timber, pulpwood or other forms of wood material by the operator of the mill.

## TAX CREDITS

**Job Creation Tax Credit** – The Job Creation Tax Credit provisions have been moved from Chapter 9 of the Job Enhancement Act (repealed on July 1, 2001) to the Tax Reform Code (Article XVIII-B). The annual cap on credits has been increased from $20 million to $22.5 million. Technical changes have been made to the method of calculating the number of new jobs created (now based on average level of employment by quarter rather than employment level during highest quarter). In addition, credits may now be assigned, in whole or in part, to an affiliated entity and DCED may now reissue, assign or award tax credits that have been recaptured or were not previously used.

**Educational Improvement Tax Credit** – Tax credits have been established for "business firms" making contributions to qualified "scholarship organizations" or "educational improvement organizations," subject to an annual cap of $30 million ($20 million for contributions to scholarship organizations and $10 for contributions to educational improve-

*Continued on page 16*

ment organizations). A list of qualified organizations will be published annually by DCED. The tax credits, which will be available on a first-come, first-served basis, may not exceed 75% of the amount contributed (or 90%, if the business firm provides a written commitment to provide the recipient organization with the same amount of contribution for two consecutive years) and are limited to $100,000 annually per business firm. Tax credits may not be carried forward or carried back and are not refundable or transferable.

## PERSONAL INCOME TAX

**Personal Income Tax Forgiveness** – For tax years beginning after December 31, 2000, the eligibility income allowance for tax forgiveness provisions has been increased from $7,500 per dependent to $8,500 per dependent. A two-parent family of four will owe no tax on income up to $30,000.

## INSURANCE PREMIUMS TAX

**Guaranty Assessment Tax Credit** – Effective for assessments paid after December 31, 1998 and for taxes paid for calendar year 2000 and thereafter, the assessment base used to calculate the amount of the credit is statutorily defined as "the amount of net direct written premiums used by the guaranty association to calculate a member insurer's assessment." This change conforms with the Department of Revenue's current policy for administering the credit.

## MISCELLANEOUS TAXES

**Filing Extensions for Bank Shares Tax** – For tax years beginning after December 31, 2000, the Department may grant up to a six-month extension for the filing of a Bank Shares Tax or Mutual Thrift Institutions Tax Report, upon application made by the last day for filing such report.

**Cigarette Tax** – Effective January 1, 2002, the Department is authorized to stop selling cigarette tax stamps to any cigarette stamping agent who is delinquent in remitting cigarette taxes or fines. H.B. 334 also gives the Department greater enforcement powers for dealing with stamping agents who fail to file timely reports and authorizes the Department to destroy forfeited cigarettes.

**Spiritous and Vinous Liquor Tax Repealed** – The tax imposed on manufacturers for producing, manufacturing, distilling, rectifying, or compounding distilled spirits, rectified spirits or wines in Pennsylvania has been repealed effective July 1, 2001.

**Other Repeals** – The following outdated or unconstitutional provisions have been repealed as of July 1, 2001:

- Alternative Bank and Trust Company Shares Tax (Article VII-A of TRC)
- Alternative Title Insurance Companies Shares Tax (Article VIII-A of TRC)
- Excise Tax on Foreign Corporations (Article X of TRC)
- Economic Revitalization Tax Credit (Article XVII of TRC)
- New Bank Tax Credit (Article XIX of TRC)

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THE PENNSYLVANIA ACCOUNTANT

# The Economic Growth and Tax Relief Reconciliation Act

The Economic Growth and Tax Relief Reconciliation Act is the most significant tax legislation in almost 20 years. It encompasses individual rate reduction, a new lower tax rate structure, marriage penalty tax relief, enhancement of the child tax credit and the dependent care tax credit, improvement in education tax benefits, enhancement of retirement breaks, and gift and estate tax relief. In this section we highlight all of the changes except those dealing with retirement benefits and gift and estate taxes:

## INDIVIDUAL RATE REDUCTION

Regardless of income, taxpayers will be taxed at a lower 10% rate on the first $6,000 of taxable income if you are single or married and filing a separate return; on the first $10,000 of taxable income if you are the head of a household, and on the first $12,000 of taxable income if you are married and filing a joint return. The current 15% rate than applies to amounts above the new 10% tax bracket. The end dollar amount taxed at the 15% rate ($27,050 for singles and $45,200 for marrieds filing jointly) remains unchanged.

The new 10% tax rate is retroactive to January 1, 2001 and will be rebated as a credit to taxpayers beginning in the second half of July. Those who paid tax in 2000 will be receiving checks from the Treasury up to $300 if single; up to $500 if you filed as a head of household, and up to $600 if you are married and filed a joint return. The order of mailing will depend on the last two digits of your social security number. All taxpayers who filed their 2000 return on time should receive the rebate by the Fall. When you file your return for 2001 next year, you will already have received the rate reduction. If you paid no tax in 2000 but will have a tax liability for 2001, you may claim a reduced amount of taxes due to the 10% rate, as a credit against your 2001 tax liability. Conversely, if you receive a refund check this Fall and end up with no tax liability for 2001, you do not have to refund the rebate check to the government. (Dependents who paid taxes in 2000 are not eligible for the rebate, nor will they get the benefit of the 10% rates when they file their 2001 returns.)

There are additional tax rate changes that will lead to further tax reductions for 2001 and subsequent years, depending on your income. Here is a schedule showing the rate reductions and when they become effective:

| Year | 15% Rate | 28% Rate | 31% Rate | 36% Rate | 39.6% Rate |
|---|---|---|---|---|---|
| 2001 | Refund credit | 27.5% | 30.5% | 35.5% | 39.% |
| 2002-3 | partial 10% | 27% | 30% | 35% | 38.6% |
| 2004-5 | partial 10% | 26% | 29% | 34% | 37.6% |
| 2006+ | partial 10% | 25% | 28% | 33% | 35% |

The 10% rate bracket is not adjusted for inflation until 2009. However, the other rate brackets will be changed

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## ECONOMIC GROWTH AND TAX RELIEF

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based on changes in inflation.

The 2001 Act does not reduce FICA or FUTA payroll taxes, but the IRS will issue new withholding tables to reflect the 1/2% reduction for 2001 in tax brackets above 15%. Withholding on bonuses after August 6, 2001 will be at the new 27 1/2% rate. Next year, the withholding tables will be changed again and the withholding rate on bonuses will be lowered to 27%. The rate cuts also affect the accumulated earnings tax and the personal holding company tax for corporations, which also fall to 39.1% for 2001.

### PERSONAL EXEMPTION AND ITEMIZED DEDUCTION PHASEOUTS

Upper income taxpayers have had a higher actual rate of tax than the 39.6% published rate because their personal exemptions and itemized deductions were being phased out once their income exceeded specified limits. The phaseouts actually added about 2% to the top tax rate. Under the 2001 tax legislation the personal exemption phaseout will be gradually eliminated starting in 2006 over a 5-year period. Similarly, the itemized deduction phaseout will be eliminated in stages beginning in 2006, with final disappearance in 2010.

### ALTERNATIVE MINIMUM TAX

Taxpayers who are subject to the Alternative Minimum tax are currently taxed at 26% of the first $175,000 of alternative minimum taxable income in excess of an exemption amount, and at 28% on their remaining alternative minimum taxable income. The exemption amounts for 2000 were: $45,000 for married individuals filing a joint return and surviving spouses; $33,750 for unmarried individuals, and $22,500 for marrieds filing separately as well as for estates and trusts. The exemption amounts are gradually phased out for higher income taxpayers. The 2001 tax legislation does not lower the AMT tax rate, but if you were subject to the Alternative Minimum Tax in 2000 you will receive the IRS refund check or rate reduction credit if you paid taxes in 2000. Furthermore, the legislation increases the exemption amounts for individuals beginning with 2001 and through 2004. The increased exemption amounts are $49,000 for marrieds filing a joint return and surviving spouses; $35,750 for unmarried individuals, and $24,500 for married filing separate returns. The legislation also provides that you may continue to offset your AMT tax liability with the child tax credit, and you do not need to add back your refundable tax credits to compute your AMT tax liability.

### MARRIAGE PENALTY RELIEF

The marriage penalty stems from the fact that when a couple files a joint return, they pay more tax than if each filed separately using single filing status because of variations in tax bracket break points and in the standard deduction which may be claimed. To address these issues, the new legislation increases the standard deduction for married individuals, expands the 15% tax bracket for marrieds filing joint returns, and also increases the beginning and end points of the earned income credit phaseout for married taxpayers filing joint returns.

The increase in the basic standard deduction for a married couple to twice the basic standard deduction for an unmarried individual filing as a single taxpayer is phased in over 5 years beginning in 2005, as follows:

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| Calendar Year | % of Standard Deduction for Single Taxpayer |
|---|---|
| 2005 | 174% |
| 2006 | 184% |
| 2007 | 187% |
| 2008 | 190% |
| 2009+ | 200% |

The expansion of the 15% tax rate bracket for a married couple to twice the size of a single individual is phased in over a 4-year period as follows:

| Calendar Year | Phase-in % to Twice the Amount for Single Taxpayer |
|---|---|
| 2005 | 180% |
| 2006 | 187% |
| 2007 | 193% |
| 2008+ | 200% |

To provide parity between single and married taxpayers with respect to the earned income credit, the beginning and ending points of the earned income credit phase-out for married filing a joint return are increased as follows: $1,000 for tax years beginning in 2002-4; $2,000 for tax years beginning in 2005-7, and by $3,000 for tax years subsequent to 2007. Starting in 2008, the $3,000 amount will be modified annually for inflation.

## CHILD AND OTHER TAX CREDITS

The new tax legislation doubles the $500 current child tax credit to $1,000 per child over a 10-year phase-in period as follows: 2001-2004, $600 maximum credit; 2005-2008, $700 maximum credit; 2009, $800 maximum credit, and 2010, $1,000 maximum credit per child. The child tax credit can be applied against a taxpayer's Alternative Minimum Tax liability. The credit has also been made refundable to the extent of 10% of your earned income in excess of $10,000 for tax years 2001-2004, and to the extent of 15% of your income over $10,000 after 2004.

There is an increased adoption credit of up to $10,000 per child adopted. The new credit amount applies both in the case of the adoption of a non-special needs child or a special needs child. Also, the phase-out range starting point has been doubled under the legislation from $75,000 to $150,000. These changes become effective beginning January 1, 2002.

The dependent care credit has been modified under the 2001 Tax Act as follows: (1) the credit rate has been increased from 30% to 35%; (2) the amount of eligible employment expenses to which the credit rate can be applied has been raised to $33,000 ($4,800 when the credit is taken for more than one qualifying individual) and (3) the beginning point of the income phase-out has been increased from $10,000 to $15,000.

There is a new credit for up to 25% of the cost of employer childcare facilities, such as day care centers for children of employees, up to $250,000 per year, starting in 2002. Qualifying expenditures include the cost of building and operating these facilities. Usage of the facilities may not favor highly paid employees, and at least 30% of the children enrolled in the center must be children of employees. There is also a 10% credit for expenses incurred in providing childcare resources and referral services.

## EDUCATION RELATED MODIFICATIONS

Parents who itemize as well as those who do not will be able to obtain a deduction for qualified higher education expenses. For years 2001-2003, if you are single with

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## ECONOMIC GROWTH AND TAX RELIEF

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adjusted gross income below $65,000 or married filing jointly with adjusted gross income below $130,000 you will be entitled to a tax deduction of $3,000 for college tuition. For 2004 and 2005, the deduction cap rises to $4,000. The legislation also permits single taxpayers with incomes up to $80,000 and joint filers with incomes up to $160,000 to take a maximum tuition deduction of $2,000 for 2004 and 2005. The tuition deduction provisions are repealed after 2005.

The education IRA contribution limit of $500 per child has been increased to $2,000 per child annually from birth through age 17. Also, in the case of a special needs beneficiary, contributions to an education IRA may be made even if the individual is 18 or older. Furthermore, the accounts can be used to cover the cost of elementary and secondary education in private and parochial schools. In general, qualifying expenses include tutoring, acquisition of computer equipment, Internet access costs, room and board, uniforms and extended day programs. Income limits for married are double those for single filers. Full pay-ins can be made if adjusted gross income does not exceed $190,000 for joint filers, and the pay-ins are phased out as adjusted gross income increases to $220,000. The income limits and phaseout for single filers are half the amounts for joint filers. Beginning in 2002, contributions will be allowed not only from individuals, but may also be made from corporations, tax-exempt organizations and other entities. Contributions counted toward any tax year will be permissible until April 15 of the following year, rather than being cut off on December 31. The legislation also provides that the Hope and lifetime learning credits can be claimed in the same year that a distribution from an education IRA is made, so long as distribution from the education IRA is not used to cover the same expenses for which the education credits are claimed. It is also permissible now to make contributions to an education IRA as well as to a qualified state tuition program in the same year for the same child without incurring a penalty.

The rules governing the deduction for student loan interest have been expanded. The restriction that the deduction could only be taken with respect to the first 60 months during which student loan interest payments are required has been dropped. Additionally, the restriction that limited deductions of student loan interest only to taxpayers whose adjusted gross income fell below certain limits has been liberalized. The new law raises the income phase-out range to $50,000-$65,000 for single taxpayers and to $100,000-$130,000 for joint filers.

The scope of qualified tuition plans has been broadened. Taxpayers will no longer be restricted to making tuition prepayments of tuition and higher education expenses to state sponsored qualified tuition programs. Instead, private institutions of post-secondary learning will be able to sponsor qualified tuition programs to which you may make prepayments. Furthermore, distributions from state-sponsored qualified tuition programs will be excludable from income after December 31, 2001, and so will distributions from non-state programs if made after December 31, 2003.

The income tax exclusion for up to $5,250 of employer provided education assistance has been expanded to pay for graduate as well as undergraduate courses, and it has also been made permanent.

# Odds & Ends

## Correction

There was an error in the May 2001 issue of the *PA Accountant* on Page 19. The error was in the Odds & Ends section under *"Estimated Tax Rules for 2001 Have Been Changed*." The first sentence should read "to avoid underpayment penalties, taxpayers with adjusted gross income over $150,000 in 2000…" The erroneous sentence stated the income amount to be $50,000, which is incorrect. Thank you to PSPA member Mark Poppel for informing us of the error.

## Outsourcing Can Expand Your Market Reach

A survey by International Data Corporation indicates that while only 60% of small businesses (100 or fewer employees) have a web site and a home page on the Internet compared to 96% of larger businesses, they have more e-business capabilities than their larger brethren. For example, whereas just 7% of large companies provide for online credit card payment, 19% of the small companies offer this service on their web site. The reason is not that the small businesses are more sophisticated, but rather that the web site hosting tasks have been outsourced to a service provider with sophisticated Internet capabilities. It's estimated that over half of small and medium sized businesses outsource. Since there are numerous service providers that offer web storefront facilities at modest cost it should not be difficult to find a reliable and capable firm. Outsourcing in this area may provide a solution for getting on the Internet and expanding your marketing reach. Incidentally, although cost is a consideration in deciding to go on the Internet, unlike the dot.com companies, almost half of regular firms with fewer than 10 employees have profitable websites today.

## Creative Communication as Postal Costs Soar

Postal costs have risen again, giving business managers an incentive to look for alternative means of communicating with customers. Significant savings and enhanced cashflow could result from the faxing instead of mailing invoices. Telephone costs are now significantly lower than mailing costs, and if the transmission is made during non-business hours.

## ERISA

New regulations by the Department of Labor revise minimum requirements for ERISA Benefit Plan Internal Claims Procedures. The regulations establish tighter requirements for employer group health plans to respond to employees who submit benefit claims or appeal denial of a claim that was previously submitted. The rules, which go into effect on January 1, 2002, establish specific time deadlines for arriving at decisions and providing responses.

## Brokerage Divisions Exemption

New SEC rules for banks explain how their brokerage divisions can continue to qualify for an exemption from registering as broker/dealers. Under the regs, the Wall Street divisions that were eligible for full exemption under former regs would have to meet a 15 point test. Although the regulations took effect on May 15, 2001, the SEC agreed to extend the full exemption for banks' broker/dealers until October 1. The Agency has also given banks until January 1, 2002, before their compensation agreements must meet all the conditions of the new legal exemption from registration requirements. In separate regulations, the SEC has also indicated that it will treat savings and loans and other thrift institutions much the same as banks for broker/dealer registration purposes.

## Speedier Work Visas

The Immigration and Naturalization Service has announced that it will speed work-visa processing for foreign celebrities, athletes and executives for an additional fee of $1,000. Upon payment of the fee, instead of waiting 3-months or longer, the processing will be completed with 15 days. The new fee is on top of the usual $110 processing charge and is expected to generate $80 million per year in revenue.

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# Odds & Ends

## Changes to Publication 225, "Farmers Tax Guide"

Late last year, the IRS made changes to its Publication 225, "Farmers Tax Guide," that indicated that if a taxpayer is based in a farming business, the person may be able to use income averaging with respect to some or all of the year 2000 farm income by shifting it to the three preceding years. Use of income averaging requires an election and is limited to taxpayers who, in the year of the election, are engaged in a farming business as an individual, a partnership, or as a shareholder of an S corporation. Conversely, corporations, partnerships, S corporations, estates and trusts are not eligible to elect to use farm income averaging.

## MSSP – Hobby Losses

The IRS has issued a Market Segment Specialization Program audit technique guide dealing with hobby losses in connection with farm cattle operations and horse activities. The guides are designed to help IRS auditors focus on specific industry issues and make audits more efficient while also ensuring that tax laws are uniformly applied. The guide on farm hobby losses specifically addresses the application of Internal Revenue Code section 183 as it relates to horse activities and cattle operations.

## Third Quarter Interest Rates

The IRS has announced the tax overpayment and underpayment interest rates for the third quarter of 2001. The new individual rate for overpayments and underpayments will be 7%. The quarterly interest rate for corporate underpayments will be 9%. The interest rate for corporate overpayments under $20,000 will be 6%, and for corporate overpayments in excess of $10,000 it will be just 4.5%. The new rates are 1% lower than the rates for the second quarter of the year, reflecting the decline in Federal short-term interest rates.

## Windfall States

Missouri, Iowa, Oklahoma, Louisiana, Oregon, Alabama, North Dakota and Montana are the eight states that allow taxpayers to deduct Federal income taxes on the state tax return. Now that the IRS is going to provide tax rebate checks of up to $600 per couple, these states are about to gain a tax windfall, since the rebates reduce their residents' income tax deduction. Whether these states will tax the rebates is uncertain. Politically, it may be suicidal to impose tax on the rebates. So far the states have not indicated what they intend to do.

## Credit Card Tax Payments Not Deductible

Use of a credit card for paying one's income tax may offer convenience, delay to the last moment payment of one's tax liability, as well as provide a reward in the form of frequent flier miles. However, remember that the fee imposed for payment of taxes by credit card, it is not a tax-deductible expense. The fee which is about 2.5% of the amount charged is to be treated as a personal expense that is non-deductible, according to the IRS National Office.

## Erroneously Paid Alternative Minimum Tax

The IRS reports that thousands of small corporations erroneously pay Alternative Minimum Tax they do not owe. As a result, they lose accelerated depreciation tax benefits, tax credits and other tax-lowering tax preference items and pay higher income taxes than required. The reason for this is that the companies are not aware that small corporations (with annual gross receipts of not more than $5 million for one period and not more than $7.5 million, thereafter) were exempted from the Alternative Minimum Tax in 1997. In processing tax returns, the IRS does not look for this and the IRS won't automatically refund the excess tax payments.

## Offers in Compromise

The IRS is overwhelmed with "offers of compromise" requests from taxpayers. The reason is that instead of rejecting about one-half the offers received for lack of informa-

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# Odds & Ends

tion, the Agency now processes offers and then asks for missing information and also assists taxpayers in determining the size of the offer that would be acceptable. One result is that the Agency is short of personnel to handle the paperwork, so that taxpayers may have to wait 6 months or longer to find out whether their offer was accepted and to determine the impact on their tax situation. Another is that unpaid taxes are routinely being written off by revenue officers before the IRS even contacts taxpayers to determine whether there is a collection potential. It's estimated that since mid-1999, nearly $12 billion in tax delinquencies involving 688,000 taxpayers have been written off. In contrast, in 1988, only 98 cases were written off.

## Taxes Eating Up Family Budgets

Taxes are the single biggest item in family budgets, according to the Tax Foundation, a non-profit organization. It says that Federal and State taxes represent 39% of the total budget of a median two-earner family's income, compared to 15.9% for housing, 10.8% for medical care, and 8.9% for food, the next biggest items.

## Domestic Partner Benefits

The IRS has issued two private letter rulings that indicate that employees may not exclude health insurance benefits an employer provides for domestic partners from income. Accordingly, the Agency has told employers to withhold Federal taxes on the value of the benefits. The taxable wage value of the benefit equals the fair market value of the part of the coverage the employer pays. According to the IRS, the benefit is taxable as long as the domestic partner cannot be claimed as a dependent of the employee, and that it is the employer's responsibility to make the assessment. Until now, the IRS has not penalized any company that failed to withhold the value of domestic partner benefits, but this is likely to change as more companies cover domestic partners. An estimated 25% of Fortune 500 companies now provide domestic partner benefits.

## Wage Withholding

Recently, the IRS was confronted with a business owner who received no compensation during the year and also paid no income taxes. Instead, he had his company make a single year-end compensation payment from which sufficient taxes were withheld to cover his entire year's estimated tax liability. The owner argued that although underpayment of withholding is a violation of the tax code, the IRS regulations provide that wage withholding is considered to be administered evenly throughout the year, no matter when the withholding payments are actually made. In effect, a late makeup payment can avoid penalties for earlier underpayments of estimated or withheld taxes. Since the payment was proper and sufficient, the IRS had no choice but to acquiesce to the unusual compensation payment and withholding.

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