



# 2003 Small Business advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS YEAR END 2003 Volume IX, Number 4

**Brenda J. McGivern, CPA**

Volume IX, Number 4/ YEAR-END 2003

**Here is your issue of Small Business Advisor. Enjoy!**

## INSIDE THIS ISSUE:

[Tax Calendar](#)

[Keep It in the Family \(Your Money, That is...\)](#)

[Year-End Strategies That Reduce Taxes!](#)

[Buying a Vehicle for a Big Tax Write-Off? Read This First!](#)

[Questions & Answers](#)

### Keep It in the Family (Your Money, That is...)



In 2004, another way to reduce the overall family tax bill is by employing family members to work in your business by shifting income to them and providing them with employment benefits.

- **Employing Your Child** - By employing your child, you are entitled to many income tax advantages, including obtaining a business deduction for a reasonable salary paid to that child and reducing your self-employment income and tax by shifting income to the child. [click here for full article](#)

### Year-End Strategies That Reduce Taxes!

The following are a number of year-end strategies that can reduce your tax bite in 2003 or optimize your taxes between 2003 and 2004. The strategies discussed employ a number of techniques that advance or delay deductions, defer income, increase deductions, gift gains, accelerate losses and make business purchases. [click here for full article](#)

### Buying a Vehicle for a Big Tax Write-Off? Read This First!

If you are planning to take advantage of the new liberal expense deductions and bonus depreciation by acquiring a business vehicle, you may need to rethink your strategy. Although business vehicles are qualifying property for these deductions, they also fall under the more restrictive "luxury vehicle" rules, which can substantially limit the annual deduction.



A "luxury vehicle," regardless of its cost, is defined as a four-wheeled vehicle, used mostly on public roads, that has an unloaded gross weight (or in the case of trucks and vans, gross vehicle weight) of no more than 6,000 pounds. [click here for full article](#)



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## Questions & Answers

**Q** – I lease a vehicle that I use for business. Can I use the standard mileage rate for my business use of the vehicle?

**A** – Yes, the standard mileage rate (36 cents per mile for 2003) can also be used for a leased vehicle. However, if you elect to use the standard mileage rate, you cannot switch back to the actual expense method of computing your deductible vehicle expenses. [click here for full article](#)



2  
0  
0  
3

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## INSIDE THIS ISSUE:

**Tax Calendar**

**Keep It in the  
Family (Your  
Money, That is...)**

**Year-End  
Strategies That  
Reduce Taxes!**

**Buying a Vehicle  
for  
a Big Tax Write-  
Off? Read This First!**

**Questions &  
Answers**

Volume IX, Number 4/ YEAR-END 2003

## Tax Calendar (November 2003 - April 2004)

### November-December 2003:

- Time for 2003 Year-End and 2004 Tax Planning. Please call for an appointment.

### December 31, 2003:

- Last day to pay deductible expenses for 2003 return (doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2003).

- Last day to withdraw funds from a Traditional IRA Account if you turned age 70½ before 2003.

- Last day to set up a Keogh Retirement Account if you plan to make a Year 2003 Contribution.

### January 15, 2004:

- Fourth Quarter 2003 Estimated Tax Payment due unless 2003 return is filed by January 31, 2004

### January 31, 2004:

- Deadline for providing 1099s and W-2s to those people you paid during 2003.

### February 28 , 2004:

- Deadline for sending 1099s and W-2s to the government.

### April 1, 2004:

- Last day to withdraw funds from your Traditional IRA if you turned age 70½ in 2003 and you haven't taken your 2003 Distribution yet. In addition, last day to withdraw funds from your SEP or Keogh plan if you're retired and turned age 70½ in 2003.

### April 15, 2004:

- Deadline for Individuals to file 2003 return or request an extension of time to file.

- First Installment of 2004 Estimated Tax Payment due.

- First Installment of 2004 Defined Benefit Pension Plan Contributions due.

- Deadline for making 2003 IRA Contributions. Deadline for making 2003 Contributions to Keogh/SEP Plans unless an extension is filed.

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2003

Small Business

advisor

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YEAR END 2003 Volume IX, Number 4

## INSIDE THIS ISSUE:

### Tax Calendar

**Keep It in the Family (Your Money, That is...)**

**Year-End Strategies That Reduce Taxes!**

**Buying a Vehicle for a Big Tax Write-Off? Read This First!**

**Questions & Answers**

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## Keep It in the Family (Your Money, That is...)

In 2004, another way to reduce the overall family tax bill is by employing family members to work in your business by shifting income to them and providing them with employment benefits.

- **Employing Your Child**—By employing your child, you are entitled to many income tax advantages, including obtaining a business deduction for a reasonable salary paid to that child and reducing your self-employment income and tax by shifting income to the child. Since the salary paid to your child is considered earned income, it is not subject to the rules that apply to children under the age of 14. The maximum standard deduction available to your child in 2004 is \$4,850 (\$4,750 for 2003) as earned income. Therefore, the standard deduction eliminates all taxes on this income if you pay your child \$4,850 in compensation.

Additionally, if your business is unincorporated, wages paid to your child under age 18 are not subject to Social Security taxes. Not only are there significant income tax advantages to employing your child, but you may provide him or her with fringe benefits such as group-term life insurance and qualified pension plan contributions.

Your child may also make deductible contributions to an IRA of the lesser of earned income or \$3,000. These contributions can offset earned and

unearned income. Therefore, for 2004, your child could receive \$7,850 gross income (\$4,850 earned and \$3,000 unearned) by combining the IRA deduction with the standard deduction and pay no tax. You should consider giving him or her \$3,000 (as part of your \$11,000/\$22,000 annual exclusion gift) if your child does not want to use his or her earned income to fund an IRA contribution.



- **Employing Your Spouse**—Reasonable wages paid to your spouse entitles you to a business deduction. The wages are subject to FICA taxes and your spouse may qualify for Social Security benefits to which he or she might not otherwise be entitled. In addition, your spouse may also be entitled to receive coverage under the qualified retirement plan of your business or be able to contribute to his or her own IRA if he or she otherwise qualifies. Also, while maintaining the same family coverage, you can increase your business deductions by providing your spouse with family health insurance coverage as an employee.

Please keep in mind that when you employ a family member in your business, the wages should be reasonable for the work performed and the services performed are necessary to the business.

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2003

Small Business

advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS

YEAR END 2003 Volume IX, Number 4

## INSIDE THIS ISSUE:

### Tax Calendar

### Keep It in the Family (Your Money, That is...)

### Year-End Strategies That Reduce Taxes!

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## Year-End Strategies That Reduce Taxes!

The following are a number of year-end strategies that can reduce your tax bite in 2003 or optimize your taxes between 2003 and 2004. The strategies discussed employ a number of techniques that advance or delay deductions, defer income, increase deductions, gift gains, accelerate losses and make business purchases.

### **Prepay Deductible Taxes** –

Deductible taxes primarily consist of real property taxes, state and local income taxes, and personal property taxes. If you itemize your deductions, you can deduct these taxes. For example, you can pay your January 2004 state estimated tax payment in December and make it deductible on your 2003 return rather than the 2004 return. Or, you could pay your entire property tax bill upfront rather than in installments running into next year. However, taxes are not deductible against the Alternative Minimum Tax (AMT). If you are affected by the AMT for 2003, some or all of your tax deductions may be wasted, and you might consider delaying some tax payments until 2004.

**Considering a New Car Before Year's End?** If you are, you might consider one of the new fuel-efficient hybrid vehicles that are powered by both a gasoline internal combustion engine and a rechargeable electric motor. These vehicles, if certified, can qualify for the clean-fuel vehicle deduction of up to \$2,000 in 2003 even if only used personally. When shopping for your vehicle, be sure to

received from the annuity that were excludable from income. Before making your decision to surrender, you should consider any possible surrender penalties and the potential for the annuity to recover.



**Take Investment Losses** - If you have investments that are worth less than what you paid for them, you can use the losses to offset other gains and in certain circumstances, other types of income. Tax law allows you as an investor to offset capital gains with capital losses, and if the losses exceed the gains, you can deduct losses up to a maximum of \$3,000 (\$1,500 if filing married separate) for the tax year. Any additional losses carry over to future years. For this reason, you should review your securities portfolio at year's end and search for stocks and other securities whose sales will result in a loss and that you don't expect will recover. This allows you to minimize your gains or maximize your losses for the year. When planning this strategy, keep in mind that under the wash sale rules, a loss is disallowed if the security sold at a loss is repurchased within 30 days. A loss will also be disallowed if the investor buys the same security 30 days before the sale.

**Give Away Your Tax Liability** – If you have a substantial gain in a stock or other asset you want to sell but don't want the resulting tax liability, there are a couple of techniques you can employ to simply give

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ask if the vehicle is certified and how much of the cost qualifies for this deduction.

**Purchase Business Equipment** – If you are considering acquiring equipment to be used in your business or required for your job, you might consider purchasing that equipment before year's end. You may be able to expense up to \$100,000 (\$50,000 for married taxpayers filing separately) of the cost of the equipment in 2003. Qualifying equipment generally includes those with a depreciable life of seven years or less, such as tools, electronic equipment, machinery, etc. This deduction is limited to the income from all of your trades and businesses. There are additional restrictions if more than \$400,000 of assets were placed in service during the tax year. Taxpayers filing married separate are only allowed \$50,000.

Although business vehicles are qualifying property, they fall under the more restrictive luxury auto rules. Those rules substantially limit the annual deduction. However, some vehicles, such as SUVs that exceed the 6,000-pound limitation and trucks or vans that are placed in service after July 7, 2003 and are qualified nonpersonal use vehicles<sup>(1)</sup>, are exempt from the luxury auto limitations and can provide a substantial tax deduction in the year of purchase.

*(1) The truck or van must have been specially modified with the result that it is not likely to be used more than a de minimis amount for personal purposes.*

**Make Noncash Contributions** – Are your closets full of clothes you never wear anymore or no longer fit you? Is your garage full of stuff you don't need? If so, you might consider donating these items to a local charity before year's end. You can deduct the fair market value of these gifts as a charitable contribution.

**Take Variable Annuity Losses** - If you have a variable annuity that is worth less than what you paid for it, you might consider surrendering it before year's end so that you can realize a deductible loss. Usually, the amount that is deductible will be the

away the appreciated asset and let the recipient take the gain:

- **Charitable Gift** - Consider replacing your cash charitable gifts with gifts of appreciated property. By giving the asset to your favorite charity, you receive a charitable contribution deduction equal to the fair market value of the gift and at the same time avoid having to report the gain from the asset on your return. However, the maximum deduction for gifts of this type can be as low as 20% or 30% of AGI as compared to 50% for cash gifts.

Caution: If the value of the stock you are considering gifting is less than what you paid for it, sell it, take the loss on your return, and then contribute the cash to the charity.

- **Gifts to Individuals** - Giving a gift of appreciated property to an individual (donee) transfers the gain from that property to the donee. This can work to your advantage by gifting the appreciated asset rather than giving the donee cash. For example, you are paying for a child's college education. Instead of selling some appreciated stock to pay for the schooling, gift the stock to the student, who can generally sell it in a much lower tax bracket and pay for his or her own school expenses.

**Bunch Your Deductions** - If your itemized deductions exceed the Standard Deduction, you will want to itemize your deductions. Itemized deductions consist of five basic categories, each with its own limitations and special considerations. For higher income taxpayers, the itemized deductions are reduced by the smaller of 3% of the amount by which your AGI exceeds \$139,500 (\$69,750 if married filing separately), or 80% of your itemized deductions that are affected by the limit, which generally include taxes, home mortgage interest, charitable contributions, investment expenses, and employee business expenses.

If your deductions only marginally exceed the standard deduction, you might consider "bunching" your deductions in one year. This allows you to produce higher than normal itemized deductions that year and then take the standard deduction the other year. So, if you are close to exceeding the standard deduction in 2003, you might consider prepaying some deductible 2004 expenses in 2003. Or, if you will fall short of being able to itemize in 2003, you might delay paying

surrender value less your tax basis in the annuity. Your tax basis is generally the amount you originally invested less any amounts previously

some of the 2003 expenses until 2004.

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2003

Small Business

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YEAR END 2003 Volume IX, Number 4

## INSIDE THIS ISSUE:

### Tax Calendar

### Keep It in the Family (Your Money, That is...)

### Year-End Strategies That Reduce Taxes!

### Buying a Vehicle for a Big Tax Write- Off? Read This First!

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Volume IX, Number 4/ YEAR-END 2003

## Buying a Vehicle for a Big Tax Write-Off?



If you are planning to take advantage of the new liberal expense deductions and bonus depreciation by acquiring a business vehicle, you may need to rethink your strategy. Although business vehicles are qualifying property for these deductions, they also fall under the more restrictive "luxury vehicle" rules, which can substantially limit the annual deduction.

A "luxury vehicle," regardless of its cost, is defined as a four-wheeled vehicle, used mostly on public roads, that has an unloaded gross weight (or in the case of trucks and vans, gross vehicle weight) of no more than 6,000 pounds. The IRS has yet to announce the regular "luxury vehicle" limits for 2003, but the amount for 2002 was \$3,060. For 2003, that amount will be increased by \$7,650 with the special 50% depreciation allowance, providing a total estimated deduction of \$10,710. If the vehicle is only used partially for business, the deduction is reduced for the personal use.

However, some vehicles, such as SUVs that exceed the 6,000-pound limitation and trucks or vans that are placed in service after July 7, 2003 and are qualified non-personal use vehicles, are exempt from the luxury auto limitations. To be classified as a qualified nonpersonal use vehicle, the truck or van must have been specially modified with the result that it is not likely to be used more than a de minimis amount for personal purposes. An example of a qualifying nonpersonal use vehicle is a van with only a front bench for seating and permanent shelving that fills most of the cargo area, which constantly carries merchandise or equipment and has been specially painted with advertising or the company's name. Also not subject to the luxury auto rules is any vehicle used directly in a taxpayer's trade or business of transporting persons or property for compensation or hire, such as an ambulance, hearse, taxi, clean fuel vehicle or bus; also excluded are commuter highway vehicles.

These vehicles, which are excluded from the "luxury vehicle" category, can provide a substantial tax deduction in the year of purchase. To the extent they are used in business, they qualify for the \$100,000 expense deduction, bonus depreciation and regular depreciation. Thus, in most cases, the entire cost or any portion of the cost of the vehicle can be deducted in the year of purchase.

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0  
0  
3

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## INSIDE THIS ISSUE:

[Tax Calendar](#)

[Keep It in the  
Family \(Your  
Money, That is...\)](#)

[Year-End  
Strategies That  
Reduce Taxes!](#)

[Buying a Vehicle  
for  
a Big Tax Write-  
Off? Read This First!](#)

[Questions &  
Answers](#)

Volume IX, Number 4/ YEAR-END 2003

## Questions & Answers

**QUESTION:** An associate tells me that if I use more than one vehicle at a time in my business, I must use the actual expense method of deducting vehicle expenses and cannot use the standard mileage rate. Is this true?

**ANSWER:** For 2003, your associate is correct. However, starting in 2004 taxpayers who use no more than four vehicles at the same time for business purposes may use the standard mileage rate.

According to the IRS this will simplify the bookkeeping for more than 800,000 businesses. However, only the actual method may be used to figure the deductible expenses of autos used for hire, such as taxicabs. The standard mileage rate for business use of a vehicle in 2004 will be 37.5 cents a mile for all business miles driven, up from 36 cents a mile in 2003. Switching between methods can be tricky. Generally, if you are already using the actual method and have claimed accelerated depreciation on an existing vehicle in a prior year you must continue to do so. Please call this office for additional details.

**QUESTION** – I lease a vehicle that I use for business. Can I use the standard mileage rate for my business use of the vehicle?

**ANSWER** – Yes, the standard mileage rate (36 cents per mile for 2003) can also be used for a leased vehicle. However, if you elect to use the standard mileage rate, you cannot switch back to the actual expense method of computing your deductible vehicle expenses.

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