

# Trendlines

*New Directions in Business and Personal Planning*



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# It's a Buyer's Market

## *New Tax Law Bolsters Benefits of Equipment Purchases*

Dividend and capital gains tax cuts and Child credit refunds garnered most of the media attention about the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). But, as a business owner, you got some breaking news of your own — sizable increases in how much you can expense and depreciate newly acquired property. That means the next few years will be prime time to shop for qualifying assets needed for your business. But before you do, make sure you know the act's details.

### **Sizing Up Section 179**

Under Section 179, eligible new and used property placed in service during all of 2003, 2004 and 2005 now qualifies for up to a \$100,000 deduction (up from the previous \$25,000). Bear in mind there is a phaseout amount — \$400,000 — for qualifying assets put in service during those same years. (That's a \$200,000 increase from the previous limit.) Also remember that your Section 179 deduction can't surpass your aggregate business income before the deduction. The provision exists through 2005, after which time the expensing rules revert to their pre-2003 level.

Here's an example of how this new expensing provision can save businesses money. For simplicity's sake, let's say XYZ Corp. bought \$80,000 in new qualifying assets this year. Thanks to JGTRRA, the company can now expense all of these items as long as its taxable income before this deduction

exceeds \$80,000. In contrast, the previous rules would have allowed the business to expense only \$25,000 of those purchases. Although some first-year bonus depreciation may have applied to some of the assets, it would have then had to relegate the remaining \$55,000 to a regular depreciation schedule.

When expensing, examine your assets carefully to choose those that will provide the most benefit if your total exceeds \$100,000. Look for property with longer recovery periods so you can recoup its total cost in the shortest possible time. One purchase to particularly consider, and which JGTRRA refers to specifically, is "off-the-shelf" software. These products did not qualify under the previous law, but do now.

### **Being Clear on "Bonus" Depreciation**

Perhaps you recall the 30% "bonus" depreciation served up by the Job Creation and Worker Assistance Act of 2002. Well, JGTRRA goes one better — or 20 percentage points better, to be precise. Companies may now write off 50% of the cost of qualifying new assets acquired on or



### 3 More Benefits for Businesses

Bonus depreciation and a greater expensing limit are certainly the headline grabbers for businesses in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). But here are three other, less-publicized benefits:

**1. Extended quarterly corporate estimated tax payments.** Under the new tax law, 25% of the amount of any required installment of corporate estimated tax which is otherwise due by Sept. 15, 2003, isn't due until Oct. 1, 2003. The due date for the remaining 75% of the Sept. 15, 2003, estimated tax payment hasn't changed.

**2. Increased value of bigger vehicles.** Vehicles rated at more than 6,000 pounds, which now include a variety of foreign and domestic models, qualify for the expensing allowance of up to \$100,000 (see "Sizing Up Section 179" on page 2), and they aren't subject to the luxury auto limits that otherwise apply to vehicles. First-year depreciation for the "less than three ton" category is now limited to \$7,650.

**3. Clarified status of like-kind exchanges.** Under the new act, Congress spelled out that the adjusted basis of qualified property obtained in a like-kind exchange or an involuntary conversion does qualify for the "bonus" first-year depreciation. (See "Being Clear on 'Bonus' Depreciation" on page 2.)

after May 6, 2003, and placed in service before Jan. 1, 2005. Eligible property acquired before May 6, 2003, may still qualify for the previous law's 30% bonus depreciation amount. Note that while used property can qualify for Section 179 expensing, it can't qualify for bonus depreciation.

How might the new bonus depreciation work? Let's go back to XYZ Corp. and say the company bought a \$70,000 piece of new manufacturing equipment that falls into the seven-year depreciation category and intends to place it in service at the beginning of 2004. If the company was already using the expensing allowance for other assets, it would qualify for a deduction of \$10,000 (one-seventh of the cost in first-year depreciation, following the 200% declining balance method and a half-year convention). But under JGTRRA, XYZ may quadruple that first-year deduction to \$40,000 (50% of the purchase price, or \$35,000; plus \$5,000 in regular MACRS depreciation, one-seventh of the remaining \$35,000).

You may generally claim bonus depreciation for only new property with depreciation recovery periods of 20 years or less. (Used, reconditioned or rebuilt assets aren't eligible.) This usually doesn't present a problem — most personal

property assets fall in these periods, as do some leasehold improvements. But assets will be disqualified if a binding written acquisition contract existed before May 6, 2003; though, again, they may remain eligible for the old 30% bonus amount.

For additional information on the new tax law, see "3 More Benefits for Businesses" above.

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#### Planning First

Of course, tax benefits aren't the only thing you should consider when making equipment purchases. Also consider whether your cash flow can support such a purchase and whether buying used equipment might not be a better deal overall. Nevertheless, if you've been waiting for a good time to invest in new assets, that moment may have arrived. But before you reach for your corporate credit card, give us a call. We can help your company get the most from JGTRRA. □



# How To Read A Valuation Report

## *A Brief Overview of These Important Documents*

Many executives delay or avoid business valuations not to save money, but because of unfamiliarity and skepticism. And the source of this uncertainty often lies in the valuation report — a document that may give some company owners flashbacks to a particularly challenging reading assignment in high school. But these reports needn't leave you longing for CliffsNotes™, nor should they cause you to delay or minimize the importance of a regular valuation. Here's a brief overview of a typical valuation report.

### **The Subject**

The first thing you'll encounter is a thorough description of the subject: your business. The report should include the “as of” date, your company's name and business structure, its number of shares (if applicable), and the valuation's purpose. All these points are important, but the last one is particularly critical. Although the valuator will state the purpose in his or her opinion letter (a signed accompanying document summarizing the report's scope, methods and limitations), restating it here prevents confusion.

As you read the report, make sure it accounts for your company's unique characteristics. These include history; ownership, management and employees; products and services; customers and suppliers; and facilities. The appraiser should also allow for external factors, including the national and local economies, government regulations, and demographic trends.

### **The Method and Procedures**

Next comes the nitty-gritty — valuation methods and procedures. Valuators can choose from a variety of approaches, so the report should discuss all of your appraiser's options, including why he or she favored some approaches over others. From there, your valuator needs to describe his or her procedures. These will usually include a site visit as well as a detailed financial analysis. Any information he or she uses in the report must have been available (or at least foreseeable) at the valuation's “as of” date. For instance, if an appraiser is valuing a business as of June 1 and a tornado destroys the facilities on June 2, he or she shouldn't consider the tornado's effects.



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Having detailed his or her methods and procedures, your valuator then must explain whether he or she applied valuation discounts (or premiums) to the preliminary value. Common discounts include the minority interest and marketability discounts. If your appraiser did apply discounts, he or she should justify the choices, based on empirical evidence and your company's unique characteristics.

When applying valuation discounts, a valuator must be able to define an interest's basis of value: Is it a controlling or minority interest? Is the interest marketable or nonmarketable? Make sure your appraiser can answer these questions in detail. And be careful: Novice valuers often simply apply averages from empirical studies without providing support for their numbers. Such unsupported discounts can leave you vulnerable to an IRS or courtroom attack.

Last, your valuator should submit a value conclusion about your company. Ask yourself: Would this conclusion make economic sense if you were a hypothetical buyer or seller looking at your company? Reading the report from both perspectives is important: In divorce cases, spouses that own businesses are often criticized for considering only the hypothetical buyer, thereby undervaluing the business. Seeing just one side of the coin results in a skewed value conclusion.

### **The Valuator**

After reading the report, you should feel confident in its accuracy. But if you're still uncertain, you may want to review your valuator's qualifications. (You presumably did this before hiring him or her, but it doesn't hurt



to recheck them.) Most experienced appraisers belong to one or more professional business valuation organizations. Contact the one to which your expert belongs.

You might also examine his or her work paper files, or have your financial advisor do so. To save time (and possibly money), some valuers omit some details from their reports. For example, an expert may perform a thorough financial analysis but touch on it only briefly in the report. Regardless of the report's contents, the work paper file should contain in-depth information about your valuator's actions.

Another option to consider is checking with the IRS — not about your valuator, but about his or her report. The agency's "Business Valuation Guidelines" include a glossary of business valuation terms and a valuation report checklist. To download a free copy of these guidelines, visit the Business Valuation Resources' Web site at [www.bvlibrary.com](http://www.bvlibrary.com) and click on "free downloads." Is your valuator's report consistent with the IRS standards? If not, you may have a problem.



In addition, check out Revenue Ruling 59-60. This IRS ruling clearly defines the term “fair market value,” a critical factor in business valuations. It also provides a list of items valuers need to consider when valuing a business, including the company’s adjusted book value, earning capacity and goodwill.

## The Significance

Valuation reports are undeniably formidable documents, especially considering their contents’ significance. So don’t be surprised if yours contains complex analyses that you can’t fully comprehend. But also don’t hesitate to ask your valuator to explain any confusing information. You may even wish to contact another appraiser for a second opinion. What’s important is to regularly reassess your company’s value — for purposes as commonplace as a buy-sell agreement to as life-altering as a business sale. Still wary of valuations? Call us; we’d be happy to explain further. □



## Moneylines: News Briefs for Businesses and Individuals

**Recent IRS stats point to audit likelihoods.** Like many taxpayers, you’d no doubt like to know what kind of person the IRS targets for an audit. Well, a look-see at the examination statistics for returns reviewed in the 12 months ending Sept. 30, 2002,

reveals some indicators. Among the most scrutinized are Schedule C filers (essentially, self-employed persons without business partners), who garner examination rates four times higher than average. Taxpayers who earn more than \$100,000 also appear to be in the spotlight, mainly because of recent IRS inquiries into higher income earners. To select future targets, the agency initiated a new batch of random audits earlier this year affecting 47,000 households.

**Benefits overseer changes its name.** Do you know where to go to ensure your company’s benefits are in compliance with federal laws? If you answered, “Why, the Pension and Welfare Benefits Administration (PWBA), of course,” you’re not quite right. Secretary of Labor Elaine L. Chao announced in February that this agency, which administers employer-based retirement, health and other benefits programs for more than 150 million workers and their families, is now the Employee Benefits Security Administration (EBSA). In addition, their Web address is now: [www.dol.gov/ebsa](http://www.dol.gov/ebsa).

**Added pension benefits may stop, earned ones may not.** If you’re a pensioner and you arranged with your employer to receive cost-of-living increases during your retirement, watch out. An appellate court ruled earlier this year that employer plans may stop paying out cost-of-living increases they’d previously been granting pensioners. On the bright side, your employer cannot cut benefits you earned during your employment.

**New postage rate offers often-overlooked savings.** The U.S. Postal Service raised postage rates in the summer of 2002. Like many business owners, you may have rolled your eyes and sarcastically quipped, “What else is new?” But you likely also overlooked a critical detail — the new “Delivery & Signature Confirmation” service for first-class parcels. With it, you may save \$2 or more over using certified or priority mail, or even going with a commercial delivery service. But to qualify, you must comply with some very specific rules regarding box types and dimensions. Visit [www.usps.com](http://www.usps.com) for more details.

# Juggling JGTRRA's Advantages for Investors

Like many professionals and parents, Bob wanted to do more with his money. So several years ago he decided to start investing. And earlier this year, when Congress passed the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), he visited his financial professional's office to see how it would affect his portfolio as well as other parts of his life.

As the stock market is among Bob's primary passions, his advisor began by explaining that this year the top long-term capital gains rate drops from 20% to 15%. And gains that previously would have been taxed at 10% or 8% are now taxed at 5% — and won't be taxed at all in 2008. The rates apply to gains from sales, exchanges and installment payments received on or after May 6, 2003, and before Jan. 1, 2009. They're scheduled to revert to their previous levels in 2009.

Although these details piqued Bob's interest, his advisor cautioned that JGTRRA shouldn't change his allocation strategy, but rather reinforce prudent investing principles. For instance, as the law broadens the spread between short-term gains (which run as high as 35%) and long-term gains (which now peak at 15%), day-trading and other heavy-turnover activities are now less tax efficient than ever. And, of course, Bob (or anyone else) must not base investment decisions on tax considerations alone.

## Don't Ignore Dividends

Because he owns some dividend-paying stocks, Bob's in for more good news. Starting this year and continuing through 2008, the tax rate on qualified dividend income from domestic and eligible foreign companies has been reduced to 15% — the same as the new long-term capital gains rate. Note that this rate takes effect retroactively on Jan. 1, 2003, about five months earlier than the new capital gains rates.

With the introduction of the lower rate, dividend-paying stocks became potentially more valuable. Ideally, put those that qualify for the 15% rate outside of your retirement plans so you will benefit from the lower rate, and keep taxable

bonds inside your retirement plan. And if you hold real estate investment trusts (REITs), also keep them in your retirement plan if possible, because they don't qualify for the special dividend rate.

## Keep All Eyes on the AMT

More people — including Bob — could end up subject to the alternative minimum tax (AMT) as top regular income tax rates get closer to the 26% and 28% AMT rates. On the bright side, for 2003 and 2004, the AMT exemption increases from \$49,000 to \$58,000 for joint filers, from \$35,750 to \$40,250 for single filers and from \$24,500 to \$29,000 for married persons who file separately. These amounts expire after 2004, returning the exemptions to pre-2001 levels of \$45,000, \$33,750 and \$22,500, respectively.

If the AMT will catch you this year, defer to next year any non-AMT deductions, such as state and local income taxes. Then consider postponing other deductions to 2004 even if you can deduct them against AMT income — they'll likely be more valuable then. Also, accelerate or short-term capital gain income to this year to qualify for the lower AMT rate. Do so especially if you suspect you'll wind up in a higher regular tax bracket next year.

## Learn the Latest

As you can see, JGTRRA has offered Bob quite a few potential tax benefits to juggle when planning his 2003 taxes. And we haven't even mentioned that, beyond the 15% bracket, regular income tax rates have dropped at least two percentage points to 25%, 28%, 33% and 35%. Plus the Child credit is higher and marriage penalty relief has finally arrived. So please follow Bob's lead and give us a call; we can inform you about the latest strategies to add to your year end tax plan. □

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