RECAP OF SIGNIFICANT TAX DEVELOPMENTS THAT OCCURRED IN THE FOURTH QUARTER OF 2003

Following is a summary of the most important tax developments that have occurred in the past three months which may affect you, your family, your investments and your livelihood.

■ Health Savings Accounts

Individuals may be able to participate in a health savings account (HSA), created by the Medicare Act of 2003, which was signed into law December 8, 2003. Contributions to HSAs generally are tax deductible by the eligible individual in whose name the account is established. Contributions made by an employer are treated as tax-free employer-provided coverage for medical expenses under an accident or health plan. Distributions from these accounts used to pay for qualified medical expenses (including over-the-counter medicines) for an individual and his family members are not taxed. Contributions may be made to an HSA:

< for any month an individual (1) is covered under a high-deductible health plan (HDHP) on the first of the month; (2) is not also covered by any other non-HDHP health plan; (3) is not entitled to benefits under Medicare (generally are under the age of 65); and (4) may not be claimed as a dependent on another person's tax return. An individual does not fail to qualify for an HSA if, while covered by an HDHP, he has other types of coverage or permissible insurance (i.e., worker's compensation benefits, dental care, vision care).

< if the HDHP for self-coverage has an annual deductible of at least $1,000 and annual out-of-pocket expenses required to be paid not exceeding $5,000; for family coverage, the minimum annual deductible is at least $2,000 and the annual out-of-pocket expenses required to be paid can't exceed $10,000. A plan does not fail to qualify as an HDHP merely because it does not have a deductible for preventive care.

Beginning this year, individuals can establish an HSA with a qualified trustee or custodian, such as an insurance company or bank. The maximum deductible contribution to an HSA is the sum of limits determined separately for each month, based on an individual's status, eligibility and health plan coverage. For 2004, the maximum monthly contribution for eligible individuals with self-only coverage under the HDHP is 1/12 of the lesser of (1) the annual deductible under the HDHP, or (2) $2,600. For eligible individuals with family coverage under an HDHP, the maximum monthly contribution is 1/12 of the lesser of (1) the annual deductible under the HDHP, or (2) $5,150.

■ Key dollar limits for plans have been increased by COLAs or by legislative changes

The following dollar limits have been increased for 2004, thanks to cost of living adjustments or legislative changes that go into effect this year:

1. The limitation for an annual benefit in a defined benefit (pension-type) plan increased from $160,000 to $165,000.

2. The maximum annual addition to each participant's account in a defined contribution (e.g. profit sharing) plan increased from $40,000 to $41,000.

3. The maximum amount of annual compensation that can be taken into account for various qualified plan purposes increased from $200,000 to $205,000.

4. The maximum exclusion for elective deferrals (which applies to 401(k) plans, 403(b) annuities, and salary reduction SEPs) increased from $12,000 to $13,000. This increase also applies to the limit on deferred compensation plans of state and local governments.

5. The maximum elective deferral under a SIMPLE plan increased from $8,000 to $9,000.

6. Generally, catch-up contributions to an employer plan by individuals aged 50 or over increased from $2,000 to $3,000. However, for SIMPLE plans, the catch-up amount for individuals age 50 or over increased from $1,000 to $1,500.

- **Military personnel given tax breaks**

Under the Military Family Tax Relief Act of 2003, signed into law on November 11, 2003, taxpayers in the military and their families get a reprieve from a key home-sale exclusion rule. They also get higher excludable military death gratuity payments. The key provisions are as follows:

< As a general rule, qualifying taxpayers may exclude gain on a home sale, provided they have owned and used the home as a principal residence for two of the five years before the sale. Under the new law, military personnel may be able to suspend the five-year test period for up to ten years. This is helpful for military personnel who retain ownership of a home, and are away on duty for an extended period of time. This new law change applies to home sales after May 6, 1997.

< The new law doubled death benefits to survivors of deceased Armed Forces members to $12,000 and made the entire amount tax-free. These changes are effective for deaths occurring after September 10, 2001. If you are a qualifying taxpayer, you will not have to report these benefits on your tax return for 2003 and in upcoming years. You may need to file amended returns to claim these tax breaks for previous years.

- **IRS boosts depreciation limits for many business autos**

IRS has released inflation-adjusted depreciation limits for business autos placed in service in 2003. The regular luxury auto depreciation limit for cars placed in service in 2003 is $3,060 for the first tax year. This applies to non-electric passenger autos that are not classified as vans or light trucks and not eligible for 30% or 50% first-year bonus depreciation.

For new passenger autos placed in service in 2003 which are eligible for 30% first-year bonus depreciation (i.e., acquired before May 6, 2003) but not classified as vans or light trucks, the first-year depreciation limit is $7,660. For new autos eligible for 50% first-year bonus depreciation (i.e., acquired after May 5, 2003), the first-year limit is $10,710.

The first-year depreciation limit for light trucks and vans (including minivans) placed in service in calendar year 2003 is the dollar limit that apply to regular passenger autos plus $300. Thus, the maximum first-year depreciation deduction for a minivan purchased and used in a business during 2003 is $3,360 if the minivan is not eligible for bonus depreciation, $7,960 if the minivan is eligible for 30% first-year bonus depreciation, and $11,010 if the minivan is eligible for 50% first-bonus depreciation.

- **2004 Toyota Prius certified for clean fuel deduction**

If you purchased and used a 2004 (model year) Toyota Prius last year, you can claim an above-the-line tax deduction of $2,000. This deduction is reduced to $1,500 for vehicles bought in 2004. Take the deduction in the year you first use the vehicle. You must be the original owner of the vehicle to qualify for the deduction.

- **Standard mileage rates increase for 2004 and applies to more businesses**

IRS announced the optional mileage allowance for owned or leased autos (including vans and pickups or panel trucks) is 37.5¢ for 2004 business travel. The mileage allowance, which was previously restricted to users of one business auto, can now be claimed by businesses using up to 4 autos simultaneously.

- **IRS explains when business costs associated with intangible assets and restructuring an entity must be capitalized**

IRS issued guidance on when expenses to acquire or create an intangible asset and to restructure a business must be capitalized. Changes incorporated into the regulations include:

< In general, employee compensation (including bonuses and commissions) and overhead costs do not need to be capitalized. However, the new rules allow taxpayers to elect to capitalize employee compensation, overhead or de minimis costs. This is useful if your business capitalizes these costs for financial accounting purposes and finds it difficult to segregate these costs for tax purposes.

< An exception allows businesses to currently deduct amounts paid to create any right or benefit which does not last beyond the earlier of: (1) 12 months after the first day on which the taxpayer may realize the benefit; or (2) the end of the tax year following the tax year in which the payment was made. This exception does not apply to amounts that are paid to create financial interests, certain amortizable intangibles and amounts paid to create or enhance a right of indefinite duration. This rule may not be applicable to businesses under the accrual-method, where items cannot be deducted

until they are actually incurred.

< Amounts paid by a business to facilitate an acquisition of another trade or business (regardless of whether it is a purchase of the entity or the underlying assets) generally must be capitalized. However, capitalization is not required for a distribution of stock by a business to a shareholder if the distribution is required by law, regulatory mandate, or court order (unless the distribution facilitates another capital transaction).

- **Eased disclosure requirements for confidential transactions under tax shelter regulations**

  Taxpayers must disclose their participation in reportable transactions which include listed transactions (i.e. those identified by IRS to be tax avoidance transactions) and confidential transactions. IRS amended the tax shelter rules to restrict the scope of the disclosure rules for confidential transactions. These changes make it easier to differentiate disclosable transactions from ordinary business transactions. IRS will only target those transactions offered under conditions of confidentiality and with a required minimum advisory fee. The minimum fee is $250,000 for a transaction if the taxpayer is a corporation and $50,000 for all other transactions unless all the owners and beneficiaries of a partnership or trust are corporations in which case the fee threshold is $250,000.