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VALLEY FINANCIAL DIGEST

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WHEN CAN YOU DEDUCT YOUR EVERYDAY HOUSING & MEAL COSTS?

If you are employed by your corporation and live on the business premises, these expenses might be deductible by your corporation and not included in your taxable income.

Assume, for example, that you are an employee of your winery corporation and live on the winery premises. You hold regular meetings of the board of directors and conduct frequent business entertainment to promote the winery in your home. The corporation furnishes the lodging (taxes, interest, depreciation, electricity, gas, heat, water, sewer and perhaps some household maintenance items). These items may be deducted by your corporation and not included in your taxable income if you can satisfy the IRS that the following requirements have been met.

- The lodging is provided for the convenience of the corporation, i.e. there is a business necessity in requiring you to occupy a residence located on the winery premises.

- You are required to accept the lodging as a condition of your employment. The benefits to the corporation of your residency on the premises and your acceptance of such lodging as a condition of your employment can be documented in the board of directors' resolutions and in your employment agreement with the corporation.

These tax-free benefits are only available to employees. Consequently, if your winery is in a partnership or is operated as a sole proprietorship, you may not take advantage of these benefits for yourself. However, you may be able to use these benefits to put together an attractive compensation package for your employees.

MAXIMIZE INVESTMENT TAX CREDITS

One of the best tax benefits available is the 10 percent Federal credit for investments in machinery, equipment and furniture. Yet, in spite of the fact that the tax savings can pay for 10 percent of the cost of qualified items, many significant items are often overlooked. Credits are often lost forever when qualified items are buried by using traditional accounting methods. Also, many businesses do not use the various interpretations of the tax laws to their maximum advantage.

The tax laws regarding which items qualify for the investment tax credit (ITC) are not precise. Buildings do not

qualify, but "buildings" are not well defined. What we may intuitively think of as a building may include some components which would qualify for ITC. The courts have approached this question by defining what is not a building.

One factor considered by the courts is permanency. If an item in a building is designed to be moveable or can be moved without damaging the structure, it may qualify for ITC. For example, carpeting that isn't permanently fixed to the floor can be qualified, even if it is glued down- so long as the glue is made to facilitate removal of the carpeting.

Another important factor can be an association with a specific machine or process. For example, although the general electrical wiring in a building won't qualify, the wiring, conduit, switches, etc. used for a specific piece of equipment may qualify. This concept has particular application in a winery where special hookups are common and often significant.

As you can see, the best time to maximize ITC is when planning for the construction or purchase of assets. It may be possible to make simple design changes that will convert nonqualified items into qualified ITC items. For example, a light fixture wired directly into the electrical system doesn't qualify, but a plug-in fixture can.

Typical building construction cost accounting is not designed to identify ITC items. These items should be identified in the design phase and arrangements should be made with the contractor to account for these costs separately, including labor, materials and an allocation of all overhead. Early creative planning can produce significant tax savings by considering qualification for ITC during planning and design, and by properly segregating the full cost of ITC property.

AVOID THE 5% LIMITATION FOR YOUR MEDICAL DEDUCTIONS

Set up a medical reimbursement plan to cover your employees. (If your business is a corporation, you can be included as an employee. If your business is a partnership or sole proprietorship, employ your spouse.)

Medical expenses paid for your employees, their spouses and dependents will be deductible by your business and not taxable to the employee. Hence, full tax benefit for these expenses without regard to limitation.

A word of caution - these plans cannot be discriminatory in favor of you or your spouse. If you have other employees, some or all of them may be required to be included in the plan. But payments to your employees in the form of medical reimbursement are worth more to them than receiving an equivalent amount as taxable additional compensation.

Keep this in mind when you formulate a compensation package for your employees and maximize the benefit for them and for you.

SAVE TAXES - CONSIDER EMPLOYING YOUR SPOUSE & CHILDREN

If your spouse and children work in your unincorporated business, consider formally treating them as "employees". This may save your family unit both income and employment taxes.

Income taxes may be saved by:

(1) transferring some of your high-bracket income to your lower-bracket children; (2) enabling your spouse and children to establish their own IRA accounts; and (3) establishing a medical reimbursement plan - (See medical deduction article in this newsletter issue.)

You are not required to pay social security or unemployment taxes (FICA or FUTA) for your employed spouse or children under 21. Consequently, by transferring some of your self-employment earnings to these family members, you may also reduce your costly self-employment tax and escape employment taxes on the transferred portion. This could result in substantial savings due to the recent large increases in the self-employment tax rate and base. (See article concerning SE tax increases in previous newsletter issue.)

Whether this is a wise move for you depends on several factors - your family member's relative income tax brackets, availability of cash, benefit plans you already have or are considering, etc. Weigh all considerations - your savings could be substantial.

PROTECT COUNTRY CLUB DUES

If you use your country club for business entertainment and wish to receive a tax deduction for the payment of those dues, make sure you keep the records necessary to support that deduction.

Of primary importance, is maintaining the records needed to show that you use the club more than 50% of the time in furtherance of your trade or business.

For each use, log the dates, names and business relationship of individuals entertained and the nature of the business discussions held. For uses other than business, enter "personal use" in your log.

You should make an entry in your log for each use of the facility, including the times when it is used for personal purposes. If your records do not also show the personal usage, the IRS may assume it is primarily used for personal purposes and disallow any deduction for the dues you pay.

HOW MUCH OF YOUR SOCIAL SECURITY BENEFITS WILL BE TAXABLE THIS YEAR?

Social Security benefits are no longer automatically free from income tax. Under certain circumstances, a portion of your Social Security benefits may be required to be included in your taxable income beginning in 1984.

To see if you will have to pay income taxes on part of your Social Security benefits, follow these steps:

(1) Add together the following:

--Your adjusted gross income (AGI);

--Your interest from tax-exempt obligations; and

--50% of your Social Security benefits.

(2) Subtract from this number \$ 25,000 if you are single, and \$ 32,000 if you are married and will be filing a joint return with your spouse.

(3) Divide the resulting number by 2.

You must include the lesser of this amount or 50% of your Social Security benefits in your taxable income.