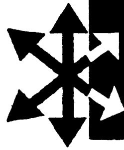

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A Quarterly Update of Essential Tax Information

DEALER TAX WATCH

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DEALER TAX WATCH *OUT*

If you had called me personally to ask, "What's happening lately with IRS audits of dealers and dealerships that I need to know about?" ... Here's what I'd say:

#1. WHAT'S NEW? ... THERE'S ALWAYS SOMETHING. No doubt, we've all been busy during the first quarter with 2003 tax returns for dealers and other clients. Fortunately, during this period, the IRS hasn't been issuing any major Revenue Rulings or Procedures. Nor have the Courts decided any significant dealer-related tax cases.

Since our last issue, the IRS has revised Form 3115 (see Update #4), and it has been busy publicizing its increasingly successful attacks on tax shelter activities, promoters and tax protestors of all off-the-wall persuasions.

For the moment, we're going to give a bit of a rest to our ongoing coverage of PORCs, listed transactions, service technician tool reimbursement plans, and cost accounting for trade discounts (i.e., floorplan assistance payments). We've devoted a lot of space to these topics in our four *DTW* issues last year. That's not to say that there haven't been any developments concerning these dear-to-our-hearts tax issues. It's just that recent developments concerning them have been relatively minor. The Tax Update for Dealers at the NADA Convention (see Update #2) touched on each of these issues, and we plan to catch up on all of these in the near future.

#2. TAX STRATEGIES FOR AUTO DEALERS ... NADA WORKSHOP PRESENTATION REPORT. On page 4, you'll find a review of the "Tax Strategies for Dealers" workshop that Bob Zwiers of Crowe Chizek presented at the NADA convention in Las Vegas. His remarks include many ideas that you can use in either reflecting on returns that you've already filed, or that you might apply to tax returns for 2003 on extension that have not yet been prepared.

There are still many opportunities to do some after-the-fact tax planning for 2003 by taking advantage of favorable accounting method changes that do not require advance approval from the IRS. One point Mr. Zwiers stressed in his presentation was that dealers could make many of these beneficial changes even if they were hearing about them for the first time at the Convention in January of 2004. Obviously, if a dealer were hearing about these for the first time, he/she might wonder why his/her CPA hadn't brought them up a long time ago.

Dealers' CPAs are well advised to carefully consider and/or study Mr. Zwiers' remarks. Because of his Firm's significant dealership client base and prestige, when he prefaces certain remarks as being indicative of "what we are seeing with some of our dealer clients," or with "what we have been doing with many of our dealer clients," smaller practitioners are getting a window or perspective of the industry that their own practices cannot provide.

If most of his remarks are familiar to you, then you're pretty well up-to-date on what's going on. If

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LOOKING FOR ADDITIONAL & "VALUE ADDED" SERVICES FOR DEALER CLIENTS?

Look no further... Just use the *Dealer Tax Watch* for a head start in golden consulting opportunities and activities to help dealer clients—and, in the process, to help yourself.

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some of his comments are less familiar, you may want to consider them as being good tax strategies for your dealers and good practice opportunities for you that you should not let slip by.

#3. WHAT ARE AUTO DEALERS BIGGEST CONCERNS? Also, at the NADA Convention, dealers shared their biggest concerns going forward into 2004. These are summarized on pages 10-11. For whatever they're worth, they're good conversation starters with current and prospective clients.

#4. IRS GIVES FORM 3115 A FACELIFT. The magic–and mandatory–passport to all changes in accounting method is Form 3115. The IRS recently revised this Form, and the new revision date is December, 2003. The revision reflects some general face-lifting, and the Instructions provide an up-to-date list of all automatic changes in accounting method.

The revisions to Form 3115 aren't too significant, and the IRS will accept the filing of either the May, 1999 ("old") version or the new version before May 31, 2004. However, in Announcement 2004-16, the IRS said that taxpayers must file using the new version after May 31, 2004.

Practitioners should be aware that when a taxpayer files a Form 3115 requesting the Commissioner's consent to a change in method of accounting, the taxpayer has "a duty to reveal all material factors pertinent to its request for an accounting method change." It is not the responsibility of the National Tax Office to try to pry all of the pertinent information out of the taxpayer who wants to make the change.

In thinking about how thorough or careful you should be in filling out Form 3115, take note of the IRS' own disclaimer about its authorship of forms and instructions. In Letter Ruling 200328001 last year, the IRS said: "Generally, forms and instructions do not bind the Service and are not intended to replace the law or change its meaning. The sources of authoritative law in the tax field are the statutes and regulations and not the informal publications and tax forms that are published by the Service.... ***Therefore, taxpayers who rely solely on IRS forms and instructions are at risk.***"

Our overview of the 20 pages of the new Form and instructions starts on page 12.

#5. IRS UNVEILS NEW SCHEDULE M-3. If your C-corp dealership has over $10 million in assets on its tax return balance sheet, there's a new form in your future.

In IR-2004-14, the IRS announced the release of a new form, Schedule M-3 ... *Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 million or More.*

This form will have to be completed by corporations filing Form 1120 for years ending on or after December 31, 2004. It is expected that a form similar to Schedule M-3 will be designed for completion with partnership returns and S Corporation returns, but at the present time, no such forms have been released.

The IRS said that this Schedule M-3 will make differences between financial accounting net income and taxable income "***more transparent***." This will help IRS agents to more quickly determine whether the return should be audited, and it will help them to identify the issues and differences that may be most significant in the audit of the return.

The draft of Schedule M-3 consists of four parts covering three pages. It requires the specific identification of 34 income (loss) items and 37 expense/deduction items. The treatment of each item on these lists as constituting either a ***temporary*** timing difference or a ***permanent*** timing difference must also be indicated.

The form has not been finalized, but the proof version is available on the IRS web site (www.irs.gov). We plan to more thoroughly analyze Schedule M-3 when it is finalized.

#6. LETTING YOUR CLIENTS KNOW HOW MUCH THEY'VE SAVED IN TAXES LAST YEAR. In preparing many 2003 individual income tax returns, we've all seen examples of how the lower 5%-15% tax rates on dividend income and capital gains saved our clients surprisingly large amounts. In some instances, these savings resulted from deliberate planning initiated last year to have business owners withdraw dividends from their closely-held C corporations (and in some cases, S corporations).

In many instances, we prepared a separate letter and then met with the client to review the tax savings they received. This reinforced the benefits of our mutual proactive tax planning to take advantage of these new rules.

We have taken a few examples of the correspondence we prepared for this purpose and modified them as case studies for your review. If you haven't done something like this with some of your key clients, this may give you a head-start if you want to go in that direction. For more on this, see page 19.

#7. DEALERS MAY BENEFIT FROM CHANGES IN FINAL REGS ON CAPITALIZATION OF INTANGIBLES. In December of 2003, the Service finalized the Regulations under Section 263(a) for the types of intangibles whose acquisition costs

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must be capitalized. These Regulations under Section 263(a) should not be confused with those under Section 263A, which contains rules for the uniform capitalization of additional costs allocable to inventories. These tweaks in finalizing the 263(a) Regulations may benefit dealers in at least two ways.

First, the IRS has relaxed the so-called 12-month rule to allow full deduction for tax purposes for certain prepaid expenses. Under Reg. Sec. 1.263(a)-4(f), a taxpayer is not required to capitalize amounts paid to create or facilitate the creation of any right or benefit that does not extend beyond the earlier of ... (1) 12 months after the first date on which the taxpayer realizes the right or benefit or (2) the end of the taxable year following the taxable year in which payment is made.

If the year-end balance sheet for your dealership client contains significant prepaid expenses, you should analyze Examples 1 and 2 that are shown at Reg. Sec. 1.263(a)-4(f)(8). Unfortunately, one complication is that in order to get this accelerated deduction benefit, the IRS requires the filing of Form 3115 for the change in accounting method, rather than simply allowing these changes to be made on a cut-off basis.

If prepaid amounts are significant, there may be some tax savings available to your dealer client through the acceleration of these deductions.

The second "tweak" in the Regulations that may benefit your dealer clients comes from the fact that now the Regulations list the types of intangibles for which costs must be capitalized. These costs include expenditures directly or indirectly related to acquiring a financial interest in a dealership and to acquiring covenants not to compete from the sellers.

Taxpayers are not required to capitalize employee compensation or other overhead allocable to these acquisitions. Also, if these expenditures are under $5,000, Reg. Sec. 1.263(a)-4(d)(6)(v) includes a *de minimis* rule that may allow the entire write-off.

Some of these new rules are retroactive to include payments made in 2002. However, dealers seeking to benefit from these changes would have to file Form 3115, rather than filing an amended return claiming the deduction. Rev. Proc. 2004-23 provides guidance for filing some of these Forms 3115.

#8. PUT SOME NEW *"LIFE"* INTO YOUR IRS AUDITS. In IR-2002-133, the IRS announced the implementation of a new streamlined examination process called the ***Limited Issue Focused Examination***, or ***"LIFE"*** for short. So you may be able to both speed up and simplify an IRS audit if one should come up.

This alternative to the more traditional IRS audit is available for taxpayers with assets in excess of $10 million who are "served" by the IRS' Large and Midsize Business (LMSB) Division.

Before agreeing to employ the ***LIFE*** audit process, the IRS will normally first prepare a risk analysis involving a review of preliminary data, books and records to determine whether there may be any large, unusual or questionable items.

If the Service agrees to employ the ***LIFE*** audit process, the taxpayer and the IRS will execute a formal agreement which governs the key aspects of the examination. This Memorandum of Understanding (MOU) will contain case-specific dollar-limit thresholds below which the IRS will agree not to raise issues and the taxpayer will agree not to file claims.

The resolution of significant technical issues that come up during the audit may be expedited as a result of the application of another new IRS process intended to shorten the time involved in obtaining guidance from the IRS on tenuous issues. The IRS refers to this new expidited guidance ruling process as ***"TEAM"*** (***Technical Expedited Advice Memorandum***).

If a dealer signs an agreement with the IRS for the ***LIFE*** exam process for the dealership corporation, that process is only applied on an entity-by-entity basis. Therefore, any related partnership or shareholder would not be covered under that ***LIFE*** audit MOU unless it had secured a separate MOU in connection with its own audit.

These ***LIFE*** audits can be a win-win situation for both the IRS and the taxpayer, as each party only has to focus its resources and time on the issues that are most significant to the return under audit.

Robert Zwiers, in his NADA workshop presentation, indicated that his firm has had successful experiences with the ***LIFE*** audit process. Under this new procedure, what happened in one case was that the examining agent gave the dealership a list of 25 tax shelters and asked if it was involved in any of them. The taxpayer said that it was not ... and the IRS completed its audit in 1½ days.

#9. WE WELCOME YOUR QUESTIONS & COMMENTS. We receive and respond to many questions throughout the year raised by our readers. As you can see, this is our 10th year of publication, and many of you have been with us since the first issue in June of 1994. We appreciate your continued interest in the *Dealer Tax Watch.*

Your calls or e-mails are always welcome, and they help me to be more aware of areas and issues that warrant coverage in this publication.

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TAX STRATEGIES FOR DEALERS

NADA WORKSHOP REPORT

In February, one of the workshops at the 2004 National Automobile Dealers Association (NADA) Convention in Las Vegas was a presentation by Robert C. Zwiers of Crowe Chizek & Company entitled *Making the Tax System Work to Your Advantage.* This article summarizes Mr. Zwiers' presentation. In some areas, we have added additional commentary.

Mr. Zwiers' presentation was an excellent update and summary of many areas that have been written about in recent issues of the *Dealer Tax Watch.*

MAJOR AREAS

- *JGTRRA* 2003 tax changes that dealers should be aware of,
- Opportunities available by changing to more favorable tax accounting methods, and
- Other topics and issues.

2003 TAX CHANGES

$100,000 Depreciation Deductions for Assets Purchased After 2002 and Before 2006. The increased special and accelerated depreciation opportunities, including Section 179 expensing, were the first topics Mr. Zwiers covered. He pointed out that the increase in the limit from $25,000 to $100,000 would affect many dealers who were simply upgrading their normal equipment, furniture and fixtures asset base. He also indicated that there might be some change in the future in this generous provision.

We would add that if a dealer were going to make significant purchases, then it would be important to consider the $400,000 phase-out and try to plan the timing of those purchases so that they fall in two different taxable years.

50% Special Depreciation Allowance. In addition to the expanded ($100,000) upper limit for asset purchases qualifying for immediate write-off, Mr. Zwiers pointed out the 50% bonus depreciation that is available for assets acquired after May 7, 2003. In addition to their time-sensitive nature, these provisions apply only to "new" equipment (i.e., equipment where the original use begins with the taxpayer). Property qualifying for this favorable treatment includes any assets with a 20-year or shorter depreciable life and qualified leasehold property.

Annual Limits on Depreciation Deductions for Luxury Vehicle. Mr. Zwiers cautioned dealers to pay particular attention to the $10,700 annual limit on luxury vehicles. He noted that this limit does not apply if the vehicle exceeds the 6,000 pound weight limit and added that the 6,000 pound limit might be increased to 14,000 pounds if the so-called "*JOBS*" (or *Jump-start Our Business Strength*) legislation that was under discussion at the end of January were to be enacted.

Capital Gain Rates of 5% and 15% for Sales of Property and Lower Tax Rates on Qualified Dividends for Individuals. Tax Planning Opportunities as a Result of the Lower Rates. Mr. Zwiers reviewed the reduction for individuals of the capital gains tax rates for certain sales and also the application of similar rates to qualified dividend income. He pointed out that these favorable rates could impact decisions relating to dividend distributions from C Corporations and from certain S Corporations that had pre-sub-S accumulated earnings and profits. He also mentioned that there were certain holding period requirements and that foreign corporation restrictions might apply.

See pages 19-35 for an article and case study letters for informing clients of their 2003 tax savings on dividend income. These can be viewed as supplementary to some of Mr. Zwiers' comments on the lower tax rates for individuals on qualified dividend income and tax planning opportunities as a result of these lower rates.

OPPORTUNITIES AVAILABLE FOR DEALERS BY CHANGING TO MORE FAVORABLE TAX ACCOUNTING METHODS

This second related group of topics involved a number of opportunities available to dealers from changing their current accounting methods for certain items to more favorable methods that the Service has said it will permit.

These are changes that every dealership should be making because they basically create interest-free loans from the government. In addition, they are often accompanied by significantly large first-year deductions (under Section 481(a)) as a result of the transition to the new method of accounting.

Mr. Zwiers observed that even smaller dealerships might find that the total benefit or favorable adjustment from a combination of these accounting method changes could be upward of $160,000. Assuming a 40% tax rate, the tax savings would be $64,000.

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We would add that an additional consideration in evaluating these proposed changes is the cost of making those changes in terms of IRS user fees, accounting fees and any other associated compliance costs.

In connection with the first four "opportunities" below, Mr. Zwiers indicated that the IRS has approved hundreds of changes like these for dealers clients of his firm, Crowe Chizek.

Treatment of Nonrefundable Advertising Charges. Mr. Zwiers pointed out that many dealers look at the invoices and see advertising charges they are required to pay to the manufacturer who, in turn, sends these amounts back to dealer advertising associations for local advertising. He indicated that dealers should consider deducting these advertising charges for local (not national) advertising when the vehicle is purchased ... not when the vehicle is sold, which may be in a later year.

Dealers making this change in method do not have to change the way they handle the treatment of these accounting charges internally during the year. Their controllers or CPAs can make a single adjustment at the end of the year to reflect the net amount for all year-end invoices involved. This single year-end adjustment allows the accounting department to continue its "normal" processing of these vehicle invoices throughout the year.

Mr. Zwiers warned that, in some cases, you can't simply look at the invoices to see what the advertising charges are. Some manufacturers–like Ford–include a charge for advertising in the base price of the vehicle, rather than listing that charge separately on the face of the invoice. So, you have to know where to look for this information or how to find it elsewhere.

Treatment of Interest Assistance Payments Received from the Factory. Mr. Zwiers next addressed the accounting treatment for interest assistance payments that dealers receive from the Factory to compensate them for (or to offset) some of the floorplan interest that they pay on their inventory.

Most manufacturers give this money to the dealership, regardless of how much it pays in floorplan interest or how high the prevailing interest rate might be. Most dealers report these amounts received from the Factory as income in the year that they receive the payments. As an alternative, some dealers will reduce the amount of their interest expense at the time when they receive these interest assistance payments.

The IRS allows dealers to treat these interest assistance payments as "trade discounts" because the dealer does not have to do anything in order to receive payment. The Regulations provide that trade discount amounts should not be included in capitalized inventory cost. Instead, dealers should reduce the cost of the vehicle by the amount of the interest assistance payment on a vehicle-by-vehicle basis. In other words, this determination has to be made by analyzing the invoice for each vehicle in ending inventory. This adjustment cannot be estimated, approximated or pulled out of thin air. But, this adjustment can be recorded by a single net adjusting entry at year-end.

By changing the accounting treatment for tax purposes, the treatment of the trade discount as a reduction of the cost of the ending inventory enables the dealer to defer reporting the related interest assistance payments until the year in which the vehicle is sold. Timing is everything.

Mr. Zwiers pointed out that changing the treatment for trade discounts can be accomplished after the end of the year by filing Form 3115 with the income tax return for the year of change. He also pointed out that typically, there is a related "cash to accrual adjustment" that the IRS requires in connection with this change.

Example: A typical year-end inventory of 200 vehicles (each with $300 of interest assistance) would produce a deferral of $60,000. This amount, reduced by a $25,000 related "cash to accrual adjustment," would result in a $35,000 timing difference net benefit from making the change.

Excluding Gross Profit from Internals on Used Vehicles. The next area Mr. Zwiers covered is one that is sometimes overlooked by CPAs. This concerns the fact that when parts and labor are applied to used vehicles in fixing them up and/or making major repairs, it is standard practice in the industry to include some gross profit in the amount of cost being capitalized on that vehicle.

The amount of gross profit on parts and labor included on the internals will vary by dealership. However, for tax purposes, the dealership is not required to report that gross profit as income until the vehicle is sold. Therefore, the dealership may be paying tax on some costs capitalized in inventory that really do not have to be included. So, why pay tax on money sitting in inventory before the vehicle is sold?

Another point Mr. Zwiers made about used vehicle inventories was that some detailing and fix-up expenses that are more in the nature of ***repairs*** to the vehicle do not have to be capitalized if they do not really increase the value of the vehicle. These amounts should not be capitalized, but should be immediately expensed.

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Both of these comments suggest that, if the dollars are "material," significant deferral benefits may be found for the dealership ... and they will only be found by a dealership-experienced controller or CPA.

Avoidance of Capitalizing Unnecessary Cost Amounts Under the UNICAP Rules. Here again, Mr. Zwiers' comments may be illuminating to less experienced practitioners. First, Mr. Zwiers generalized that, often, the amounts shown in Schedule M for Section 263A capitalized costs are far too high, and many times, nothing should have been capitalized. He stated, "In many cases of dealerships we have looked at, the dealerships don't have to capitalize anything under the so-called "UNICAP" provisions– and ***the correct amount to be capitalized is zero.***"

Mr. Zwiers said that in other cases where the UNICAP rules apply, his firm has found that it can substantially reduce the amounts required to be capitalized by taking a detailed look at the rules. For typical dealerships, he summarized these rules as essentially boiling down to a few simple questions involving three potential 263A triggers.

THREE TRIGGERS
• Storage
• Purchasing
• "Retail Facility"

Storage. In this regard, the question should be: ***Are there any off-site storage facilities?*** These would be any places where the customer cannot go to view the vehicles available for sale. Generally, unless there is a separate building that is totally locked-down where the customer cannot go (or a rather remote or inaccessible storage lot location), most dealers will not have what are called "off-site storage facilities." Therefore, there would be no Section 263A storage costs to be capitalized. (Note: Mr. Zwiers did not comment on how "internet selling" by dealers might complicate this analysis.)

Purchasing. In this regard, the question should be: ***Does anyone within the dealership spend more than one-third of his or her time engaged in purely purchasing activities?*** Most dealers do not have anyone who spends more than one-third of their time involved in these activities. Mr. Zwiers pointed out that the counterperson in the parts department usually is also involved in selling and in other activities. Also, automatic order entry software significantly reduces the amount of time that an employee otherwise might have to spend attending to the purchasing function.

Mr. Zwiers indicated that, in general, most dealerships do not have anybody who spends more than one-third of their time in purchasing activities and, therefore, there would be no Section 263A purchasing costs to be capitalized.

We would observe that in connection with dealerships with larger used vehicle operations, the analysis may be a little more complicated where there are employees who spend considerable time involved with purchasing activities at various auctions. This may require a more detailed analysis of how much of their time is involved in buying/purchasing vs. how much of their time is involved in sales/disposition of inventory.

"Retail Facility." The last question in connection with the application of the UNICAP rules is: ***Is the dealership basically a "retail facility?"*** In other words, are 90% or more of the dealership sales made to customers who (physically) come into the dealership to purchase vehicles? If the answer to this question is, "Yes," then there would be no Section 263A costs to be capitalized with respect to this issue.

In connection with the "retail facility" question, we again raise the question: How does a dealer's internet presence or selling via the internet fit into the overall analysis here?

Accelerating Deductions for Prepaid Expenses. Mr. Zwiers pointed out that dealers (and other taxpayers) can benefit from a recent change in position by the IRS that now allows a deduction for a full year's worth of expenses that are paid in advance. For example, prepaid rent or prepaid insurance premiums, under standard accrual basis accounting, are usually charged against income as expenses on a month-by-month, pro-rata, basis.

Under the new rules, a dealer would be allowed to deduct one year's worth of insurance premiums paid during the year, even though a portion of the 12-month period to which the premium payment relates, falls beyond the end of the year. In other words, assume that on June 30, a dealer paid in full a $12,000 premium for one year's worth of coverage at the rate of $1,000 per month. The dealer would be permitted to deduct the entire $12,000 payment in the year of payment–notwithstanding the fact that, under proper accrual accounting, 6 months-worth of the premium paid and coverage is related to 6 months in the following year.

The acceleration of deductions attributable to changing the treatment of these prepaid expenses for tax purposes is required to be documented by the filing of Form 3115 for the tax year 2003.

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New Rules for Certain Intangible Costs to be Capitalized. Mr. Zwiers referred to the issuance by the IRS of new rules regarding the capitalization of certain costs in connection with various payments and intangibles.

Often, when a dealer buys a dealership, tax questions arise in connection with whether certain costs involved in that process have to be capitalized. When a dealer relocates, similar questions may arise.

The Regulations under Section 263(a) ... as finalized in December 2003 ... list the types of intangibles for which (acquisition) costs must be capitalized. These costs include expenditures directly or indirectly related to acquiring a financial interest in a dealership and to the acquisition of covenants not to compete. Taxpayers are not required to capitalize employee compensation or other overhead allocable to these acquisitions. Also, if these expenditures are under $5,000, a *de minimis* rule may allow the entire amount to be written off. These new rules are retroactive, covering payments made in 2002 and dealers seeking to benefit from these changes would have to file Form 3115, rather than filing an amended return claiming the deduction.

For dealers who are more active in multi-franchise operations and locations, the new list should reduce questions over whether or not certain payments must be capitalized or can be expensed. The list also may be used as a guide in planning deductions by restructuring payments in certain situations so that they will not be attributable to items on the IRS list.

Cost Segregation Studies to Accelerate Depreciation Deductions. Readers of the *DTW* should be very familiar with the benefits available on a retroactive basis to dealers who have purchased or constructed facilities within the last 18 years (i.e., since 1986). Mr. Zwiers discussed the advantages of precisely allocating construction costs to various assets that might otherwise end up having a depreciable life of 39 years.

He pointed out two major benefits from cost segregation studies. First, reclassifications from longer to shorter useful lives (i.e., 5-10-15-or-20 years) are very beneficial on a going-forward basis. Second, the dealer usually will also benefit from a catch-up adjustment for prior years. This happens under Section 481(a) as a result of filing Form 3115 for the change in depreciation accounting method.

Finally, Mr. Zwiers observed that IRS guidance issued in December 2003 on the subject of depreciable lives for assets used in retail establishments—a broad category that includes auto dealerships—has basically confirmed the professional judgments and conclusions reached by qualified professionals who in recent years have done cost segregation studies in a narrower context for automobile dealerships.

Form 3115 Filings and Automatic vs. Advance Consent Changes in Method. Dealers cannot unilaterally change to a more favorable tax treatment and claim the benefits in the current year's income tax return they file. Nor can they get those benefits by claiming deductions on amended returns for past years.

In commenting on the IRS procedures for granting approval to taxpayers who want to change accounting methods, Mr. Zwiers emphasized the attractiveness of the one-year catch-up deduction as the major incentive for making these changes. This is the so-called negative Section 481(a) adjustment.

Over the years, the IRS has looked at so many similar requests by taxpayers that it has now determined that many such requests no longer require the Service to evaluate and approve them in advance. Accordingly, the IRS has developed a list of accounting method changes which are "automatic." These stand in contrast with other accounting method changes for which the IRS must first grant permission. Generally, dealers permitted to make "automatic" changes do not have to pay a user fee, whereas changes that require advance IRS approval usually require the payment of a user fee. (For more on all of this, see pages 12-18.)

Mr. Zwiers identified the following changes that may be made under the automatic procedures.

AUTOMATIC CHANGES

1. Depreciation changes arising out of cost segregation studies,
2. The removal of floorplan assistance payments from inventory costs under the trade discount rules,
3. The complete expensing of certain prepaid items under the 12-month rule for annual premium payments, etc., and
4. The deduction of costs related to the acquisition of certain intangibles that were previously capitalized.

OTHER TOPICS & ISSUES

In this part of his presentation, Mr. Zwiers commented on areas where dealers should be aware of either opportunities or pitfalls in the current IRS audit environment.

LIFO Issues. Mr. Zwiers informed dealers that the IRS has now accepted the use of replacement cost for valuing parts inventories and he discussed the requirements of Revenue Procedure 2002-17.

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Regarding LIFO for used vehicles, he pointed out that if dealers are using the Alternative LIFO Method for Used Vehicles, they are also required to comply with rather strict rules for determining the cost of their used vehicles (to which the inflation or deflation indexes are applied).

In connection with using LIFO for new vehicle inventories, he referred to the ongoing publication by the IRS of lists of vehicles that should be treated as ***new items*** under the Alternative LIFO Method for New Vehicles. These lists identify the models or vehicles for which dealers will not receive the benefit of one year's worth of inflation. (Note: If you're a subscriber to the *LIFO Lookout*, you can compare our New Item determinations with those made by the IRS, and often there are significant differences in our conclusions!)

Broader LIFO Pooling. Many dealers have created multiple S Corporation (QSSS groups) or single-member LLC structures. Mr. Zwiers said that these dealers are permitted to file a single return and to include all new autos in a single pool and all new light-duty trucks in a single pool, thus minimizing their new vehicle pooling for LIFO purposes.

These dealers also may obtain similar benefits from broader LIFO pooling for used vehicles and/or for parts inventories on LIFO.

Used Vehicles ... Using a Correct Method to Determine Cost. In this section, Mr. Zwiers addressed his comments to dealers not using LIFO for valuing their used vehicle inventories. The primary issue here is the proper determination of "market" at year-end, since these dealers a writing down their year-end inventories from cost to the lower-of-cost-or-market.

Mr. Zwiers advised dealers not to use the "eyeball" method, wherein beauty (and market value) lies in the eye of the beholder. He also advised dealers not to use a "20/20 hindsight" method where the year-end value is determined by looking at the sales price of the vehicle in the following year.

Instead of these methods, the dealer should refer to an *Official Used Vehicle Guide,* taking into consideration all of the factors that affect the value and selling price of the vehicle. He noted that there are many "official" used car guides, and that the IRS has not specified a preference for or against any one of them.

Parts Inventories. Here, Mr. Zwiers' told dealers that they should avoid operating a portion of their parts department "as a museum." His Firm has found that many dealers' parts inventories contain significant amounts of obsolete and otherwise out-of-date or very slow-moving parts.

Dealers who have older or obsolete parts should consider donating, scrapping or disposing of those parts so that they can take a deduction. He said that donating these parts to local service technician training programs would not only reduce taxes, but provide a benefit to the community, as well.

Producer Owned Reinsurance Companies (PORCs). Mr. Zwiers briefly reviewed the fact that many dealers have formed their own reinsurance companies to handle the sales of extended service contracts and/or credit life, accident, health and disability insurance policies. In setting up these arrangements, the reinsurance companies often are set up so they can elect special tax benefits under Code Sections 501(c)(15), 806 or 831(b).

Mr. Zwiers reviewed briefly the impact of the IRS issuing Notice 2000-70 which requires the disclosure by organizations, owners and others involved in transactions with these PORCs. He added that despite some perfunctory interaction with industry representatives, the IRS has yet to say anything definitive or clarifying on this for auto dealers.

He also discussed certain transactions which the IRS is very likely to question if it comes across them in dealer PORCs. These transactions include

PORC ISSUES

1. Situations where extended service contracts are sold and the dealer diverts receipt of a portion of the payments by the insurer to some other entity controlled by the dealer or his family members. These are often referred to as ***oversubmits.***
2. Situations where cash generated by the insurance activities is loaned back to the dealer or to the dealership by the PORC and
3. Situations where there are "non-performing" loans of almost any amount between the PORC and the dealer-owner.

Form 8300 Cash Reporting. In this area, Mr. Zwiers discussed the need for proper Form 8300 reporting and the need for each dealership to have some individuals who are constantly monitoring the correct determination of what "cash" transactions need to be reported. He stressed the need for ***extra*** vigilance in connection with unusual transactions and in cases where transactions are handled by an employee whose responsibilities do not ordinarily include handling those types of transactions. →

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Dealers were warned not to confuse Form 8300 cash reporting responsibilities with other situations that they should never become involved with under any circumstances. These situations or activities would involve money laundering and/or the transactions with members of the terrorist financial network.

Demonstrator Vehicles. Mr. Zwiers indicated that, if a dealership is providing demos and it is not using the demo guidelines in Revenue Procedure 2001-56, then the Service will simply determine the value of the use of the vehicles by reference to the ***full*** fair market value of the lease. Typically, the annual value is about $11,000 worth of taxable income for the use of a $30,000 car ... Roughly, 25% of MSRP plus insurance, plus sales tax, plus gas, etc.

Under the safe-harbor rules for the use of demos in Revenue Procedure 2001-56, Mr. Zwiers said that generally, dealers will want to use the ***partial exclusion method for full-time salespeople***. Under this method, the taxable amount is approximately $6 per day. However, the significant limitation associated with this method is that the vehicle cannot be used for vacation purposes by the employee.

Although there is a *full exclusion method* for full-time sales employees, that method requires that the salesperson maintain a mileage log. (How many salespeople have you ever met who do that?) The warning here is that, if a dealership is claiming to use the *full exclusion method* for its sales employees, then there should be up-to-date mileage logs at the dealerships available for IRS review to support the use of this method.

For all ***other employees*** (i.e., dealership employees other than full-time salespeople), dealers generally will want to use the ***full inclusion method***. Under this method, employees are not required to maintain a log of vehicle use, and the taxable amount to be reported by an individual for the use of the demo comes to be about $18 per day. This amount is generally based on average selling prices of vehicles actually sold by the dealership during certain look-back computation periods and the taxable amounts are determined from a table published by the IRS. These amounts are required to be included in the employees' income no less often than monthly. This method is very flexible and allows for the monthly selection of methods and the application of different methods to different employees.

With the clarifications and safe harbors available under Revenue Procedure 2001-56, dealers should not necessarily forego providing demonstrator vehicles to their employees because of undue concern over adverse interpretation of these benefits by the IRS. For a full explanation of these methods, see *Dealer Tax Watch,* December 2001.

Computerized Records. Mr. Zwiers indicated that compliance with IRS requirements for maintaining computerized records was still a major problem for many dealers. He said that problems frequently arise when a dealer changes vendors and/or upgrades software, even when that upgrade is being done with the same vendor. Dealers need to be sure that they, and the IRS, will still be able to read all of the old prior year information long after the tax returns have been filed.

Service Technician Tool Plans. On this subject, Mr. Zwiers cautioned dealers that "there are a lot of problems with some of the tool plans and some problems with other plans. The IRS has not yet seen a tool plan that they think is a good tool plan."

As readers of this publication know, we believe that a lot more can be said on this subject.

IRS Audits. Mr. Zwiers' recounted most of the issues he discussed as the issues that his Firm is currently seeing in IRS audits of its dealership clients. If a dealership is using LIFO, Mr. Zwiers said that, basically, the IRS asks for records and if the dealership can produce records, computations and invoices, the IRS usually doesn't look into those records very much, if at all.

One very significant observation that Mr. Zwiers made is that where "larger dealerships" were being audited, his Firm had asked the Service to conduct the audits under the relatively new ***"LIFE"*** (Limited Issue Focused Examination) process. Under this audit process, what happened was that the examining agent gave the taxpayer a list of 25 tax shelters and asked if the taxpayer was involved in any of them. The taxpayer was not ... and the audit was completed in 1½ days. For more about the ***"LIFE"*** audit process, see Update item #8 on page 3.

CONCLUSION

Dealership controllers and CPAs should pay careful attention to Mr. Zwiers' remarks. Because of his experience and the prestige of the Firm he represents and its significant auto dealership client base, when he prefaces certain remarks as typical of "what we are seeing with some of our dealer clients," or with "what we have been doing with many of our dealer clients," smaller practitioners are getting a perspective of the industry that their own practices cannot provide.

It's always nice to know what's going on outside your own Firm.
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TOP ISSUES & DEALER CONCERNS FROM DEALER MAKE MEETINGS AT NADA CONVENTION ... LAS VEGAS ... JAN. - FEB., 2004	
ACURA	• None provided.
AUDI	1. Keep dealer profitability in the forefront. 2. Simplify terms of trade. 3. Shorten product cycles and supply lines.
BMW	1. Maintaining profitability. 2. Recruiting and keeping dealership employees. 3. Getting the word out on improved quality.
BUICK	1. Be profitable with (their) current portfolio. 2. Be more aggressive in advertising and marketing. 3. Get new product.
CADILLAC	1. Launch products successfully. 2. Maintain marketplace momentum after consecutive years of sales gains. 3. Continue to improve product and sales training.
CHEVROLET	1. Get Chevrolet back to No. 1 in car and truck sales. 2. Improve dealer profitability. 3. Make local marketing groups productive.
CHRYSLER-JEEP	1. Get more new products. 2. Market vehicles aggressively. 3. Improve communication with the Factory.
DODGE	1. Regain market share. 2. Launch products effectively. 3. Increase parts and service business.
FORD	1. Develop an acceptable replacement for the Blue Oval program. 2. Continue to press for better quality. 3. Push for simplified incentive and contest plans.
GMC	• None provided.
HONDA	1. Improve quality. 2. Find better ways to measure CSI and SSI. 3. Deliver trouble-free service.
HUMMER	1. Launch *H2 SUT* successfully. 2. Bring Hummer more into GM marketing, field structure. 3. Delay deadline for building new stores.
HYUNDAI	1. Make dealers profitable. 2. Improve product quality. 3. Introduce new models soon.
INFINITI	1. Develop a strong certified pre-owned vehicle program. 2. Emphasize future product. 3. Adjust dealership infrastructures in light of rapid growth.
ISUZU	1. Get new product. 2. Boost morale. 3. Repeal the "Chicken Tax."
JAGUAR	• None provided.
KIA	1. Keep improving quality. 2. Get the *Amanti* launch right. 3. Market the entire line-up aggressively.
LAND ROVER	1. Preserve the *Land Rover Way* process. 2. Product quality. 3. Preserve dealer profitability.

TOP ISSUES & DEALER CONCERNS FROM DEALER MAKE MEETINGS AT NADA CONVENTION ... LAS VEGAS ... JAN. - FEB., 2004	
LEXUS	1. Make sure (they) have a steady flow of new products evenly spaced. 2. Deliver the same service to (their) clients that Lexus delivers to its retailers. 3. Don't become complacent.
LINCOLN MERCURY	1. Get new products for Lincoln. 2. Craft a worthy successor to the *Lincoln Premier Experience*. 3. Keep improving dealer profitability.
MAZDA	1. Improve profits. 2. Improve sales. 3. Keep the new products coming.
MERCEDES-BENZ	1. Maintain dealer profitability. 2. Solve quality problems. 3. Sustain sales of aging *M* class.
MITSUBISHI	1. Increase awareness of, and interest in, Mitsubishi products. 2. Offer incentives that don't demean the brand. 3. Improve quality.
NISSAN	1. Maintain dealer profits. 2. Enhance marketing support for *Titan* pickup. 3. Increase overall marketing budget.
OLDSMOBILE	• None provided.
PONTIAC	1. Launch new products successfully. 2. Advertise aggressively. 3. Keep the new products coming.
PORSCHE	1. Maintain open factory-dealer relationship. 2. Find ways to bolster *Boxster* sales. 3. Support *Cayenne* with marketing and merchandising.
SAAB	1. Launch products successfully. 2. Don't remove too much content from vehicles. 3. Maintain or increase the level of communication among dealers, Saab Cars USA and Saab AB in Sweden.
SATURN	1. Get products that appeal to target market. 2. Get marketing support. 3. Strengthen key Saturn characteristics: sales process, ownership experience.
SUBARU	1. Shore up dealer profitability. 2. Limit the sharing of products. 3. Keep the products fresh.
SUZUKI	1. Improve brand awareness. 2. Improve marketing and advertising. 3. Increase interaction between the dealer council and Suzuki.
TOYOTA	1. Increase *Prius* availability. 2. Emphasize produce knowledge training. 3. Continue to be aggressive and focused in the marketplace.
VOLKSWAGEN	1. Improve produce quality. 2. Decrease produce cycle times. 3. Maintain dealer profitability.
VOLVO	1. Increase profitability. 2. Make sales programs consistent. 3. Get some consistency in management ranks.

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At A Glance	FORM 3115 & INSTRUCTIONS ... Rev. Dec. 2003 COMMENTS ON CHANGES & REVISIONS
Background	• Form 3115 must be filed to request a change in either an overall accounting method or the accounting treatment of any item. Currently, two procedures exist under which a taxpayer may request a change in accounting method. ♦ One procedure involves so-called ***automatic change*** requests, wherein advance permission or consent from the IRS to make the change in method is not required. ♦ The second procedure involves ***advance consent*** requests, and this involves all changes in method other than those specifically treated as automatic change requests. • The Previous revision of Form 3115 was dated May, 1999. • Current revision of Form 3115 is dated December, 2003. ♦ Current revision is more user- (or preparer-) friendly. ♦ All filings after May 31, 2004 must be made using the new version (IRS Announcement 2004-16). • Form 3115 and Instructions cover 20 pages ... 8 pages - Form 3115 ... 12 pages - Instructions ♦ Layout of Form 3115 pages is below; see facing page for copy of Page 1 ♦ Instructions for current Form 3115 have been significantly expanded from 12 to 24 full-page columns.
Form 3115 ***8 Pages***	• ***PAGE 1*** ♦ Taxpayer Identification, CAM Identification & Signature Blocks ♦ Part I ... Information for Automatic Change Request (Questions 1-3) ♦ Part II ... Information for All Requests (Questions 4a & b) • ***PAGE 2*** ♦ Part II ... Information for All Requests ... Continued (Questions 4c-12) • ***PAGE 3*** ♦ Part II ... Information for All Requests ... Continued (Questions 13-17) ♦ Part III ... Information for Advance Consent Request (Questions 18-23) ♦ Part IV ... Section 481(a) Adjustment (Questions 24-27) • ***PAGE 4*** ♦ Schedule A - Parts I & II ... Change in Overall Method of Accounting ♦ Schedule B ... Change in Reporting Advance Payments • ***PAGE 5*** ♦ Schedule C ... Changes within the LIFO Inventory Method ▪ Part I ... General LIFO Information ▪ Part II ... Change in Pooling Inventories • ***PAGE 6*** ♦ Schedule D ... Changes in Long-Term Contracts, Inventories or Other Section 263A Assets ▪ Part I ... Change in Reporting Income from Long-Term Contracts ... Section 460 ▪ Part II ... Change in Valuing Inventories including Cost Allocation Changes • ***PAGE 7*** ♦ Part III ... Method of Cost Allocation ▪ Section A ... Allocation & Capitalization Methods ▪ Section B ... Direct and Indirect Costs Required to Be Allocated • ***PAGE 8*** ♦ Part III ... Method of Cost Allocation ...Continued ▪ Section C ... Other Costs Not Required to be Allocated ♦ Schedule E ... Change in Depreciation or Amortization
Instructions ***12 Pages***	• ***PAGE 1*** ... General instructions are readable and straightforward. (Portions appear on page s 15 & 16.) ♦ Purpose of Form 3115 and discussions of ***Automatic Change*** Request vs. ***Advance Consent*** Request ♦ Who Must File ♦ When and Where to File ... Automatic Change Requests ... Advance Consent Requests • ***PAGE 2*** ... Provides specific instructions for who should sign and for different entity filing situations • ***PAGES 3 - 5*** ... Provide specific instructions for completing change requests involving ***automatic*** CAMs and for ***advance consent*** CAMs • ***PAGES 4 - 8*** ... Contain specific instructions for many, but not all, questions and line items on Form 3115 • ***PAGES 8 - 12*** ... Current IRS List of ***Automatic*** Accounting Method Changes ♦ For comments in the instructions on the Automatic CAM list, see page 16. ♦ For our condensed List of Automatic Accounting Method Changes, see pages 17-18.

Form **3115**
(Rev. December 2003)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

OMB No. 1545-0152

Name of filer (name of parent corporation if a consolidated group) (see instructions)	Identification number (see instructions)
	Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions.	Tax year of change begins (MM/DD/YYYY)
	Tax year of change ends (MM/DD/YYYY)
City or town, state, and ZIP code	Name of contact person (see instructions)
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)	Contact person's telephone number ( )

If the applicant is a member of a consolidated group, check this box . . . . ▶ ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached, check this box . . . . ▶ ☐

Check the box to indicate the applicant.

- ☐ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section ▶
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify) ▶ ....

Check the appropriate box to indicate the type of accounting method change being requested. (see instructions)

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify) ▶ ....

Caution: *The applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.*

Part I Information For Automatic Change Request

		Yes	No
1	Enter the requested designated accounting method change number from the **List of Automatic Accounting Method Changes** (see instructions). Enter only one method change number, except as provided for in the instructions. If the requested change is not included in that list, check "Other," and provide a description. ▶ (a) Change No. ______ (b) Other ☐ Description ▶ ______		
2	Is the accounting method change being requested one for which the scope limitations of section 4.02 of Rev. Proc. 2002-9 (or its successor) **do not** apply? . . . . If "Yes," go to Part II.		
3	Is the tax year of change the final tax year of a trade or business for which the taxpayer would be required to take the entire amount of the section 481(a) adjustment into account in computing taxable income? . . . If "Yes," the applicant is not eligible to make the change under automatic change request procedures.		

Note: *Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).*

Part II Information For All Requests

		Yes	No
4a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)? . . . If you answered "No," go to line 5.		
b	Is the method of accounting the applicant is requesting to change an issue (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?		

Signature *(see instructions)*

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Filer	Preparer (other than filer/applicant)
Signature and date	Signature of individual preparing the application and date
Name and title (print or type)	Name of individual preparing the application (print or type)
	Name of firm preparing the application

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At A Glance

FORM 3115 & INSTRUCTIONS ... Rev. Dec. 2003
COMMENTS ON CHANGES & REVISIONS

Caution ... You Must Be Thorough In Preparing Form 3115

- Note the warning that the IRS has placed in the middle of Form 3115, Page 1...
- "Caution: The applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. ***The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.***" (Emphasis added.)
- This warning did not appear on previous Form 3115. ... Could this warning possibly result from IRS involvement with Letter Ruling 200328001 last year? (See discussion below.)
- Similarly, Question 10 on the previous version of Form 3115 asked the taxpayer to attach an explanation of the legal basis supporting the proposed CAM. It said that the applicant was ***"encouraged"*** to include a discussion of any authorities that may be contrary to the proposed method.
  - ♦ On the new Form 3115, the corresponding question is #19 in Part III (Information for Advance Consent Requests). Form 3115 now directs the taxpayer to "attach a ***full*** explanation of the legal basis ...".
  - ♦ Instead of "encouraging" a discussion of authorities that may be contrary to the proposed CAM, Form 3115 reads, "The application ***should*** include a discussion of any authorities that may be contrary."

In CAM Requests, the Burden for Full Disclosure Is on the Taxpayer

- ***In Letter Ruling 200328001***, the IRS dealt with some CAM issues involving a taxpayer using the LIFO IPIC method. More germane to Form 3115 preparation, this LTR involved a situation where the taxpayer did not include as much information with the Form 3115 as the IRS thought it should have.
  - ♦ When there is less than (what the IRS considers to be) "full disclosure" on or accompanying a Form 3115, what can or should the taxpayer be entitled ***presume*** that the National Office will know or assume about what is going on?
  - ♦ In other words, should you "dare" to fully disclose or should you take your chances on submitting less than full disclosure to the IRS?
  - ♦ Just how much can a taxpayer rely on Form 3115 and the instructions? This applies to either making a change in accounting method where permission to make the change is ***automatically*** granted or in requesting permission to change in situations that are not ***automatic***.
- The National Office held that when a taxpayer files a Form 3115 requesting the Commissioner's consent to a change in method of accounting, the taxpayer has "a duty to reveal all material factors pertinent to its request for an accounting method change."
- It is not the responsibility of the National Tax Office to try to ferret out all of the pertinent information. And, the taxpayer cannot shift this burden to the National Office.
- One interpretation of this Letter Ruling is simply that ***the taxpayer will lose whenever it tries to rely on its own vague or sketchy attempts at disclosure in filling out a Form 3115.***

Another Example

- In *Cochran Hatchery, Inc. v. Commissioner*, (T.C. Memo 1979-390), the taxpayer was granted permission to change from an accrual method of accounting to the cash receipts and disbursements method of accounting (cash method). In requesting the change, the taxpayer fully and honestly provided all of the information requested on the Form 3115. ***However, the taxpayer had failed to disclose in the Form 3115 that most of the its sales were made to a related party.***
  - ♦ In part, the Service granted the requested change based on the taxpayer's representation that there was a long delay between the time of the sale and the receipt of payments on accounts receivable.
  - ♦ Subsequently, the Service discovered that most of the taxpayer's sales were to a related party, and it retroactively revoked the Letter Ruling.
  - ♦ The Tax Court held that the revocation by the IRS was justified, and it was not an abuse of discretion. The Court said, "It would be exceedingly difficult, if not impossible, for [the Commissioner] to design specific questions covering every conceivable circumstance relating to an accounting method change."

When in Doubt, Err on the Side of Full Disclosure

- LTR 200328001 reinforces a position about which we have always felt very strongly.
- In connection with Form 3115 filings (and Form 970 filings), it has always been our practice, without exception, to include a schedule showing the computation format that will be followed in the LIFO methodology to which the taxpayer is requesting permission to change (or that is being elected).
- Some practitioners have said that they felt it was unnecessary to include this extra disclosure which might simply draw more IRS attention to what was being done.
  - ♦ Our opinion has consistently been that adding a schedule showing the computation format should avoid any possible controversy in the future over how the IRS might interpret the changes we were electing or making.
  - ♦ This disclosure practice is especially crucial where a dual index LIFO method is being used.

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Instructions for Form 3115

Department of the Treasury
Internal Revenue Service

(Rev. December 2003)

Application for Change in Accounting Method

General Instructions

Purpose of Form

File Form 3115 to request a change in either an overall accounting method or the accounting treatment of any item. File a separate Form 3115 for each unrelated item or submethod, unless the IRS specifically permits (in published guidance) a change for more than one unrelated item or submethod to be requested on a single Form 3115.

Two procedures exist under which an applicant may request a change in accounting method:

Automatic Change Request. You must file under the automatic change request procedures if (a) the accounting method change is included in those procedures for the requested year of change and (b) you are within the scope of those procedures for the requested year of change (see **Automatic Change Request Scope Limitations** on page 3). A Form 3115 filed under these procedures may be reviewed by the IRS and you will be notified if information in addition to that requested on Form 3115 is required or if your request is denied. No user fee is required. An applicant that timely files and complies with an automatic change request procedure is granted consent to change its accounting method, subject to review by the IRS National Office and operating division director. See the instructions for Part I on page 3 for more information and the **List of Automatic Accounting Method Changes** beginning on page 8.

Advance Consent Request. If you are not within the scope of the automatic change request procedures for the requested year of change or the accounting method change you are requesting is not included in those procedures for the requested year of change, you may be able to file under the advance consent request procedures (see **Advance Consent Request Scope Limitations** on page 5). If the requested change is approved, the applicant will receive a letter ruling on the requested change. A user fee is required. See the instructions for Part III on page 5 for more information.

For general rules on changing an accounting method under:

Automatic change request procedures . . .	See Rev. Proc. 2002-9, as modified by Announcement 2002-17, Rev. Proc. 2002-19, and Rev. Proc. 2002-54.
Advance consent request procedures . . .	See Rev. Proc. 97-27, as modified by Rev. Proc. 2002-19 and Rev. Proc. 2002-54.
For more information, see Rev. Proc. 2004-1, particularly section 9.	

When filing Form 3115, applicants must determine if the IRS has published an accounting method revenue procedure, revenue ruling, notice, regulation, or other published guidance relating to the specific method the applicant is requesting to change. This guidance is published in the Internal Revenue Bulletin and, for years after 1995, is available at www.irs.gov.

For more information, see **Pub. 538,** Accounting Periods and Methods.

Late Application

In general, a taxpayer that fails to timely file a Form 3115 will not be granted an extension of time to file except in unusual and compelling circumstances. See Regulations section 301.9100-3 for the standards that must be met. For information on the period of limitations, see section 5.02(2) of Rev. Proc. 2004-1.

In certain circumstances, an automatic extension of time to file is available for automatic change requests. For details, see section 6.02(3)(b) of Rev. Proc. 2002-9.

A taxpayer submitting a ruling request for an extension of time to file Form 3115 must pay a user fee for its accounting method change request and a separate user fee for its extension request. For the schedule of user fees, see (A)(3)(b) in Appendix A of Rev. Proc. 2004-1.

Who Must File

Generally, a Form 3115 must be filed by or on behalf of each applicant seeking consent to change an accounting method. An "applicant" is a taxpayer whose accounting method is being changed.

For a consolidated group of corporations, the parent corporation must file the Form 3115 for a change in accounting method for itself or any member of the consolidated group. For a controlled foreign corporation or 10/50 corporation without a U.S. trade or business, the Form 3115 must be filed, respectively, by the controlling U.S. shareholder(s) or majority domestic corporate shareholder(s). If the U.S. shareholder(s) is a member of a consolidated group, the parent corporation must file Form 3115 for the U.S. shareholder on behalf of the foreign corporation.

Generally, a separate Form 3115 must be filed for each applicant that is part of a related group of corporations. However, a single Form 3115 may be filed by a parent corporation requesting the identical accounting method change on behalf of more than one member of a consolidated group.

When and Where To File

Automatic change requests. A Form 3115 that is filed under the automatic change request procedures is filed in duplicate. **The original must be attached to the filer's timely filed (including extensions) Federal income tax return for the year of change. A copy of the Form 3115 must be filed with the IRS National Office (see page 2) no earlier than the first day of the year of change and no later than when the original is filed with the Federal income tax return for the year of change.** See also **Late Application** on page 2 and instructions for lines 4d and 4e on page 4.

Advance consent requests. A Form 3115 that is filed under the advance consent request procedures must be filed during the tax year for which the change is requested. If the tax year is a short period, file Form 3115 by the last day of the short tax year. File the Form 3115 with the IRS National Office (see page 2). Form 3115 should be filed as early as possible during the year of change to provide adequate time for the IRS to respond prior to the due date of the applicant's return for the year of change. See also **Late Application** on page 2 and instructions for lines 4d and 4e on page 4.

File Form 3115 at the applicable IRS address listed below.

	For applicants (other than exempt organizations) filing under...	
	Advance consent request procedures	Automatic change request procedures
Delivery by mail	Internal Revenue Service Attn: CC:PA:LPD P.O. Box 7604 Ben Franklin Station Washington, DC 20044	Internal Revenue Service Attn: CC:IT&A (Automatic Rulings Branch) P.O. Box 7604 Ben Franklin Station Washington, DC 20044
Delivery by private delivery service	Internal Revenue Service Attn: CC:PA:LPD Room 5336 1111 Constitution Ave., NW Washington, DC 20224	Internal Revenue Service Attn: CC:IT&A (Automatic Rulings Branch), Room 4516 1111 Constitution Ave., NW Washington, DC 20224

The IRS normally acknowledges receipt of a filed Form 3115 for an advance consent request within 60 days after receipt. If an acknowledgement has not been received within 60 days of filing Form 3115, the filer of an advance consent request can inquire to: Internal Revenue Service, Control Clerk, CC:IT&A, Room 4516, 1111 Constitution Ave., NW, Washington, DC 20224.

Note: *The filer of an automatic change request will not receive an acknowledgment.*

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IRS Comments on Its List of 76 Automatic CAMs

This information is from Page 8 of the Instructions for Form 3115 (Rev. Dec. 2003).

The IRS has assigned a "change number" to each of the Automatic Accounting Method Changes. This *Change #* is to be used to identify an ***automatic*** change in method on Page 1, Part I, Line 1 of Form 3115. Pages 8-12 of the Instructions list 76 automatic changes, along with additional information (see below) concerning each one.

Our condensed list of the IRS list appears on pages 17 and 18. We have indicated that the identification of the CAMs in the right-hand columns is for general purposes only and is not intended to be all inclusive. Some of the CAMs identified as "Other Applications" on our list may apply to very small or very large dealerships, or in cases where special activities (such as buy-here, pay-here operations) are conducted.

We would emphasize the IRS' warning from the information below that you may not rely on the list or on the descriptions of the accounting method changes in the list as authority for making an accounting method change. If any information on the IRS' ***List of Automatic Method Changes*** in the Instructions conflicts with other guidance published elsewhere by the IRS, then that other published guidance applies.

List of Automatic Accounting Method Changes

Listed below are automatic accounting method changes providing for the filing of Form 3115. The **List of Automatic Accounting Method Changes** includes regulatory automatic changes, changes provided for in the Appendix of Rev. Proc. 2002-9, and automatic changes provided for in other guidance. These automatic changes may be modified or supplemented with additional automatic changes by subsequently published guidance.

Note: *The list provides a brief description of each automatic accounting method change that is included in the list. A filer/applicant may not rely on the list or the descriptions of accounting method changes in the list as authority for making an accounting method change. A filer/applicant that is within the scope of, and complies with, all the applicable provisions of the published guidance that authorizes each listed change may rely on the applicable published guidance as authority for its automatic accounting method change. If any information in the* ***List of Automatic Accounting Method Changes*** *conflicts with published guidance, the published guidance applies.*

Each item in the list below:

- Designates an automatic accounting method change number for each change for entry on line 1a of Form 3115.
- Briefly describes the accounting method change.
- Indicates if scope limitation rules may not apply.
- Indicates if audit protection may not apply.
- Indicates in some cases which schedules of Form 3115 to complete.
- Indicates in some cases any additional reporting requirements.
- Indicates in some cases if the change is made on a cut-off basis.
- Provides a reference to the basic published guidance (e.g., revenue procedure) that provides for the automatic change which filers should review prior to completing Part I, Information For Automatic Change Request, on page 1 of Form 3115.

Part I Information For Automatic Change Request	Yes	No
1 Enter the requested designated accounting method change number from the **List of Automatic Accounting Method Changes** (see instructions). Enter only one method change number, except as provided for in the instructions. If the requested change is not included in that list, check "Other," and provide a description. ► (a) Change No. ________ (b) Other ☐ Description ► ________		

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76 "Automatic" CAMs

AUTOMATIC ACCOUNTING METHOD CHANGES PER FORM 3115 INSTRUCTIONS (Rev. Dec. 2003)

(Page 1 of 2)

Code Section	Assigned Reference # for CAM		Auto Dealer- and/or LIFO-Related	Other Applications
77	1	Commodity Credit Corporation loans		✓
162	2	Lawyers handling cases on a contingent fee basis		✓
	3	ISO 9000 costs		✓
	4	Restaurant smallwares costs		✓
166	5	Bad debts		✓
	6	Bad debt conformity for banks		✓
Various	7	Depreciation or amortization (impermissible)	✓	
56 & 167	8	Depreciation (permissible)	✓	
Various	9	Post-disposition depreciation or amortization	✓	
Various	10	Sale or lease transactions	✓	
Various	11	Modern golf course greens		✓
168	12	Original and replacement tire costs		✓
Various	13	Depreciation of gas pump canopies		✓
Various	14	Depreciation of utility assets		✓
168	15	Depreciation of cable TV fiber optics		✓
171	16	Amortizable bond premium		✓
174	17	Research and experimental expenditures		✓
162 & 167	18	Computer software expenditures		✓
263	19	Package design costs		✓
	20	Line pack gas or cushion gas costs		✓
	21	Removal costs		✓
263A	22	Certain uniform capitalization methods used by small resellers, formerly small resellers, and reseller-producers	✓	
	23	Certain uniform capitalization methods used by producers and reseller-producers	✓	
	24	Research and experimental expenditures under uniform capitalization methods		✓
	25	Impact fees		✓
267	26	Related party transactions	✓	
404	27	Deferred compensation determination		✓
	28	Bonus or vacation pay deferred compensation		✓
	29	Grace period contributions		✓
446	30	Overall accrual method		✓
	31	Multi-year insurance policies for multi-year service warranty contracts (SWIM - Service Warranty Income Method)	✓	
	32	Overall cash method ($1 million)		✓
	33	Overall cash method ($10 million)		✓
448	34	Overall accrual method		✓
	35	Nonaccrual-experience method		✓
451	36	Interest accrual on non-performing loans		✓
	37	Advance rentals		✓
	38	State tax refunds		✓
	39	Capital cost reduction (CCR) payments		✓

See Page 18 for Changes #40 - 76 and for Explanatory Note

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76 "Automatic" CAMs

AUTOMATIC ACCOUNTING METHOD CHANGES PER FORM 3115 INSTRUCTIONS (Rev. Dec. 2003)

Code Section	*Assigned Reference # for CAM*		*Auto Dealer- and/or LIFO-Related*	*Other Applications*
458	40	Exclusion for certain returned magazines, paperbacks, or records		✓
460	41	Percentage-of-completion		✓
461	42	Timing of incurring employee medical benefit liabilities		✓
	43	Timing of incurring real property, personal property and state income tax liabilities	✓	
	44	Timing of incurring workers' compensation act, tort, breach of contract, or violation of law liabilities		✓
	45	Timing of incurring payroll tax liabilities	✓	
	46	Cooperative advertising		✓
	47	Distributor commissions	✓	
471	48	Cash discounts	✓	
	49	Estimating inventory shrinkage		✓
	50	Small taxpayer ($1 million) inventory exception	✓	
	51	Small taxpayer ($10 million) inventory exception	✓	
	52	"Floor stocks"	✓	
	53	Qualifying volume-related trade discounts	✓	
	54	Impermissible methods of inventory valuation	✓	
	55	Valuation of remanufactured cores	✓	
472	56	Change from LIFO inventory method	✓	
	57	Determining current-year cost	✓	
	58	Alternative LIFO Inventory Method (for *New* Vehicles)	✓	
	59	*Used* Vehicle Alternative LIFO Method	✓	
	60	Determining the cost of used vehicles purchased or taken as a trade-in	✓	
	61	Change to IPIC inventory method	✓	
	62	Changes within IPIC inventory method	✓	
	63	Replacement cost method for automobile dealers' parts inventory	✓	
475	64	Mark-to-market		✓
	65	Dealer status changes		✓
585	66	Bank reserves for bad debts		✓
832	67	Insurance company premium acquisition expenses		✓
846	68	Discounted unpaid losses		✓
861	69	Income from sources within the United States		✓
985	70	Functional currency		✓
1272	71	Rule of 78s		✓
1272 & -73	72	Original issue discount		✓
1278	73	Market discount bonds		✓
1281	74	Interest income on short-term obligations		✓
	75	Stated interest on short-term loans		✓
1286	76	Sales of mortgage loans		✓

Note: The identification of the CAMs in the right-hand columns is for general purposes only. It is not intended to be all inclusive. Some of the CAMs identified as "Other Applications" may be relevant or pertinent to very small or very large dealerships or in cases where special activities (such as buy-here, pay-here operations) are conducted.

ENHANCING CLIENT RELATIONSHIPS BY EXPLAINING THEIR TAX SAVINGS FROM REDUCED TAX RATES FOR QUALIFIED DIVIDEND INCOME

5% - 15% DIVIDEND TAX RATES

The personal returns you just prepared for 2003 reflected a blend of reduced tax rates on ordinary income and on certain dividend income and capital gains. These 2003 tax returns provide a great opportunity to let your clients know how much they really benefited from the tax cuts made by the *Jobs and Growth Tax Relief Reconciliation Act of 2003* ... sometimes abbreviated as "*JGTRRA.*"

Our discussion here ignores, or otherwise takes for granted, last year's overall reduction in ordinary income tax rates. It focuses, instead, on the many clients with sizeable amounts of dividend income and capital gains from sales after May 5, 2003. These folks received significant tax savings in addition to the overall rate reductions as a result of the preferential, lower rates that applied to their investment income.

If you were paying attention to the Forms 1099-DIV, Schedules K-1s and other information that your clients gave to you to prepare their tax returns, you already know that "eligible dividend income" had its own boxes and lines on the tax forms and schedules. However, after running all this information through your software, can you answer a simple question from your client like, "How was my tax liability computed?" ... or, "How much did I save?"

PRACTICE DEVELOPMENT OPPORTUNITIES

We decided that there were great benefits if we would make the effort to explain to our clients exactly how much tax they "saved" as a result of the lower, preferential rates on investment income. In one instance where the dealer's corporation paid out a large dividend before year-end, he was also interested in finding out how much it had "cost" him to receive the additional dividend that he withdrew from his corporation ... That's Case III. In another case, a client with taxable income in excess of $250,000 saved nearly $40,000 as a result of these preferential rates. ... That's Case IV.

Surely you saw similar situations in the tax returns passing through your hands. If you were to send out letters like these to your clients and they told their friends about your special attention, wouldn't those friends be envious because their CPAs didn't pay that much attention to them?

PRESENTING THE GOOD NEWS 4 CASE STUDIES

The accompanying four case studies are adapted from our client correspondence and are sufficient to illustrate some of the combinations you might encounter. The specifics of each situation are summarized on page 20.

Each letter contains a brief general discussion of the preferential tax rates. These standard paragraphs appear on page 21. These are followed by an analysis of the "composition" of the client's taxable income as it needs to be viewed in order to "see" what was really going on. After that, we included a schedule showing how the client's tax liability was computed. You may decide to present only a portion of this information. However, our experience in meeting with clients and reviewing these letters was that they devoured all the details.

Some clients do a lot of reading or talk with business associates and friends about taxes. These folks have already heard about the dreaded Alternative Minimum Tax. They're wondering ... "Did the AMT apply to me?" "Did I get stuck?" "If I did, how much more did I pay?" These are reasonable questions to anticipate, and we have answered them in our letters.

Two situations (Cases I and II) do not involve the AMT. Cases III and IV do reflect the AMT interplay, with Case IV reflecting some unusual results.

In last year's tax returns where clients saved "only" modest amounts from these changes, we thought it sufficient to add a simple paragraph in their tax return transmittal letter.

SIMPLER SITUATIONS ... SIMPLER EXPLANATIONS

"In your Federal return, you received a tax savings of $780 resulting from the tax rates which were lowered beginning in 2003 for *qualified dividend income.* Line 9(b) of your return reports $6,000 as qualified dividend income. This amount would have been taxed at the 28% tax rate that applied to your taxable income over $68,800. However, it was taxed instead at a flat 15%. This saved you the $780 difference between a 28% rate and a 15% rate (13% x $6,000 = $780)."

see **ENHANCING CLIENT RELATIONSHIPS, page 26**

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Case Studies	***CLIENT LETTERS EXPLAINING 2003 TAX SAVINGS FROM REDUCED TAX RATES FOR QUALIFIED DIVIDEND INCOME, Etc.***
Case I ***Pages 22-23***	• ***Single Taxpayer.*** • 50% of taxable income consisted of qualified dividend income. • Taxable income was relatively low. • The Alternative Minimum Tax did not apply and was not a factor in the analysis. • Schedule D capital gains all were from sales before May 5, 2003.
Case II ***Pages 24-25***	• ***Married Taxpayers, filing joint return.*** • Relatively low taxable income. • Income qualifying for reduced rates splits over qualifying tax table brackets. • Multiple capital gain rates applications. • The Alternative Minimum Tax did not apply and was not a factor in the analysis.
Case III ***Pages 27-31***	*Dealership Special Planning Example* • ***Married Taxpayers, filing joint return.*** • After discussing the 5%-15% lower preferential rates on eligible dividends with the dealer in 2003, the dealership paid out a dividend of $160,000 to the dealer. ♦ The dealership is a C Corporation with sizeable accumulated earnings & profits. ♦ Note: If the dealership did not have adequate cash available to pay out the dividend in order to take advantage of the lower rates, it could have borrowed the money to do so. • Fairly large amount of income from other sources ... Form W-2 wages, taxable interest income, Form 1099-R distributions, etc. • Taxpayers claimed standard deduction because charitable contributions, real estate taxes and State income taxes were relatively small. • The Alternative Minimum Tax applied. • Dealer wanted to know how much the additional dividend "cost" ... and that cost was not simply 15% of the dividend amount. • AMT illustrates a number of cut-backs and limitations that are triggered differently when there is a large amount of dividend income that is either entirely included in, or entirely excluded from, taxable income. ♦ Phase-out of personal exemptions in regular tax calculation. ♦ Phase-out of itemized deductions in Schedule A due to total deductions in excess of 3% of adjusted gross income. (Not a factor in this specific case.) ♦ Phase-out of AMT exemption based on filing status and amount of AMTI.
Case IV ***Pages 32-35***	*Unusual Alternative Minimum Tax (AMT) Application* • ***Single Taxpayer.*** • Very high taxable income, principally from investment income and amounts received as a trust beneficiary. • Very large Schedule A itemized deductions for real estate taxes and State income taxes. • Qualified dividend income and post-May 5, 2003 long-term capital gains exceed taxable income. • The Alternative Minimum Tax applied. • Lower rates applied to the ***entire*** AMT tax calculation and "saved" this taxpayer $40,000.
2003 Tax Rates	• Applicable tax rate schedule was not included as an attachment to client letters. • Each letter includes references to tax brackets, rates, etc., applicable to that client's case. • For your reference, tax rate schedules for 2003 are included on opposite page.

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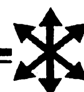
"STANDARD" PARAGRAPHS FOR PAGE 1 OF LETTERS TO CLIENTS

Intro	*Each letter (except for Case III) began basically as follows:* Dear Client: "This letter explains the ***tax savings of $*** _______ that you received in your Federal income tax return for 2003 resulting from the lowered tax rates for qualified dividend income and for certain capital gains."
Standard Explanation of JGTRRA Preferential Rates on Investment Income ***(Included on Page 1 of Each Letter)***	*After the above Intro, the following standard language was used to explain the lower rates:* By way of background, the *Jobs and Growth Tax Relief Reconciliation Act of 2003* enacted lower tax rates on income from investments, including so-called ***"qualified dividends"*** and capital gains realized from sales after May 5, 2003. In the past, you were taxed on all dividend income at your highest marginal tax rate, and long-term capital gains were generally taxed at a flat 20%. The way the preferential tax rates for qualifying dividends work is that ... (1) ***A flat 5% tax rate*** is applied to that portion of the qualified dividend income you received that would otherwise be taxed in your return in either the 10% or in the 15% tax rate brackets. (2) ***A flat 15% tax rate*** is applied to the remaining portion of any qualified dividend income that would otherwise be taxed in your return in the higher-than-15% tax rate brackets (i.e., that would have fallen into the 25%, 28%, 33% or 35% tax brackets). (3) Basically the same two-step approach above applies to the taxation of capital gains resulting from sales after May 5, 2003, and the beneficial tax treatment for both qualified dividends and these capital gains is also available in computing the Alternative Minimum Tax. (4) "New" columns had to be added to the Forms 1099 that you received this year in order to record this special dividend and capital gain information because some of your dividend income may not be considered "qualified" due to the character of the underlying security or because certain holding period requirements were not met. *[Each of the four Case Study Letters has omitted the above standard paragraphs to avoid repetition and permit a more concise presentation of the analysis of the taxpayer's information.]*

2003 TAX RATE SCHEDULES

Schedule X: Filing Status ... SINGLE				*Schedule Y-1: Filing Status ...* MARRIED FILING JOINTLY			
If the Amount on Form 1040, Line 40 is: *Over ...*	**But, *Not Over ...***	**Enter on Form 1040, Line 41**	***Of the Amount Over ...***	**If the Amount on Form 1040, Line 40 is: *Over ...***	**But, *Not Over ...***	**Enter on Form 1040, Line 41**	***Of the Amount Over ...***
$0	$7,000	______10%	$0	$0	$14,000	______10%	$0
7,000	28,400	$700.00 + 15%	7,000	14,000	56,800	$1,400.00 + 15%	14,000
28,4000	68,800	3,910.00 + 25%	28,400	56,800	114,650	7,820.00 + 25%	56,800
68,8000	143,500	14,010.00 + 28%	68,800	114,650	174,700	22,282.50 + 28%	114,650
143,500	311,950	34,926.00 + 33%	143,500	174,700	311,950	39,096.50 + 33%	174,700
311,950	_____	90,514.50 + 35%	311,950	311,950	_____	84,389.00 + 35%	311,950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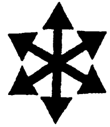

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April ___, 2004

Dear Case I Client:

This letter explains the ***tax savings of $2,900*** that you received in your Federal income tax return for 2003 resulting from the lowered tax rates for qualified dividend income.

* * *

*[See **Standard Background Information Paragraphs**, omitted here due to space limitations.]*

* * *

You cannot easily see these new tax rates or your tax savings anywhere on the schedules in your tax return. The problem lies in picking out how much of the qualified dividend income you received is taxed at the respective 5% and 15% flat rates. In fact, your tax liability was actually calculated using four different tax rates (5% - 10% - 15% - 20%) which were applied to different portions, or components, of your taxable income.

Even though your taxable income for 2003 was $57,151, none of your income was taxed at the 25% rate which is shown as the applicable rate in the 2003 Tax Rate Schedule for single taxpayers with taxable income between $28,400 and $68,800.

Your taxable income for 2003 consisted of the following elements.

"Regular" Taxable Income less Deductions (i.e., the portion of your taxable income that does not consist of either qualified dividends or long term capital gains)	$ 21,719	(A)
Qualified Dividend Income	28,981	(B)
Long-Term Capital Gains (all realized before May 5, 2003)	6,451	(C)
Taxable Income (Form 1040, Page 2, Line 40)	$ 57,151	(D)

A portion of the qualified dividend income you received (equaling $6,681) would have been taxed in the 15% bracket. However, because of the new preferential rates, this portion of your qualified dividends was subject to tax at a flat 5% rate. The remainder of the qualified dividend income (equaling $22,300) would have been taxed in the 25% bracket, but instead, it was taxed at a flat 15% rate. The difference of 10% between each of these two components resulted in a total tax savings to you of 10% of $28,981 or $2,898. For discussion purposes, this is rounded to $2,900.

Calculation of your 2003 tax liability.

The actual amount of tax you paid for 2003, before credits, is $7,878 (Page 2, Line 41 of your tax return.) The calculation is shown on the following page:

(Continued)

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	Taxable Income		Tax Rate	Amount of Tax
The portion of the regular taxable income that does not consist of either qualified dividends or of long-term capital gains				
First $7,000	$ 7,000		10%	$ 700
Remaining $14,719 of regular taxable income	14,719		15%	2,209
	21,719	(A)		2,909
Qualified Dividend Income				
First $6,681 (i.e., amount needed to reach $28,400 cut-off point in the 15% bracket)	6,681		5%	334
Remaining qualified dividends otherwise falling into the 25% bracket ($28,981 - 6,681 = 22,300)	22,300		15%	3,345
	28,981	(B)		3,679
Long-Term Capital Gains (all pre-May 5, 2003) taxed at 20%	6,451	(C)	20%	1,290
Taxable Income and Total Tax, respectively	$ 57,151	(D)		$ 7,878

From the table above, you can see that the portion of the qualified dividend income that would have fallen in to the 15% tax bracket is $6,681. Also, the portion that would have fallen in to the 25% tax bracket is $22,300. These two amounts total $28,981, the amount reported on Page 1, Line 9(b) of your tax return as your income received from qualified dividends.

Capital Gains. Another beneficial change for investors under the 2003 Tax Relief Act applies a flat 15% tax rate to capital gains realized from transactions that occurred after May 5, 2003. In your case, since you had no net capital gains from these transactions, this change did not apply to you in 2003. Accordingly, the net long-term capital gain shown in Schedule D of your tax return was taxed at the (already somewhat) preferential lower rate of 20%.

Alternative Minimum Tax (AMT). You undoubtedly have heard or read quite a bit about the Alternative Minimum Tax. Most general articles on taxes in financial magazines and newspapers have included cautions on this trap for the unwary. Some have called it a "stealth tax" or worse.

In your case, ***the AMT did not apply to you in 2003.*** Line 42 on Page 2 of your return shows $-0- as the amount of AMT liability transferred from Form 6251. Therefore, I've omitted any discussion of how these preferential tax rates for qualified dividend income and for post-May 5, 2003 capital gains would have applied if you had been liable for the Alternative Minimum Tax.

In Summary. Another way of looking at your $2,900 tax savings is as follows. If the lower rates for qualified dividends had not been available, your 2003 tax liability would have been $10,781. This amount is $2,900 greater than your actual tax liability of $7,878 (not counting the $3 rounding).

According to the Tax Tables (for a single taxpayer) with taxable income of $50,700 (excluding long-term capital gain), the tax would have been	$ 9,491
Add to this, the tax on the net long-term capital gain of $6,451 at a flat 20%	1,290
Total tax, if there were no special treatment for qualified dividends	10,781
Deduct income tax, per tax return (before credits)	(7,878)
Savings due to preferential tax rate treatment for qualified dividends	$ 2,903

You can see the actual calculation of your tax liability for 2003 on Page 2 of Schedule D. Line 53 of Part IV shows "Tax on all taxable income … $7,878." Although this part of Schedule D is a virtual maze to many, it accurately shows the contortions your income went through in arriving at the final tax tally.

Sincerely,

Willard J. De Filipps, CPA

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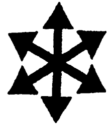

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April ___, 2004

Dear Case II Client:

This letter explains the ***tax savings of $1,162*** that you received in your Federal income tax return for 2003 resulting from the lowered tax rates for qualified dividend income and for certain capital gains.

* * *

*[See **Standard Background Information Paragraphs**, omitted here due to space limitations.]*

* * *

You cannot easily see these new tax rates or your tax savings anywhere on the schedules in your tax return. The problem lies in picking out how much of the qualified dividend income and capital gain is taxed at the respective 5% and 15% flat rates. In fact, your tax liability was actually calculated using four different tax rates (10% - 15% - 20% - 25%) which were applied to different portions, or components, of your taxable income.

Your taxable income for 2003 consisted of the following elements.

"Regular" Taxable Income less Deductions (i.e., the portion of your taxable income that does not consist of either qualified dividends or long-term capital gains)	$ 65,083	(A)
Qualified Dividend Income	5,522	(B)
Long-Term Capital Gains realized after May 5, 2003	12,189	(C)
Total Income Subject to Preferential, Lower Rates	17,711	
Long-Term Capital Gains Subject to 25% Recapture Rate	897	(D)
Other Long-Term Capital Gain Subject to 20% Rate ($987 - 897)	90	(E)
Taxable Income (Form 1040, Page 2, Line 40)	$ 83,781	(F)

None of the qualified dividend income / special capital gains that you received would have been taxed in the 15% bracket because the applicable tax rate in the 2003 Tax Rate Schedule for your joint return with taxable income between $56,800 and $114,650 is 25%. Your qualified dividend income would have been taxed in the 25% bracket, and your post-May 5, 2003 long-term capital gains would have been taxed at the maximum rate for regular long-term capital gains, which is 20%.

(Continued)

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Calculation of your 2003 tax liability.

The actual amount of tax you paid for 2003, before credits, is $12,788 (Page 2, Line 41 of your tax return.) The calculation is shown below:

	Taxable Income		Tax Rate	Amount of Tax
The portion of the regular taxable income that does not consist of either qualified dividends or of long-term capital gains				
First $14,000	$ 14,000		10%	$ 1,400
Next $42,800	42,800		15%	6,420
Remaining $8,283 of regular taxable income	8,283		25%	2,069
	65,083	(A)		9,889
Qualified Dividend Income	5,522	(B)	15%	828
Long-Term Capital Gains realized after May 5, 2003	12,189	(C)	15%	1,827
Total Income Subject to Preferential, Lower Rates	17,711			2,657
Long-Term Capital Gains Subject to 25% Recapture Rate	897	(D)	25%	224
Other Long-Term Capital Gain Subject to 20% Rate ($987-897)	90	(E)	20%	18
Taxable Income and Total Tax, respectively	$ 83,781	(D)		$ 12,788

From the table above, you can see that all of your qualified dividend income that would have been taxable at the 25% tax rate was taxed instead at 15%. This resulted in a tax saving to you of $552 (25% - 15% = 10% x $5,522 = $552.

In addition, your net post-May 5, 2003 long-term capital gains (C above) were taxed at 15% instead of 20%. This resulted in an additional tax saving to you of $610 (20% - 15% = 5% x $12,189 = $610). ***Therefore, your tax for 2003 was lower by $1,162 ($552 + 610) than it would have been if the lower rates for certain investment income had not been applicable.***

Alternative Minimum Tax (AMT). You undoubtedly have heard or read quite a bit about the Alternative Minimum Tax. Most general articles on taxes in financial magazines and newspapers have included cautions on this trap for the unwary. Some have called it a "stealth tax" or worse.

In your case, ***the AMT did not apply to you in 2003.*** Line 42 on Page 2 of your return shows $-0- as the amount of AMT liability transferred from Form 6251. Therefore, I've omitted any discussion of how these preferential tax rates for qualified dividend income and for post-May 5, 2003 capital gains would have applied if you had been liable for the Alternative Minimum Tax.

You can see the actual calculation of your tax liability for 2003 on the Tax Worksheet for Line 53 of Page 2 of your Schedule D. Line 53 of Part IV shows "Tax on all taxable income … $12,788." Although the Tax Worksheet for Schedule D is a virtual maze to many, it accurately shows the contortions your income went through in arriving at the final tax tally.

Sincerely,

Willard J. De Filipps, CPA

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(Continued from page 19)

PROACTIVE PLANNING FOR THE LOWER RATES

Last summer (if not earlier), as the impact of the provisions of *JGTRRA* on investors and business owners became more evident, many of us saw opportunities for some full-scale tax planning that could be done to take advantage of the seemingly, "too-good-to-be-true" low rates on investment income.

Many dealers may have built up accumulated earnings and profits (somewhat akin to retained earnings) in regular C corporations or in pre-subchapter S years if they're operating as S Corps. The lower *JGTRRA* rates on eligible dividend income were considered by many to be invitations (possibly short-term?) to withdraw some of this accumulated income at minimum tax cost. After all, who knows how long these lower rates may last?

For these dealers (and other owners of closely-held corporations), the opportunity was too good to resist, and they decided to take out rather sizeable dividends at very low effective tax rates. Typically, the effective tax rate on the shareholder would vary between "more than 15%" and "less than 20%."

This could be especially attractive to more elderly individuals whose corporations had accumulated assets (not necessarily cash) and who now wanted to take some of that accumulation out of the corporation. In family business continuity planning situations, relieving the corporation of unneeded, accumulated assets often makes it easier for the next generation of successors to pay for the stock in the dealership/business.

Another related planning opportunity involves a corporation that owns property that is not really needed in the operations of the business. In our planning scenario, when the corporation distributes this property as a (non-liquidating) dividend, it will have to pay tax at the corporate level because that distribution is treated as a sale.

However, if the amount of corporate tax on the distribution will not be significant, then the payment of a small amount of tax at the corporate level will be worth it to "simplify" things and reduce exposure to the IRS questioning the ownership of these assets by the corporation. So, in this case, the shareholder benefits from the low rates on qualified dividend income since the property distribution is pulling out accumulated earnings and profits and, after the distribution, the corporation's balance sheet will look a lot "cleaner."

Perhaps you have some variations on these basic situations in your own practice. Just one word of caution: In doing the projections, don't overlook the somewhat adverse effect that you might encounter if the individual has a (large) deduction for investment expense on Form 4952.

TEACHING & TRAINING POSSIBILITIES

Assuming you didn't outsource the preparation of your dealer's 1040 personal tax return to Bombay for $6 an hour, for some of your staff, their past "tax season" experience may have been more limited to developing a mechanical proficiency in data entry in whatever (*XYZ*) tax return software program you were using. If that's the case, then these letters may be useful in helping newer professionals study the interaction of our dual "regular" tax and Alternative Minimum Tax systems.

There are some real plusses to staying close to the mechanics of the tax calculations. One is that if you really understand how the taxes were calculated, then you have a great opportunity to train your staff to explain to your clients what really happened in their personal tax returns.

Equally important, if you want to develop your tax practice, you need to be alert for situations and circumstances where tax rate changes and differentials permit strategic tax planning.

CONCLUSION

A recent practice development article in the *Journal of Accountancy* stated that "CPAs who want to survive in a turbulent business environment and grow their firms must emphasize maintaining a relationship with existing and potential clients – that means contacting them more than just a few times annually." This article included a few simple tips to help stay in touch, including (1) maintain a high level of contact throughout the year, (2) use variety in your approach, (3) send something of interest and (4) *stand out from the crowd.*

Most clients need for you to reforce their sense of confidence that the person who prepared and signed their tax return (that's you) really understands how their tax liability was calculated.

So, if you were busy "cranking out tax returns" over the past few months, you might want to use these letters for staff training. Or, you might want to select a few situations and use these formats to help enhance your own client relationships. More significantly, these efforts may lead to some beneficial 2004 tax planning for your clients while these lower rates are still in effect. If appropriate action is taken, when you prepare the tax return after the end of this year, the story shown on that return will have a very happy ending for your client. ✻

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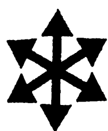

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April ___, 2004

Dear Case III Dealer Client:

This letter discusses the impact and the tax benefit that you received in your Federal income tax return for 2003 resulting from the lowered tax rates for qualified dividend income and for certain capital gains. Since your 2003 tax strategy included deliberately taking a taxable dividend of $160,000 out of the dealership in order to more greatly maximize your benefits from these lower rates, this letter will answer three questions.

(1) How was your tax liability calculated for 2003?

(2) How much "additional tax" did you pay on the $160,000 dividend?

(3) How much "tax savings" did the lower dividend rates provide in 2003?

* * *

*[See **Standard Background Information Paragraphs**, omitted here due to space limitations.]*

* * *

You cannot easily see these new tax rates or your tax savings anywhere on the schedules in your tax return. The problem lies in picking out how much of the qualified dividend income and capital gain is taxed at the respective 5% and 15% flat rates. In fact, even though your taxable income for 2003 was $449,202, none of that income was taxed at the 35% rate which is shown as the applicable rate in the Tax Rate Schedule for married taxpayers with taxable income in excess of $311,950. The next bracket below the 35% rate is the 33% bracket which applies to all taxable income between $174,700 and $311,950.

<u>Question #1 ... How was your tax liability calculated for 2003?</u>

Answer: Although your tax liability was calculated on a *tentative* basis using every tax rate in the Tax Rate Schedule ... 10% - 15% - 25% - 28% and 35%, in the end, the Alternative Minimum Tax determined your tax liability.

(Continued)

Your taxable income for 2003 consisted of the following elements.

"Regular" Taxable Income less Deductions (i.e., the portion of your taxable income that does not consist of either qualified dividends or long term capital gains)	$ 293,110
Qualified Dividend Income ($160,000 from the dealership and $7,438 received from other companies and sources)	167,438
Net Long-Term Capital Gains realized after May 5, 2003	54
Total income Subject to Preferential Lower Rates	$ 167,492
Adjusted Gross Income (Form 1040, Page 1, Line 34)	460,602
Less: Standard Deduction Claimed (Schedule A, Itemized Deductions Not Applicable)	(11,400)
Taxable Income	$ 449,202

Alternative Minimum Tax (AMT). Because of the absolute size and composition of your taxable income, you were subject to the Alternative Minimum Tax in your 2003 tax return.

Because the Alternative Minimum Tax applied, the actual amount of tax you paid for 2003, before credits, is $103,434 (Page 2, Line 43 of your tax return.) The calculation of this amount is shown below:

	Taxable Income	Tax Rate	Amount of Tax
The portion of the regular taxable income that is ***not*** treated as consisting of either qualified dividend income or of long-term capital gains realized after May 5, 2003			
First $174,700	$ 174,700	10%-28%	$ 39,097
Remaining regular taxable income	107,010	33%	35,313
Regular taxable income ($293,110-$11,400)	$ 281,710 *		
Tax on regular taxable income			$ 74,410
Qualified dividend income and long-term capital gains realized after May 5, 2003, taxed at a flat 15% rate	167,492	15%	25,124
Taxable Income	$ 449,202		
Tax on Taxable Income			$ 99,534
Alternative Minimum Tax ... See Schedule I			3,900
Total Tax Including AMT, Form 1040, Page 2, Line 43			$ 103,434

* This amount, $281,710, includes all of your Form W-2 wages, interest income, dividends that were not eligible and Form 1099-R taxable distribution amounts.

(Continued)

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The schedule above does not appear in your 2003 tax return. This schedule simply summarizes differently the components of your taxable income so that we can interpret the end result of the much more involved calculations that are buried in the tax return schedules designed by the IRS.

A detailed calculation of your Alternative Minimum Tax liability appears in Schedule I. What these schedules show is that the Alternative Minimum Tax would apply even if there were no qualified dividend income and post-May 5, 2003 capital gains. This is because of (1) the absolute amount and "mix" or composition of your income and (2) the amount of qualified dividend (and capital gain) that is subject to the preferential, lower rates.

The Alternative Minimum Tax of $3,900 from Schedule I is the same $3,900 amount of difference that is computed by subtracting $74,410 (the regular tax before considering qualified dividend income) from $78,310 (the Alternative Minimum Tax before considering qualified dividend income in Schedule I). The tax on the qualified dividend income (and capital gain) is computed at the flat rate of 15% in either case (i.e., in the AMT computation or in the computation of the regular tax above).

Question #2 ... How Much "Additional Tax" Was Paid on the $160,000 Dividend?

The total tax (including the Alternative Minimum Tax) for 2003 is $103,434. If the special taxable dividend of $160,000 paid out to you in 2003 by the dealership had not been received, your income tax for the year would have been $75,010. The difference, or $28,424, is the amount of tax paid on the additional dividend you received from the dealership.

The difference is not simply 15% of the $160,000 dividend or $24,000. There are several reasons for this. First, in recalculating the Alternative Minimum Tax with the big dividend excluded, the amount of Alternative Minimum Taxable Income is only $299,671. With this lowered amount, a portion of the AMT exemption becomes available. In other words, the AMT exemption is not fully phased out ... It is allowable to the extent of $20,582. As a consequence, the tax on the Alternative Minimum Taxable income becomes less than the tax under the regular tax calculation. This means that the Alternative Minimum Tax ***does not apply*** in the scenario where the large dividend that was accelerated from the dealership is excluded. Therefore, taking the big dividend in 2003 triggered the Alternative Minimum Tax to the extent of $3,900.

That's not all. In recalculating the regular income tax liability with the big dividend excluded, the recomputed taxable income drops to $289,202 ($449,202 - 160,000). As a result of this lower taxable income, an amount of $1,586 becomes allowable for your personal exemptions. This personal exemption amount is fully phased down to zero ($0) when the entire accelerated dividend of $160,000 is included in your taxable income. Therefore, including the large dividend in income meant that you lost the availability of $1,586 worth of personal exemption deductions. At the 33% marginal tax rate, this "cost" you another $524.

These three factors explain the additional cost of taking the big dividend.

Additional qualified dividend income ... $160,000 x 15%	$ 24,000
Alternative Minimum Tax triggered by taking big dividend	3,900
Loss of personal exemptions ... $1,586 x 33%	524
Additional tax cost of large dividend	$ 28,424

(Continued)

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The effective rate of tax on this dividend was 17.7% ($28,424 divided by $160,000).

Last year, when we discussed the opportunity for you to take a large dividend out of the dealership at a low tax cost, I mentioned that, although the new flat rate of tax on the dividend would be 15%, the ***effective rate of tax*** probably would be a little higher because of the interplay with the Alternative Minimum Tax. At that time, there were too many variables and unknowns to be estimated, and that prevented a more precise estimate of the effective tax rate. As you can see, the effective rate of 17.7% was slightly higher than the flat rate of 15%. However, taking out a large dividend at the low net cost of 17.7% still seems to be very much to your advantage.

Question #3 ... How Much Tax Savings Did the Lower Dividend Rates Provide in 2003?

Answer: You received a tax savings of $21,774 from the lowered tax rates for qualified dividend income and capital gains.

In the computation of your Alternative Minimum Taxable Income, your base amount is $292,179 ... before considering any qualified dividend income. At that point, your income is subject to the highest AMT tax rate which is 28%. The tax savings from the lower, preferential rate is, therefore, the difference between the highest Alternative Minimum Tax rate that would have applied to this income (i.e., 28%) and the 15% flat rate that was actually applied.

The income to which the reduced rate applied totaled $167,492 (qualified dividend income of $167,438 and post-May 5, 2003 capital gain of $54). Therefore, the tax savings provided by the lower rates is $21,774 (28% - 15% = 13% x $167,492 = $21,774).

The bottom line is that your tax liability for 2003 would have been $21,774 higher if there hadn't been a reduction in the tax rates on certain investment income.

Sincerely,

Willard J. De Filipps, CPA

Encl.: Schedule I

Schedule I AMT

Calculation of Alternative Minimum Tax for Case III Dealer Client

	Amount	Tax Rate	AMT Tax
The portion of your Adjusted Gross Income that does not consist of either qualified dividends or long term capital gains	$ 293,110		
Qualified dividend income long-term capital gains realized after May 5, 2003	167,492		
Adjusted Gross Income (Form 1040, Page 1, Line 34)	460,602 *		
Adjustments to Compute Alternative Minimum Taxable Income, Net	(931) *		
Alternative Minimum Taxable Income, Before AMT Exemption	$ 459,671		
Less: AMT Exemption: None … fully phased-out because of high income	0		
Alternative Minimum Taxable Income, After AMT Exemption	$ 459,671		
Calculation of AMT			
First AMT Bracket at 26%	$ 175,000	26%	$ 45,500
Second AMT Bracket … Remainder of Regular AMTI at 28%	117,179	28%	32,810
Subtotals	$ 292,179		$ 78,310
The preferential rates also apply for AMT purposes to qualified dividend income and the capital gains. Therefore, the balance of the AMT is calculated using the flat 15% rate.	167,492	15%	25,124
Alternative Minimum Taxable Income	$ 459,671		
Tax on AMTI			$ 103,434
Less: Regular Income Tax, as Computed			(99,534)
***Alternative Minimum Tax** (Form 1040, Page 2, Line 42)*			$ 3,900 **

Notes:

* Instead of claiming itemized deductions in Schedule A of your tax return, you claimed a standard deduction of $11,400. Therefore, the calculation of your Alternative Minimum Taxable Income is rather straight-forward, and it basically starts with your Adjusted Gross Income of $460,602.

** If the tax on the Alternative Minimum Taxable Income as computed ($103,434) exceeds the regular income tax as computed ($99,534), the Alternative Minimum Tax is the difference between these two amounts. This amount (i.e., the difference or $3,900) is added to the regular income tax so that the total tax liability for the year equals the amount of tax computed on the Alternative Minimum Taxable Income.

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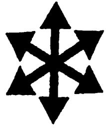

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April ___, 2004

Dear Case IV Client:

This letter explains the ***tax savings of over $41,500 ... $41,587 to be exact ...*** that you received in your Federal income tax return for 2003 resulting from the lowered tax rates for qualified dividend income and for certain capital gains.

* * *

*[See **Standard Background Information Paragraphs**, omitted here due to space limitations.]*

* * *

You cannot easily see these new tax rates or your tax savings anywhere on the schedules in your tax return. The problem lies in picking out how much of the qualified dividend income and capital gain is taxed at the respective 5% and 15% flat rates. In fact, even though your taxable income for 2003 was $256,138, none of that income was taxed at the 33% rate which is shown as the applicable rate in the Tax Rate Schedule for single taxpayers with taxable income between $143,500 and $311,950.

Your tax liability was calculated on a *tentative* basis using every tax rate through the 33% rate bracket; however, in the final analysis, because your taxable income was so high, your real tax savings turned out to be the difference between these 5% and 15% flat rates, and the rates applied to your Alternative Minimum Taxable income ... not to your regular taxable income.

Your taxable income for 2003 consisted of the following elements.

"Regular" Taxable Income less Deductions (i.e., the portion of your taxable income that does not consist of either qualified dividends or long term capital gains)	$ 53,551
Qualified Dividend Income	349,061
Net Long-Term Capital Gains realized after May 5, 2003	12,025
Total income Subject to Preferential Lower Rates	$ 361,086
Adjusted Gross Income (Form 1040, Page 1, Line 34)	414,637
Less: Itemized Deductions from Schedule A	(158,499)
Taxable Income	$ 256,138

(Continued)

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This shows two important facts. First, because of your large itemized deductions, your taxable income of $256,138 is less than the total of your qualified dividend income and long-term capital gains ($349,061 + 12,025 = 361,086). Second, from this it follows that all of your taxable income is considered to consist of income that is eligible for the 5%-15% preferential rates on eligible dividend income.

As a result, the first $28,400 of your regular taxable income that would have been taxed at 10% (in the lowest tax bracket) is instead taxed at 5%. All of your remaining taxable income ($227,738) is taxed at 15%.

Alternative Minimum Tax (AMT). You were subject to the Alternative Minimum Tax for a number of reasons including ...

1. Large itemized deductions in Schedule A, especially for state income taxes, real estate taxes and other miscellaneous itemized deductions,

2. The other items of tax preference that flow-through from various trusts and other sources and from interest income earned on some municipal bonds that are referred to as "Private Activity Bonds," and

3. The complete phase-out of the exemption amount otherwise allowable against the Alternative Minimum Tax because of your high-income status.

Note, however, that your charitable contribution deduction reduces your taxable income for both regular tax and Alternative Minimum Tax computation purposes.

Because the AMT applied, the actual amount of tax you paid for 2003, before credits, is $45,906 (Page 2, Line 43 of your tax return.) The calculation of this amount is shown below:

	Taxable Income	Tax Rate	Amount of Tax
The portion of the regular taxable income that is treated as consisting of either qualified dividend income or of long-term capital gains realized after May 5, 2003			
First $28,400	$ 28,400	5%	$ 1,420
Remaining regular taxable income that is treated as consisting of either qualified dividend income or of long-term capital gains realized after May 5, 2003	227,738	15%	34,161
Taxable Income per Above	$ 256,138		
Tax on Taxable Income			$ 35,581
Additional "income" subject to the Alternative Minimum Tax. This amount is also eligible for the flat 15% tax rate ...			
Net additional tax preference adjustments	68,836	15%	10,325
Alternative Minimum Taxable Income	$ 324,974		
Alternative Minimum Tax			$ 45,906

(Continued)

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The calculation summarized above is not to be found in your tax return schedules. It simply interprets the end result of the much more involved calculations that are part of the tax return schedules designed by the IRS.

The calculation above also shows two important facts, similar to those on the previous page. First, note that your Alternative Minimum Taxable Income of $324,974 is less than the total of your qualified dividend income and special capital gains ($361,086). Second, from this it also follows that all of your Alternative Minimum Taxable Income is considered to consist of income that is eligible for the 5%-15% preferential rates.

A detailed calculation of your Alternative Minimum Tax liability appears in Schedule I.

"Proof of Savings." If the lower rates had not been available, your entire 2003 tax liability would have been computed at the applicable Alternative Minimum Tax rates. Therefore, as shown below, your tax savings is the difference or "play" between the 5% and the 15% rates and the Alternative Minimum Tax rates of 26% and 28%.

Proof of "Tax Savings"	***AMTI***	***Rate of Savings***	***"Savings"***
Difference of Applicable AMT Rate (26%) Minus Flat Rate of 5% Equals 21%	$ 28,400	21%	$ 5,964
Difference of Applicable AMT Rate (26%) Minus 15% Flat Rate Equals 11% Applied to Remainder of Income Subject to 26% AMT Rate	146,600	11%	16,126
Subtotal for AMT first bracket cut-off	$ 175,000		$ 22,090
Remainder of Alternative Minimum Taxable Income Subject to 28% AMT Rate Minus 15% Flat Rate Equals 13%	149,974	13%	19,497
Alternative Minimum Taxable Income	$ 324,974		
"Tax Savings"			$ 41,587

In Summary. The bottom line is that your tax liability would have been $87,493 if there had not been a change in the rates. Because of the preferential lower rates, your tax liability was only $45,906. ***Thus, your tax savings in 2003 due to the lowering of tax rates on certain investment income was $41,587*** ... no matter which way you look at it.

Sincerely,

Willard J. De Filipps, CPA

Encl.: Schedule I

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Schedule I AMT

Calculation of Alternative Minimum Tax for Case IV Client

	Amount		
"Regular" Taxable Income less Deductions (i.e., the portion of taxable income that does not consist of either qualified dividends or long term capital gains)	$ 53,551		
Qualified Dividend Income	349,061		
Net Long-Term Capital Gains realized after May 5, 2003	12,025		
Total income Subject to Preferential Lower Rates	$ 361,086		
Adjusted Gross Income (Form 1040, Page 1, Line 34)	414,637		
Less: Itemized Deductions from Schedule A	(158,499)		
Taxable Income, Form 1040, Page 2, Line 38	$ 256,138		
Additions to Compute Alternative Minimum Taxable Income			
Real Estate and Other Taxes Deducted in Schedule A	$ 46,755		
Adjustment for Capital Gain Sales	16,559		
All Other Preference Items (net)	5,522		
Net Additions	68,836		
Alternative ***Minimum*** Taxable Income	$ 324,974		
Less: AMT Exemption ... None fully phased-out because of high income	0		
Base for Computation of Alternative Minimum Tax	$ 324,974		
Calculation of AMT		***Tax Rate***	***AMT Tax***
First Bracket at 26%	$ 175,000	26%	$ 45,500
Second Bracket ... Remainder at 28%	149,974	28%	41,993
Totals	$ 324,974		$ 87,493

Since qualified dividend income and preferential capital gains total $361,086 and the preferential rates also apply for AMT purposes, all of the AMT liability is calculated using the 5% & 15% rates.

Revised AMT Calculation			
First Level or Bracket of Preferential Income Taxed at 5%	$ 28,400	5%	$ 1,420
Remainder of Preferential Income Taxed at 15%	296,574	15%	44,486
Totals	$ 324,974		$ 45,906
Tax Savings for 2003 due to Lower Rates			***$ 41,587***

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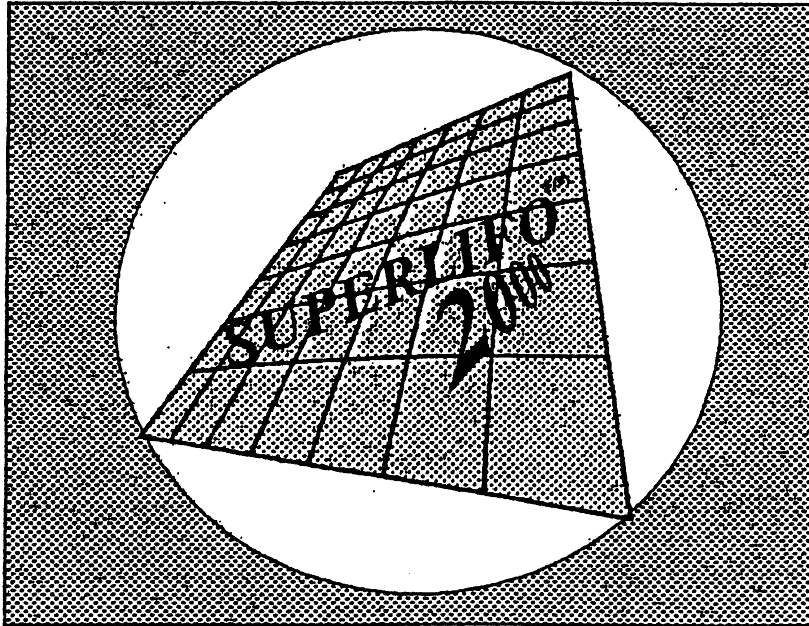

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De Filipps' DEALER TAX WATCH

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