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Inside this Issue:

- Flex Plan Rule Amended
- Tax Planning Thoughts
- Brown Armstrong Debuts as Fastest Growing Firm
- Privacy Policy
- Staff News
- Katrina Tax Relief Act

**BROWN
ARMSTRONG**
—
CERTIFIED
PUBLIC
ACCOUNTANTS

4200 Truxtun Ave. Suite 300
Bakersfield, CA 93309
Ph: (661) 324-4971
Fax: (661) 324-4997
Toll: (800) 565-1040
e-mail: bainfo@bacpas.com
www.bacpas.com

Flex Plan "Use-It-Or-Lose-it" Rule Amended

Employee benefit plans come in many different varieties. One plan, called a "flexible spending arrangement" or "flex plan," allows employees to set aside pre-tax dollars to pay for qualified benefits. Now the IRS has come out with a new rule that will make these plans even more flexible — and more popular.

How It Works

Typically, with a flexible spending arrangement, the employee elects to have a certain amount deducted from her/his pay before taxes are taken out. Then, the money is put into an account that is used to pay the employee's qualified expenses.

Qualified expenses can include the costs of employer-provided group health coverage, dependent care assistance, dental plans, qualifying group-term life insurance, and adoption assistance, depending on the terms of the plan. Often, out-of-pocket medical expenses (i.e., those not covered under the employer's health plan) are reimbursed with pre-tax money set aside in the plan.

One downside to a flexible spending arrangement is a rule providing that money set aside in a flex plan during one year cannot be used to pay expenses incurred

in a subsequent year. This "use-it-or-lose-it" rule requires amounts remaining in an employee's flex plan account at the end of the plan year to be forfeited.

Example: Joe elects to participate in his employer's flexible spending arrangement having a plan year ending December 31. Joe defers \$1,000 of his pay to his plan account during the year. At the end of the year, he still has \$100 left in the account. Under the use-it-or-lose-it rule, the \$100 would be lost.

New IRS Guidance

Recently, the IRS provided guidance with respect to the use-it-or-lose-it rule. The IRS now says an employer can

give employees a *two and one-half month grace period* during which unused benefits or contributions could be used.

The new rule allows — but does not require — employers to amend their flexible spending arrangements to provide all participants with a grace period lasting no longer than two and one-half months after the plan year ends.

Qualified expenses incurred during the grace period may be paid or reimbursed from account balances remaining unused at the

(Continued on page 2)



(Use It or Lose It - Continued)

end of the immediately preceding plan year. Any payments for qualified benefits made during the grace period will be treated as though they were made for expenses incurred in the earlier plan year.

Example: In the above example, Joe's employer adopts an amendment to its plan allowing participants a grace period of two and a half months after the plan year. On the February 15th following the plan year end, Joe incurs a \$100 medical expense. The flex plan may reimburse that expense from the prior year's balance and, as a result, Joe would not forfeit the \$100 balance remaining at the end of the prior plan year.

Impact on Participants

With this new guidance, the use-it-or-lose-it rule becomes less of a barrier to an employee's participating in a flexible spending arrangement. Now, a participant may have as long as 14½ months to use the benefits or contributions for a plan year before any amount would be forfeited.

There are, however, some restrictions on use of account balances during the grace period.

- Unused contributions or benefits cannot be cashed out or converted to any other taxable or nontaxable benefit.
- Unused money set aside for a specific benefit can only be used to pay or reimburse expenses for that benefit. Thus, money set aside specifically for dependent care may only be used during the grace period for dependent care, not for another benefit such as medical expense reimbursement.

The IRS says employers may continue the current practice of providing a "run-out" period. The run-out period may extend after the end of the grace period, allowing additional time for expenses incurred during the plan year and grace period to be submitted and paid.

Steps To Take

An employer can adopt a grace period for the current plan year by amending the plan document before the end of the plan year. So, if you offer employees a flex plan with a plan year ending on December 31, 2005, you can provide a grace period for the 2005 plan year by adopting an amendment by that date.

Before you take any action, however, be sure to talk with one of our professionals, who can review your plan with you and help you determine which approach is best for you and your employees. And, if you don't already have a flexible spending arrangement, see us for more information about how such a plan might benefit your organization.

Tax Planning Thoughts . . .

Even with the year nearly gone, you still have time to save income taxes for 2005. The federal tax law provides many opportunities for taxpayers to cut their tax bills. All you need to do is identify and implement appropriate planning strategies.

Know Where You Stand Income-wise

Now is the time to get out your last pay stub and see how much income you've earned this year. Take a look, too, at your savings and investment statements and any other paperwork showing how much investment income you have earned. Then, estimate how much more salary, interest, dividends, and other income you might expect for this year. Add up the totals to see how your estimated 2005 income compares to last year's total income. Use that comparison to estimate how much more or less income you are likely to have this year.

Business Tax Breaks

Make sure to take full advantage of the business growth incentives that the tax law gives you.

Included among these provisions is the ability to write off up to \$105,000 of the cost of qualifying business assets in the year of purchase (rather than depreciating the assets over time). And, if your business is involved in manufacturing or other "production activities" (which include such diverse activities as qualified property leasing, U.S. construction and architectural services, and qualified movie or TV film production), your company may be entitled to a deduction for a percentage of its business income from those activities.

Establish a Company Sponsored Retirement Plan

Today's typical employees are brighter and more financially perceptive than ever. Today's employers have learned that if they are to remain competitive in the attraction and retention of top-notch quality employees, they must provide a company sponsored, cost-effective employee retirement plan benefit. Recent surveys have proven that employees rank retirement plans among the highest benefit priorities.

(Continued on pg. 6)



Brown Armstrong CPAs Debuts in the 99th Position in Public Accounting Report's List of 100 Fastest Growing CPA Firms in America

Brown Armstrong CPAs has been ranked as the 99th fastest growing accounting firm in the United States by Public Accounting Report (PAR), a leading industry publication. The annual survey by PAR ranks firms based on percentage of increased revenues, while also listing information on the professional makeup and service offerings of the fastest growing firms in the nation. This is the first time Brown Armstrong has been included among this prestigious list of firms. Andrew Paulden, CPA and Brown Armstrong's Managing Partner, says, "This is an exciting

time for the firm. We've been working very hard to break into this prestigious list. Our team is building on our progress and we expect to move higher on the list in future years."

PAR reported that Brown Armstrong had a 9.1% increase in revenue with 7 owners, 39 professional staff, and 2 business offices located in Bakersfield and Shafter, California.

To view the Public Accounting Report visit the Press Room located on our website at www.bacpas.com.



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NOTICE OF PRIVACY POLICY

Information Only – No Response Necessary

To Our Valued Clients and Friends:

To better serve you, Brown Armstrong has a strong commitment to protecting your privacy. As long as you are a client, we are required by law to send you an annual “Notice of Privacy Policy” that describes our policies and procedures that protect your privacy.

Federal and California privacy laws require tax preparers and others to destroy financial records of their clients. These laws require that businesses must take all reasonable steps to destroy, or arrange for the destruction of, all customer records no longer being retained by the business that contain personal information on customers. The destruction must be made by (1) shredding, (2) erasing, or (3) otherwise modifying the personal information in those records to make it unreadable or undecipherable through any means.

We want to ensure all of our clients that we have taken all the steps necessary to comply with these laws and have a secured shredding policy in our firm. Our service is through **Recall Secure Destruction**. Due to the seriousness of these laws, any violation of this policy can result in disciplinary action, including discharge.

All confidential information that might identify, relate to, describe, or is capable of being associated with a particular individual, company or agency in any form, such as drafts, workpapers, notes, telephone messages with unlisted numbers and/or financial and tax information, etc., is placed in securely locked recycle bins. The bins are then emptied into security trucks and transported to a lock-down facility where they are destroyed by hammermill shredding (pulverized).

We do not disclose, and do not wish to reserve the right to disclose, nonpublic personal information about our clients or former clients to affiliates or non-affiliated third parties.

Please call our office if you have questions about these laws or would like more information on how you can protect the confidential information of your clients.

Staff News

New CPAs On The Block



The firm is pleased to announce that ***Dominic Brown and Ryan Johnson*** have received their CPA license.



Dominic is a senior accountant in the audit division and Ryan is a senior accountant in the tax division.

Both are providing great service to our clients and we congratulate their success.

CPA Exam Results

The firm is pleased to announce the following accountants have passed all sections of the CPA exam...

Michael Olivares
Hanna Sheppard
Ryan Nielsen
Jian Ou-Yang
Jialan Su
Amanda Fedewa
Natalie Arduain

Welcome Aboard !



Mark Sturn recently graduated Magna Cum Laude from California State University Bakersfield with his accounting degree and is now a full time staff accountant since completing his internship with the firm.



Paul Sampietro recently graduated from California State University Bakersfield with his accounting degree and is now a full time staff accountant since completing his internship with the firm.



Charlotte Wilmert recently graduated Magna Cum Laude from California State University Bakersfield with her accounting degree and is now a full time staff accountant since completing her internship with the firm. She was the recipient of Brown Armstrong's CSUB Scholarship in 2004 for her academic achievements.



Heidi Rocha recently graduated Magna Cum Laude from California State University Bakersfield with her accounting degree and is now a full time staff accountant since completing her internship with the firm.



Tony Jones graduated with honors from Long Beach State in 1987 with a dual major in history and physical education. He recently completed additional accounting field course-work from California State University Bakersfield to pursue his CPA credentials. Since completing his internship with the firm in June, he is now a full time staff accountant.



Wendy Johnston recently graduated Magna Cum Laude from California State University Bakersfield with her accounting degree and is now a full time staff accountant since completing her internship with the firm in June. She was the recipient of Brown Armstrong's CSUB Scholarship for her academic achievements.

Tax Planning Thoughts continued...

The good news is that since employer contributions to a company sponsored retirement plan are a tax-deductible expense; employers experience an immediate tax break as they provide this employee benefit. Employees understand that as an employer uses a company sponsored retirement plan to hire and keep good people, an employee can use such a benefit to take advantage of sound tax-deferred investment earnings to accelerate the growth of their retirement savings.

There are many options in choosing the right plan for your company. These plans include 401(k) plans, Safe Harbor 401(k) plans, Profit Sharing plans, Money Purchase Pension plans, Defined Benefit plans, 403(b) plans, 457(b) plans and Deferred Compensation plans.

To learn which plan will work best for your company and other tax planning ideas, contact us today for a ***complimentary tax planning guide*** to find out the requirements you need to meet to take advantage of these tax breaks.

President Signs Emergency Tax Relief Act To Aid Katrina Victims, Volunteers And Donors; IRS Also Takes Action

Billions in relief

Immediately after Hurricane Katrina hit, Congress appropriated \$10.6 billion for relief work. Congress has since added \$51.8 billion and is likely to appropriate even more. In addition to these huge appropriations, Congress has passed the Katrina Emergency Tax Relief Act of 2005 (H.R. 3768). The new law gives Hurricane Victims - individuals and businesses - temporary tax breaks scored by the Joint Committee on Taxation at over \$6 billion.

To read the full report that includes checklists of major benefits, the scope of Katrina relief, how the IRS responds to victims, and the time-line for Katrina Act benefits, visit our website at www.bacpas.com.