

# THE Erblaw News

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## The ins and outs of your power of attorney

by Kelly Phillips Erb

A recent article in the Philadelphia Inquirer focused on a controversial clause in the state's power of attorney statutes. According to the Inquirer, Darby Mayor Paula M. Brown was being investigated as a result of questions raised over the management of finances for Michael Martyszko, over whom Brown held power of attorney. Ultimately, no charges were filed against Brown though the Delaware County District Attorney cited "poor judgment" on Brown's part regarding her handling of Martyszko's funds.

Under state law in Pennsylvania, an agent acting as power of attorney is entitled to "reasonable compensation" and reimbursement for "reasonable expenses." Those terms are not defined in the statute. Generally, professionals and financial institutions serving as agent will provide a statement of services which outlines any such compensation or expenses.

However, there is no such requirement in the statute, and friends or family may not think such documentation is necessary. So, how do you protect yourself?

First, understand what your Power of Attorney says. You can limit your agent's powers in a number of ways, such as access to accounts, specific instances where the Power of Attorney is to be used, and the scope of time or circumstances under which your agent is empowered to act.

Second, don't put off your Power of Attorney until the last minute! Think about it. This is a big decision. You are essentially asking someone to act in your shoes during a specific

period of time or instance. You'll want to give this some thought. Don't wait until you're getting on the plane to think about who you want to act on your behalf. Discuss your options with an attorney - and ask your potential agent whether he or she might be interested in serving. Don't get stuck with a decision that makes you uncomfortable because you procrastinate.

Finally, and most importantly, choose someone you trust to act on your behalf. You may love your spouse, oldest child or best friend, but that person may not be financially savvy or fully understand your circumstances. If that's the case, choose someone who can make those decisions in your best interest. This may be your accountant, your lawyer, your next door neighbor, a business partner or a combination of people. Make sure you are comfortable with your decision and remember that you can revoke a Power of Attorney at any time!

## For The Record...

By Kelly Phillips Erb

Chris is a pack rat. It's true. He has bank statements from his banks in Munich... He hasn't lived in Munich for about ten years. I don't know what possesses him to keep so many records. I think he holds onto things "just in case" he needs them<sup>1</sup>.

Many taxpayers either keep too many records or not enough. I often

1. Note from the editor: *Won't you feel silly when I do need them some day... even the electric bills from 1989 and my apartment lease from 1990. We won't even talk about the bank statements I have from when I was in college, and the pay statements from my first job. Museums are made of this stuff, so I am simply doing my part to preserve the legacy of the 1980s for future generations. If it wasn't for people like me, there'd be no Rosetta Stone, "Ah, that old thing? I don't need to read that any more. Throw it away!"*

get asked what records should be kept for tax purposes. Chris' track record notwithstanding, here are some recommendations about what kinds of records to keep and for how long:

### What to Keep:

1. Checkbooks. You can use your checkbook as a record of your income and expenses. Make notes about sources of deposits and reasons for expenses.
2. Computerized records. There are some excellent packages available for bookkeeping on your personal computer; a popular and relatively easy package to use is Quicken. While these packages are great, they aren't a substitute for other documents.
3. Receipts and sales slips. If you itemize, hold onto your receipts and sales slips. In particular, if you pay cash for doctor's appointments and medications, get receipts and make notes on the back for your reference. The same applies for gifts made to charities - if you make donations, hold onto your receipts. Generally, if you make a charitable contribution that is more than \$75 for goods or services, the organization must give you a written statement that you should keep; if it is \$250 or more, you must have writ-

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ten confirmation. You should also keep records of your out-of-pocket expenses when you perform services for a charitable organization. If you use your car when doing volunteer work or for medical purposes (i.e. going to the doctor), you should record the destination and purpose of the trip; keep records of unreimbursed gas and oil expenses. You should also keep a log of the miles you drove your car as well as any parking fees, tolls, taxi fares, and bus fares.

4. Home-related expense records. You will need to determine your home's value if you have a home office or if you intend to sell or rent your home in the future. Your records should show the purchase price, settlement or closing costs, and the cost of any improvements. You should also keep records of any casualty losses, such as those due to fire, flooding or storm damage, and insurance reimbursements those losses.
5. Employment-related records. If you have deductible expenses withheld from your paycheck, such as union dues or medical insurance premiums, keep your pay statements as proof of payment of these expenses.
6. Child Care expenses. Keep a record of the name, address, and EIN or SS number for all persons or organizations that provide care for your child or dependent.
7. Copies of tax returns. Prior years' returns can prove to be invaluable to prepare your current return and are absolutely necessary if you file an amended return.
8. Copies of official tax documentation. Keep your federal forms W-2 as well as federal forms 1099. Also keep bank statements, brokerage statements and forms K-1.

*A special note about brokerage statements!* Brokerage statements are an exception to the rule that you don't need to keep records indefinitely. You must be able to document your basis in order to accurately determine capital gains and losses. Keep records that include purchase price, sales price, and

commissions. Also keep documentation related to reinvested dividends, stock splits and dividends, load charges, and OID.

#### How should you organize?

This is completely up to you. You should keep your records in an orderly fashion and in a safe place. It's best to arrange them by year and type of income or expense. I recommend a home filing cabinet with records grouped by type and year. In the alternative, you can try an updated "shoe box method" and stash your records in a waterproof container; Rubbermaid makes great totes that serve the purpose nicely. Use a different container for each year.

#### How long should you keep records?

Generally, you must keep records that support items shown on your return until the statute of limitations for that return runs out. As a rule of thumb, this means three years. However, if you under-report income by more than 25%, that statute is extended to six years. If you do not file a return at all, there is no statute of limitations! This means that the IRS may request documentation for any year that you do not file - at any time.

### **Understanding Stock Options**

by Lorenzo Bacciardi

Has your employer ever given or offered you stock options? Did you know what they are or what to do with them? Stock options are a different form of compensation, sometimes referred to simply as "options," and enable an employee to acquire stocks in an employer's company. Options also provide the employee with an interest in the success of the employer, and is particularly popular in cash-poor or startup ventures.

Generally speaking, an "option" represents an offer to the employee to buy stocks at the "option price." The option price usually is lower than the

#### **Tidbits**

- The IRS has indicated that more than 4 million taxpayers have made errors on the Rate Reduction Credit line of tax forms. If you received your advanced payment last year, you should leave the credit line (line 47 on the form 1040, line 30 on Form 1040A and line 7 on Form 1040EZ) blank.
- So you have a great idea for a non-profit organization but the whole process seems a little daunting? Kelly will be teaching a course on forming and operating a nonprofit. Classes will be Tuesday nights, 7:00 pm - 9:00 pm on April 23, April 30 and May 7. To register, call the MALT Office at 215-843-6333.
- Kelly has also given a number of presentations for the art community, including *Taxation for the Freelance Artist* for students at the University of the Arts and *How to Keep Your Art Out of the Garage Sale: Estate Planning for the Visual Artist* before the College Art Association Convention. A new section on tax planning for artists has been added to the web site, so check it out.
- The Immigration and Naturalization Service (INS) reports that for the first quarter of 2002 (October 1, 2001, to December 31, 2001) approximately 28,000 H-1B petitions had been approved against the 195,000. An additional 18,000 petitions were pending.
- The Erb Law Firm, in cooperation with volunteers from Notre Dame University, Interac, and the IRS Volunteer Income Tax Assistance program, provided free tax assistance to seniors in March.
- Effective April 8, 2002, US passports will no longer be issued overseas. Instead, all passports will be issued by the National Passport Processing Center in Portsmouth, New Hampshire

market price of the stock; this is one of the advantage of options. In addition, you may benefit from the lower capital gain tax rate at the time of the sale of the stocks.

In many cases, no taxable income is actually recognized when stock options are granted, but income can be recognized when options are vested and have value. In addition, income is recognized when options are exercised and, ultimately, capital gain is reported when stocks are sold.

There may be a condition on your exercise of the option. Generally, the condition is employment based; that is, if you remain at your job for a fixed period of time. If you receive options that do not vest until a certain date, you will not recognize any income between the granting date and the vesting date. Additionally, when the options vest but do not have an ascertainable value, you still have no income to report. When the options do have an ascertainable value or are exercised, you have income in the amount that the fair market value of the stock exceeds the option price.

Finally, when the stocks are sold in the market, you may have capital gains or loss in the amount that the selling price differs from the fair market value. By way of example, say your employer grants you stock options on January 1, 1997 to buy 1,000 shares of company stocks at \$100 a share. The shares vest immediately, at the granting date, when the market value is \$130. You exercise the options the same day. On August 31, 2001, you sell the stocks for \$150 a share. What result? On January 1, 1997 you have ordinary income of \$30,000 because you receive a benefit of the right to buy the stocks at less than the fair market value of the stocks. In other words because of your employment, you were able to purchase \$130,000 of stock for \$100,000. Additionally, on August 31, 2001, you have \$20,000 of capital gain because you sold shares for \$150,000 for which you have a basis of \$130,000.

Options can provide you two main advantages. First, you have an opportunity to defer part of your compensation from immediate taxation. Second, you may subject the gain received from the sale of the stocks to the capital gain tax rate which is lower than the ordinary income rate. While the classic fixed salary guarantees you a constant income, such income is taxed immediately at a higher rate, eliminating the possibility to put in place some valuable financial and tax planning. In conclusion, ask yourself: do you have freedom of planning your investment with options? Options can be best for you provided that you meet the holding requirement and the stocks are expected to increase their value. If not, then the advantage of having options may not be as great as it is said to be.

#### Definitions

*Option.* a firm offer to buy stocks for a certain period of time. An option is said to be granted at the time the employer's board of directors makes the resolution.

*Option price.* the price at which the stocks are offered to the employee. The option is exercised when the stocks are purchased and transferred from the employer to the employee.

#### **IRS Weighs In**

*By Kelly Phillips Erb*

The IRS has released a ruling (Rev. Rul. 2002-19) regarding expenses for weight-loss programs which may qualify as medical deductions.

Taxpayers may deduct weight loss expenses as part of qualifying medical expenses to the extent the total of such medical expenses exceeds 7.5% of the adjusted gross income. Expenses related to weight loss programs are deductible as qualifying medical expenses if the expenses are medically necessary, such as the treatment of obesity or hypertension. However, health care expenses which are not

medically necessary but are merely to improve general health or appearances are not deductible.

The cost of diet foods remains non-deductible. This ruling applies to the taxable year 2001 and any years for which taxpayers may file amended returns (generally three years after the due date, or currently, 1998 returns).

#### **Still more tax incentives...**

*by Kelly Phillips Erb*

President Bush signed the revamped economic stimulus package, titled the Job Creation and Worker Assistance Act, on March 9, 2002. The new package contains \$38.7 billion in tax incentives spread out over ten years. Similar to the economic bill passed last year, the new law makes several tax breaks retroactive. This means that some of the tax benefits will be applicable for the 2001 tax year, even though those returns are to be filed by 15 April 2002.

The tax benefits are as follows:

#### Businesses

As expected, businesses receive the most benefit under the new law.

*Depreciation.* An additional first-year depreciation deduction equal to 30% of the adjusted basis of qualified property is allowed retroactive to 2001. The 30% "bonus depreciation" is allowable for regular and AMT purposes for the tax year in which the property is placed in service. Eligible property includes:

- Property with a recovery period of 20 years or less;
- Water utility property;
- Non-IRC §197 computer software; and
- Qualified leasehold improvements.

To qualify, property must be purchased between September 10, 2001 and September 11, 2004, and placed in service before January 1, 2005. The basis of the property and the deprecia-

tion allowances in the year of purchase and in later years must be adjusted to reflect the additional first-year depreciation deduction.

*Net operating losses.* The new law temporarily extends the general carry-back period for net operating losses from two to five years. In addition, three-year NOLs, like casualty losses, can be carried back five years.

The losses must arise in taxable years ending in 2001 and 2002. There is one opportunity to elect out of this treatment and the election is final.

*Method of accounting.* The new law allows for the use of the non-accrual experience method of accounting only for amounts to be received for the performance of qualified services (e.g., health, law and consulting) and for services provided by certain small businesses.

*Electronic transmittal of Forms 1099.*

Prior to the new law, forms 1099 must be presented to the taxpayer either in person or via first-class mail. The new law now allows forms 1099 and other information returns to be sent electronically so long as the recipient agrees.

*Extensions of expiring business tax credits.* The new law extends many business tax credits which had expired on December 31, 2001, to December 31, 2003. These credits include:

- Work Opportunity Tax Credit;
- Welfare-to-Work Tax Credit;

- Taxable income limit on percentage depreciation from marginal wells;
- Clean-fuel vehicle deduction;
- Suspension of reduction of deductions for mutual life insurance companies; and
- Other energy incentives.

*Discharge S-Corp indebtedness.* The new law reverses the Supreme Court's decision in *Gitlitz v Commr*, 531 US 206 (2001). The new law does not treat the amount discharged and excluded from an S corporation's income as an item of income by a shareholder. Consequently, the shareholder's basis is not increased. Generally, this applies to discharges of indebtedness after October 11, 2001.

*NYC Liberty Zone.* Additional tax incentives are available to taxpayers in a special "Liberty Zone" located in southern Manhattan. These breaks are in addition to those in the Victims of Terrorism Tax Relief Act of 2001.

Individuals

*Limited AMT relief.* EGTRRA (2001) made permanent the use of child tax and adoption credits against AMT but did not extend the other personal credits beyond their cut-off date of December 31, 2001. The new law allows taxpayers to make full use of all the nonrefundable tax credits for an additional two years, through December 31, 2003.

*Teachers.* The new law allows teachers to take an above-the-line deduction for classroom expenses. Educators, in elementary and secondary schools, will be able to deduct qualifying classroom expenses up to \$250 annually for 2002 and 2003.

*Archer Medical Savings Accounts.*

The new law extends the use of the Archer Medical Savings Accounts through December 31, 2003.


The bill also includes some technical corrections related to EGTRRA and pre-EGTRRA laws.

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The Erb Law Firm, P.C.  
5235 Ridge Avenue  
Philadelphia, PA 19128  
Telephone: 215.508.4419  
Facsimile: 215.508.4428  
erblaw@erblaw.com

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Return to: The Erb Law Firm, PC, 5235 Ridge Avenue, Philadelphia, PA 19128, phone 215-508-4419, fax 215-508-4428, [www.erblaw.com](http://www.erblaw.com)