

The Alternative Minimum Tax: An Additional Burden for Maine Taxpayers

By Peter Way, Supervisor

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Quill

NEWSLETTER

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Although federal tax rates for individual taxpayers are uniform across the country, and do not vary from state to state, living in Maine can increase your overall income tax liability. More and more Maine taxpayers are finding that factors within this state are causing them to effectively lose their federal itemized deductions for real estate, excise, and state income taxes, thus many pay more in federal taxes than they once would have under similar circumstances. Whereas in the past, the pinch of increases in state and local taxes was typically lessened by the federal tax saved thereon by claiming them as itemized deductions, this is often no longer the case. All this comes at a time when individual federal income tax burdens have supposedly been reduced, and while the steady increase in real estate taxes throughout Maine makes daily headlines.

The reason for this effective increased federal tax load for many Mainers is the loss of their ability to deduct all or part of their real estate, excise, and state income taxes. Why? This is because of the Alternative Minimum Tax (AMT), which was introduced by Congress in the 1970's as a way of making sure that the most creative, but legal tax avoiders, paid at least a minimum tax. Subsequently, investors in such devices as R&D, oil exploration, incentive stock options, passive activities, and other transactions may have found themselves with a lower regular tax but ended up paying some additional tax in the form of AMT. In recent years the AMT has netted more and more 'ordinary taxpayers', who do not engage in any special tax strategies, but nonetheless find themselves subject to this additional tax.

The reason that more Mainers are becoming subject to this tax is that, in addition to the more exotic AMT items noted above, real estate, excise, and state income taxes are not allowed as deductions when computing AMT. If AMT is higher than the regular tax, then that is the tax that is due. In effect, these deductions are wasted. Because of our high state income tax burden, rising real estate tax load, and Maine's non-conformity to recent federal legislation dealing with depreciation deductions available to businesses, more Maine taxpayers are now snared by AMT. When Maine taxpayers lose the ability to deduct all or a part of these Maine based taxes, they wind up paying a higher overall tax than those in states with lower real estate, excise, and state income taxes.

Thus, many non-wealthy Maine taxpayers are finding their overall tax burden growing faster than their counterparts in other states and that the benefits of recent federal tax rate reductions are being negated by increased exposure to Alternative Minimum Tax. It is unlikely that Congress will address the growing unintended application of this tax due to the magnitude of the potential revenue loss to the federal government. Thus, Mainers are stuck with a disproportionately higher exposure to AMT and a resulting overall higher tax burden than their counterparts in other states. They are left only with the prospect of more tax planning to try and offset some of the potential exposure to AMT. Be sure to call RKO to determine the impact of AMT on your tax returns.

Non-Profit Organizations and Audit Committees

By Laura Bryant, In-Charge Accountant

There are a number of important reasons non-profit organizations set up audit committees. These reasons include: the sharing of responsibilities, involving more members, using the specialized skills of members, helping inexperienced members gain confidence, examining issues in greater detail, and completing business in a more efficient manner. Audit committees especially help to complete business more efficiently and effectively by taking some of the financial responsibilities from the board of directors.

There are a few questions an organization should consider before establishing a committee:

- What is the purpose of the committee?
- What are its responsibilities and limitations?
- What are its specific tasks?
- When should the job be completed and what type of report is expected?
- What is the role of officers and how are committee members picked?
- Is there a committee budget?
- What authority does the committee have?
- What resources are needed? Are any already available?

Once a non-profit organization has determined they should develop an audit committee, the board of directors should assign responsibilities and tasks to this committee. An audit committee basically has two missions. First, it helps the board of directors to oversee establishment of, and adherence to, appropriate accounting policies and internal controls. This helps ensure that the organization issues financial statements and reports on time and in accordance with applicable laws and regulations. Second, the audit committee encourages and facilitates communication between the board, organization management, and internal and external auditors to ensure the open and accurate exchange of ideas and information.

Responsibilities for an audit committee depend on the organization, its size, the nature of its activities, and the responsibilities that have already been assigned to other committees. A few common tasks that are assigned to an audit committee are:

- Recommending an independent audit firm to the board of directors
- Reviewing the scope and plan for the independent audit
- Reviewing the results of the audit with the external auditors
- Providing oversight of the internal structure
- Resolving disagreements between auditors and management

(Note: If a non-profit organization does not have an audit committee, these tasks would most likely be completed by their budget and finance committees.)

If an audit committee is new to a non-profit organization, the board of directors should draft a charter or bylaws that spell out the audit committee's specific responsibilities.

When the organization is considering potential members for the audit committee, it should start by reviewing their backgrounds. The organization should try to find members with solid experience in business and finance. They should also have a good understanding of internal control issues and should be familiar with financial statement terminology. If no members of the board have this type of experience, the organization could turn to a banker, an accountant, or other financial professional to fill this position. There should be three to five members on the audit committee, depending on the size of the organization and the size of the board.

Audit committees must work with a variety of the organization's groups including the board of directors, the management team, and if applicable, an internal audit department. The audit committee assists the board with its financial responsibilities by acting as a liaison between the internal and external auditors, management, and the board. The audit committee also helps to filter out financial reporting and internal control issues that do not require the board's full attention, and prioritizes issues that should get the board's full attention. Even though the management of the organization is responsible for establishing internal controls within the organization, the audit committee is responsible for seeing that those controls are sufficient and being followed. The responsibility of an external auditor is to report on the internal controls and make suggestions for improvement where they feel necessary. The role of an audit committee is to discuss the issues reported by the external auditor to management and review management's plan to address the issues at hand. Management should inform the audit committee whether they agree with the external auditor's recommendations, or otherwise propose an alternative solution due to costs.

An audit committee will spend the majority of its time dealing with the external auditors of an organization. The audit committee will deal with two major areas: evaluating the auditors and reviewing the auditor's report. When evaluating the external auditors some of the key areas the audit committee should check are: industry expertise, tax capabilities, consulting capabilities, manpower, location, price, use of technology, and staff rapport.

This is just a brief overview of the responsibilities of an audit committee. A committee's duties will vary from one organization to another. Depending on an organization's size and structure, RKO has begun suggesting that the use of an audit committee in non-profit organizations represents a 'best' practice.

Health Savings Accounts

By Peter McPartland, Senior Accountant

As part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Congress approved a new type of account called the Health Savings Account (HSA). Effective January 1, 2004, HSAs allow certain health insurance policyholders to set aside money, tax free, to cover future personal health care costs. HSAs were created in response to the rising costs of healthcare in recent years.

HSAs are tax-exempt accounts held with a financial institution in which individuals can accumulate savings to pay for medical expenses. Contributions made and income earned on funds in the accounts are 100% tax-free. The account allows you to enjoy tax reductions while paying affordable health insurance premiums and decreasing your out-of-pocket expenses without risking health insurance protection.

How do HSAs work?

There are 2 basic components of HSAs: (1) The only requirement for an individual or family to qualify for an HSA is that they must have health insurance coverage under a Qualified High Deductible Health Plan (QHDHP). Such a policy provides important health care benefits, but with relatively modest premiums. Typically, with health insurance plans, the higher the deductible, the lower the annual premiums. For the tax year 2004, a QHDHP is defined as having an annual minimum deductible amount of \$1,000 for an individual and \$2,000 for a family and having an out-of-pocket expense maximum of \$5,000 for individuals and \$10,000 for family coverage. Health insurance providers and/or agents can disclose to you whether or not the high-deductible plans they offer are qualified. (2) A qualified tax-exempt Savings Account with a financial institution accumulates savings to pay for future medical expenses. Contributions are tax deductible and income earned on funds in the HSA grow deferred and are not taxed when distributed to pay qualified medical expenses. The account can be used for qualified medical expenses until the stated deductible has been met and insurance coverage begins. Funds can also be used for dental, vision, and other services that may not be covered under the QHDHP.

Benefits of opening an HSA are as follows:

1. Eligible contributions are 100% tax deductible.
2. Investment earnings on contributed amounts are tax-free (or deferred).
3. Lower health insurance premiums paid under the required QHDHP.
4. Money saved can be used for qualified medical expenses tax-free for life as outlined by the IRS.
5. Money saved can also be used to pay COBRA or other medical insurance premiums during periods of unemployment or temporary layoff.

Why were HSAs created?

Congress approved HSA legislation to provide a financial incentive for individual consumers and employers of all sizes to provide more affordable health insurance and put health care decisions back in the hands of the consumers. HSAs are a part of the movement towards Consumer-Driven Healthcare. They will allow employees to retain contributions made on their behalf in the event they change employers. Also, unlike the typical pre-tax Section 125 "cafeteria plans" presently utilized by many employers, HSA assets are not lost if not used within a one-year period. Assets can be carried over from year to year with the opportunity to save unused funds to cover future medical expenses.

What can an HSA be used for?

Amounts that have accumulated in an HSA are intended to be withdrawn and used for qualified medical expenses. If amounts contained in an HSA are not needed for medical purposes, they may, however, be withdrawn penalty free for other uses after the individual reaches age 65, or if death or disability occurs. HSA withdrawals for non-qualified medical expenses must be added to the beneficiary's gross income and thus taxed in the year distributed; a 10% penalty also applies. In addition, HSA savings can, similar to IRA assets, be rolled over to another HSA once every 12 months, but may not be combined with IRA assets.

Who receives a decedent's unused HSA assets?

Like an IRA, the assets of an HSA become the property of a named beneficiary upon the account holder's death, or go to their estate if no beneficiary is named. A spouse beneficiary can treat such assets as their own account, while a non-spouse must include them as ordinary income for taxation purposes.

New Audit Standards for Fraud

By Chris Stevenson, Senior Accountant

Professional standards have long required auditors to be aware of potential fraud risks within an organization and to communicate these risks to the appropriate client personnel. In addition, auditors have been responsible for annually documenting overall fraud risk on each engagement and obtaining reasonable assurance that financial statements are free from material misstatement due to fraud. On October 15, 2002 the American Institute of Certified Public Accountants (AICPA) and the Accounting Standards Board expanded auditor responsibility for the detection of fraud with the issuance of Statement on Auditing Standards (SAS) No. 99.

Effective for audits of financial statement for periods beginning on or after December 15, 2002, SAS 99 mandates, at a minimum, the audit team (1) perform a group brainstorming session identifying potential fraud risks associated with the client, (2) interview several client personnel, both financial and non-financial, concerning their knowledge of fraud or fraud risks, (3) formally document the client's specific fraud risks based on the brainstorming session and personnel interviews, and (4) perform audit procedures aimed to specifically address identified risk areas.

The audit procedures performed will vary from client to client, but on all engagements the audit team must respond to the potential for management to override controls. It is the AICPA's position that since management is often in a position to override controls, every audit must, at a minimum, include procedures to respond to the risk of management override of controls.

The AICPA has made it known that SAS 99 is the first of a multi-step antifraud program. Through the multi-step initiative the AICPA hopes to improve the likelihood that any fraud being committed by the client is revealed through the audit process and to restore confidence in the accuracy of audited financial statements. On SAS 99 AICPA President and CEO Barry Melancon states: "The standard reminds auditors that they must approach every audit with professional skepticism....it puts fraud at the forefront of the auditor's mind."

CONTACTING RKO JUST GOT EASIER.....

We have restructured our South Portland office's front desk coverage in an attempt to expedite your phone calls. While RKO will still normally have someone at the front desk to greet you and/or take your call, we will at various times throughout the day be offering an automated phone-in option which will give you the choice of bypassing the receptionist and dialing your party's extension directly. For your convenience we have included below an updated list of phone extensions, sized to cut out and put in your Rolodex. Our Waterville office phone coverage will remain unchanged.

Runyon Kersteen Ouellette

| | <u>South Portland</u> | <u>Waterville</u> |
|-----------|-----------------------|-------------------|
| Telephone | 207 773 2986 | 207 877 9397 |
| Toll Free | 800 486 1784 | 800 639 2160 |
| Facsimile | 207 772 3361 | 207 877 9398 |

**RKO Employee Extensions
South Portland Office**

| | | | |
|----------------|-----|------------------|-----|
| Paul Ainsworth | 409 | Paula Henckel | 402 |
| Amy-Jo Brown | 425 | Roger Lebreux | 406 |
| Ryan Brown | 423 | Casey Leonard | 419 |
| Steve Bruning | 438 | Angela Matson | 431 |
| Laura Bryant | 434 | Peter McPartland | 417 |
| Greg Chabot | 408 | Rob Neal | 421 |
| Barbara Childs | 428 | Sheena Pass | 424 |
| Todd Cloutier | 415 | Meghan Rochefort | 427 |
| Patty Donahue | 403 | Amy Rossignol | 422 |
| Mike Dubois | 414 | Chris Stevenson | 426 |
| Hank Farrah | 410 | Kathy Tyson | 405 |
| Almalee Foote | 407 | Jack Sullivan | 416 |
| Don Gaudet | 413 | Jaimee Watts | 420 |
| Jennifer Giles | 430 | Peter Way | 433 |

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