

CALIFORNIA TAX AMNESTY PROGRAM

by Dennis M. Veeh, CPA

The Franchise Tax Board and State Tax Board of Equalization are each running a tax amnesty program from February 1, 2005 through March 31, 2005. Individuals, businesses, and other taxpayers are eligible to participate in these programs. Tax amnesty allows taxpayers to be relieved of most unpaid civil and criminal penalties and fees for taxable years beginning before January 1, 2003. Generally the amount of the past due tax and interest must be paid by May 31, 2005 in order to qualify, unless an amnesty installment agreement has been requested. Penalties that can be forgiven include:

- Late filing penalty
- Late payment penalty
- Failure to file on demand penalty
- Understatement of estimated tax (FTB only)
- Any other civil penalties
- Cost recovery fees
- Criminal penalties

Taxpayers who should consider applying for the tax amnesty include those who:

- Have an unpaid balance due
- Have not filed income tax or sales and use tax returns
- Have unreported income/sales/purchases or questionable deductions
- Are involved in a state audit, protest or appeal
- Have a federal assessment but have not been notified or paid the state's comparable assessment

The general requirements in order to qualify include (1) file an amnesty application during the amnesty period, (2) file any tax returns, including amended tax returns, on or before May 31, 2005, and (3) pay all taxes and interest by May 31, 2005.



CALENDAR

- March 1** Due date for tax returns of taxpayers filing as farmers
- March 4 – 6** Fresno State Winemaster's Weekend, Tenaya Lodge. For information visit: www.tenayalodge.com
- March 11** Common Threads luncheon event at CSUF. For ticket information call (559) 278-4266
- March 15** Due date for tax returns of calendar year-end corporations
- April 15** Due date for individual tax returns
- June 5** A Celebration of Wine, Dennes Coombs Riverbend Ranch in Madera. For ticket information call (559) 244-5741

TAXABILITY OF SOCIAL SECURITY BENEFITS: ARE YOU CONFUSED?

By Toni Porter, CPA, MST

Depending on the taxpayer's other income, they could wind up paying tax on up to 85% of their Social Security benefits.

Social Security income used to be tax-free to all, but that's no longer so. Depending on the taxpayer's other income, they could wind up paying tax on up to 85% of their Social Security benefits, at a time when they need steady income the most. There may be strategies that will reduce the exposure to federal income tax on Social Security benefits.

What causes Social Security income to be taxed, and if so, to what extent? Following are the rules in brief:

- Social Security benefits completely escape federal income taxes if adjusted income for the year doesn't exceed \$32,000 for married taxpayers filing a joint return, or \$25,000 for single taxpayers and heads of household. The base amount is zero for taxpayers who are married at the close of the taxable year, do not file a joint return for the year, and do not live apart from their spouse for the entire year.
- Up to one-half of Social Security benefits will be subject to federal income taxes if adjusted income for the year is over \$32,000 but doesn't exceed \$44,000 (for married taxpayers filing a joint return), or is over \$25,000 but doesn't exceed \$34,000 (for single taxpayers and heads of household).
- If adjusted income for the year is over \$44,000 (married taxpayers filing a joint return) or over \$34,000 (single taxpayers and heads of household), more than 50% of the benefits will be subject to federal income tax. Depending on income and benefit levels, a taxpayer may pay tax on more than 50% but less than 85% of their Social Security benefits, or in some cases may pay tax on a full 85% of their benefits.

For most people, "adjusted income" for purposes of determining how much of the benefits is taxed is (1) regular adjusted gross income, plus (2) tax-exempt income (such as tax-exempt bond income), plus (3) one-half of the Social Security benefits.

If there is a chance that Social Security income will be subject to federal income tax, a taxpayer may be able to reduce their exposure by using the following techniques:

- Consider switching some funds into investments (such as annuities) that pay monthly amounts that include a tax-free return of capital component. That part of each annuity payment representing the investment is not currently taxed and is not factored into the calculation of how much Social Security income is subject to tax.
- If a taxpayer currently is not expending all of their investment income on living expenses, they can defer as much income as possible. For example, the interest buildup in U.S. Government Series EE bonds isn't taxed until the bonds are redeemed. In addition, taxpayers can defer taking cash out of their IRAs and qualified plan accounts for as long as possible.
- If they have the choice, a taxpayer can consider withdrawing interest from their municipal bond funds before withdrawing cash from IRAs for living expenses. This helps because municipal bond interest they earn is taken into account when computing the tax on Social Security benefits, but interest and dividends accumulating in an IRA account are not taken into account.

continued on next page

Bear in mind that taxes should never be the motivating factor behind an investment decision. It's important to consider the financial, investment, and tax situation in detail before using one of these techniques.

Social Security Earnings Limit

One category of taxpayer that for years has seen its Social Security benefits reduced because they continued to earn a salary or work for wages after reaching retirement age—but before reaching age 70—have had a pleasant surprise, thanks to recent legislation. Whereas these taxpayers formerly received reduced Social Security benefits (\$1 for every \$3 they earned in excess of the exempt amount of \$17,000 in 2000), they now receive their full Social Security benefit without any reduction. Many of these workers between the ages of 65 and 70 are turning for help in understanding just how the new rules affect them. For a “non-tax” provision, the repeal of the earnings limit impacts a surprising number of tax strategies.

The Senior Citizens’ Freedom to Work Act of 2000 is effective for tax years ending after December 31, 1999. It repealed the “earnings limit” rule for taxpayers in the 65-70 age group; that is, those at and above full retirement age (presently, age 65) through age 69. Those age 70 and above can, as before, continue to earn unlimited amounts without any reduction in Social Security benefits, while retirees under the age of 65 (i.e., full retirement age) still have their benefits reduced by \$1 for every \$2 they earn over the \$11,640 exempt amount for 2004 and over \$12,000 for 2005.

New Tax Considerations

Since income tax is not withheld on Social Security, estimated tax may be necessary if not enough tax is withheld on other income.

Affected taxpayers should remember that estimated tax payments are due on April 15, June 15, September 15, and January 15.

Even though Social Security benefit payments are not automatically subject to withholding, a taxpayer may request to have federal income tax withheld from them. The payment then is treated as wages paid by an employer to an employee for purposes of federal withholding.

The stock market run-up and the trend toward short-term trading has resulted in many retirees having considerable capital gains. Seniors should watch that the hidden cost of capital gains does not result in a larger portion of Social Security income taxed, even though more Social Security benefits may be received as a result of the new law.

Full retirement age

Some people dream of retiring early. Others prefer to continue working and saving money until they are age 65, or even past age 65. Although other issues—such as benefits available from an employer—factor into a decision about when to retire, a worker has three options under the Social Security system:

- (1) Retire before full Social Security retirement age, with a reduced benefit.
- (2) Retire with a full benefit at full Social Security retirement age.
- (3) Continue working past full Social Security retirement age and earn additional benefits for each year of work until reaching age 70.

Although most people think of 65 as the “magic” age for retirement—the age at which a worker can stop working and receive a full Social Security benefit—this is true only if the worker reached age 65 before 2003. If born in 1938 or later, a worker is not eligible to retire with full benefits until he reaches the age indicated in the following table:

continued on page 6

Bear in mind that taxes should never be the motivating factor behind an investment decision.

PROTECTING YOUR ASSETS: ANTIFRAUD PROGRAMS AND CONTROLS

By Brandon Vance, CPA, CFE

In agriculture there are several key measures, or indicators, which are monitored to help determine the vitality of your business, such as yield per acre, gross profit per acre and pack-out percentages. While these are definitely important in terms of measuring the performance of your operations, I believe that there is something of equal significance that must be reviewed—antifraud programs and controls.

Why Antifraud Programs and Controls?

Antifraud programs and controls are designed, in effect, for the protection of your business. They can determine the types of employees to hire, establish the ethical culture, provide traditional internal controls (segregation of duties, proper oversight, etc.), and as a result, prevent losses due to fraud.

Responsibility – Management is responsible for designing and implementing programs and controls to prevent, deter and detect fraud. Although significant publicity is often focused on external auditors if fraud is detected, you as management are ultimately responsible. This responsibility is not a new one. It has always been management's responsibility to ensure a system of sound accounting policies for establishing and maintaining internal control that will, among other things, initiate, record, process and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

Protection – Fraud loss is something experienced by most companies, regardless of size or industry, including agriculture. According to the Association of Certified Fraud Examiner's 2004 Report to the Nation on Occupational Fraud and Abuse, the typical U.S. organization loses 6% of its annual revenues to fraud. The

same report determined that small businesses (those with less than 100 employees) were the most susceptible to fraud, and that those frauds resulted in a median loss of \$98,000. The Report also concluded that more effective internal controls are needed in businesses in order to detect fraud and that the most cost-effective way to deal with fraud is to prevent it—in other words, to be proactive in designing and implementing antifraud programs and controls.

In the past few years, fraud has increasingly come into the public eye with high profile cases such as Enron, WorldCom, HealthSouth and others. Fraud such as that which occurred in these companies, as well as in many others throughout the country, could have been prevented, or at the very least, have been detected much earlier had the proper programs and controls been in place.

What are Antifraud Programs and Controls?

Antifraud programs and controls are the policies and procedures put in place to help ensure that management directives are carried out. They are part of the overall system of internal control established to achieve reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. An effective and comprehensive system of antifraud programs and controls should encompass three basic elements—prevention, deterrence and detection.

Prevention – helps to ensure that fraud cannot occur because the opportunity does not exist, or the pressures that motivate a person to commit fraud are eliminated. For example, a company policy that screens all new employees through the use of drug tests and background checks

continued on next page

The greater the perceived risk of detection and apprehension, the less likely a person is to commit fraud.

could help eliminate the hiring of individuals who naturally might have a higher tendency to commit fraud, particularly in the area of theft. Thus, such a control over the hiring process helps to ensure that the company does not employ individuals who might be more inclined than the average individual to commit fraud.

Preventative techniques are important in an overall program to reduce fraud because the actual loss due to fraud can greatly exceed the cost of establishing and maintaining a fraud prevention program. Fraud can cost monetary damage through theft of assets as well as corruption schemes, such as kickbacks and bribes. Fraud can also have a damaging effect on your business's good reputation if fraudulent financial reporting is uncovered.

Deterrence – helps to modify behavior through the threat of sanctions. The terms prevention and deterrence are often confused and used interchangeably. However, prevention implies removal of the root cause of the problem, while deterrence modifies behavior so that individuals will not attempt to commit fraud. The perceived threat of getting caught generally is considered one of the strongest deterrents against fraudulent actions. It is important to note that it is the perpetrator's perception of the chance of getting caught that modifies his or her behavior by persuading the individual to abandon the thought of committing fraud. The greater the perceived risk of detection and apprehension, the less likely a person is to commit fraud. Deterrence, like prevention, is another proactive activity designed to stop the fraud before it occurs.

Detection – helps to uncover fraud if it occurs. Fraud detection is often difficult because fraud commonly involves concealment through falsification of accounting records and documents and/or collusion. In addition, fraud detection, investigation and apprehension are more costly than providing protection through prevention and deterrence programs and con-

trols. The following are examples of policies or procedures that may be used to detect fraudulent acts:

- Comparing actual financial performance between two related periods
- Comparing actual financial performance to budgets
- Providing customers or vendors incentives if they report suspected fraudulent activities

Implementing a System of Antifraud Programs and Controls

In establishing fundamental activities to circumvent fraud through prevention, deterrence and detection, it is necessary to create and implement a system of programs and controls designed to respond to the three conditions that generally are present when fraud occurs—incentives/pressures, opportunity, and rationalization.

- Incentives/pressures exists when an individual has a reason to commit fraud.
- Opportunity occurs when circumstances exist that allow an individual to believe that the opportunity to commit and conceal fraud is present.
- Rationalization exists when an individual has the ability to rationalize committing a fraudulent act.

By designing a system of antifraud programs and controls that respond to each of these three conditions, the risk of fraud is reduced.

The antifraud programs and controls established should focus on the following three fundamental activities:

- Creating an ethical company culture
- Implementing antifraud processes and controls
- Developing an effective oversight process

continued on next page

The antifraud programs and controls should focus on three fundamental activities: prevention, deterrence and detection.



Creating an ethical company culture – At the core of an effective system of antifraud programs and controls is the overall company culture. If integrity is not a foundational value, the vulnerability of fraud becomes higher. This would include such things as setting the tone at the top (management’s ethics and values), establishing a code of conduct, creating a positive workplace environment, and hiring and promoting ethical employees among others.

Implementing antifraud processes and controls – Theft of assets and fraudulent financial reporting are less likely to occur when perceived opportunity is absent. Opportunity to commit fraud can arise when an employee is trusted too much or when internal controls are weak or nonexistent. Accordingly, it is necessary to design and implement processes and procedures that will reduce or eliminate the perceived opportunity to commit fraud. This process would include identifying and assessing fraud risks, and implementing both general and specific controls to respond to those risks.

Developing an effective oversight process – Because your business and personnel change, it is essential that controls be monitored over time to determine whether they continue to be relevant and are able to address new risks. Monitoring is a process that assesses the quality of your programs and internal control over time and provides a mechanism for making timely changes as necessary when conditions warrant. Monitoring activities can also reveal evidence or symptoms of fraud. The oversight process can take many forms and can be performed by several sources, including management, the audit committee, board of directors, and internal or external auditors.

What Should I Do?

Remember that you as management are responsible for designing and implementing effective antifraud programs and controls to protect the business and that fraud is more prevalent today than ever before. We recommend that you take the steps to perform a formal review of your current programs and controls, and that from the review, you implement any necessary changes. If you don’t feel that you have the necessary capacity, knowledge or time to perform the review, we can help you. We have Certified Fraud Examiners on staff, and we can assist you in assessing your fraud risks and control processes. We can also recommend a plan for improvements and assist you in implementing it.

Source: Practitioners Publishing Company’s Guide to Fraud Risk Assessment, Implementing SAS99 and Related Guidance, March 2004.

Taxability of Social Security Benefits – continued

Year of Birth	Full Social Security Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and after	67

If you would like more information on how the new Social Security law may affect your tax positions, either now or in the future, please do not hesitate to call us at (559) 432-2346.

JOHN WAYMIRE

NEWEST ADDITION TO BP&F'S AG DEPARTMENT

John Waymire joined the firm in September as a staff accountant, and became the newest member of our Ag Department due to his farming background and experience.

His father began farming on the Westside and in the Hanford area growing cotton, and later began growing pistachios and other nut crops in Madera County. At age 10, John started working in the field, driving tractor, irrigating, and continued his involvement in the family farm during college summers. John also worked at his relative's dairy in Lemoore, and several members of his family are in the dairy business in California and Washington.

John feels that being a farmer is gratifying because, "What we do as farmers puts clothes on people's backs and feeds the world."

Agriculture appeals to John because he likes to work with his hands, and there is a direct relationship between hard work and the results. John feels that being a farmer is gratifying because, "What we do as farmers puts clothes on people's backs and feeds the world." Due to the globalization of agriculture and free trade, John observes that there are fewer row crops and more permanent crops in the San Joaquin Valley. "Because of our unique climate, the Valley has a geographic advantage for nuts and vineyards," he states. Another Valley change he notes is the purchase of farmland due to the relocation of dairies from Southern California.

John sees a direct tie between farming and accounting. His father told him that to be successful in farming, one must be a businessman first and the bottom line is important. John recently completed his Masters of Accountancy from Georgia Southern University, where he also received his BA in accounting. During college, he worked in the accounting department for a printer and also for a water park. John states, "I enjoy working with different businesses and industries at Baker, Peterson & Franklin, and the work is challenging. All businesses need accounting assistance, whether it be taxes, estate planning or bookkeeping. I find it very rewarding to provide solutions to our clients."

In his spare time, John enjoys golfing and archery—when he was 12, he was a national archery champion. John's wife, Sara, works for another Fresno accounting firm.



**Agriculture Department
Staff:**

Dennis M. Veeh, Partner
Karen E. Morais, Partner
Toni M. Porter, Partner
Nancy S. Ervin
John Waymire

Published by:

Baker, Peterson &
Franklin, CPA, LLP

970 W. Alluvial, Suite 101
Fresno, CA 93711
(559) 432-2346
FAX (559) 432-5831

www.bpfcpa.com
E-Mail: mail@bpfcpa.com

RETURN SERVICE REQUESTED

**CALIFORNIA TAX AMNESTY PROGRAM • TAXABILITY OF SOCIAL SECURITY •
PROTECTING YOUR ASSETS • NEW ADDITION TO AG DEPARTMENT**

Baker, Peterson & Franklin, CPA, LLP
970 West Alluvial, Suite 101
Fresno, CA 93711



PRSR STD
U.S. POSTAGE
PAID
FRESNO, CA
PERMIT NO. 1242