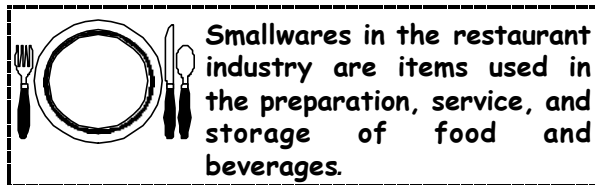


PKF PERSPECTIVES

THE IRS HELPS IN THE KITCHEN

... M. Howard Pell, CPA

The Internal Revenue Service (IRS) recently released guidance in the form of a “safe harbor” that may be used to determine whether or not certain costs, known as “smallwares” may be currently deductible.



The IRS will allow a taxpayer that operates a restaurant or tavern business to account for the cost of smallwares using a method called the “*Smallwares Method*”. **Under this method, smallwares would be considered consumed or used in the taxpayer’s business in the taxable year in which they are received at the restaurant and available for use.** Smallwares bought and stored in a warehouse or facility other than the restaurant would not be included as received at the restaurant and available for use.

This procedure will **not apply to the cost of smallwares that are considered “start-up” expenditures.** Accordingly, a taxpayer that is not already in the business of operating a restaurant, that opens a new restaurant may not use this method to account for the cost of smallwares paid or incurred, before the restaurant opens.

For purposes of this safe harbor, smallwares are defined as follows:

1. Glassware and paper or plastic cups;
2. Flatware and plastic utensils;
3. Dinnerware (dishes) and paper or plastic plates;
4. Pots and pans;
5. Table Top Items. These include items placed on customer tables, such as salt and pepper shakers, ash trays, cheese shakers, teapots, cruets, sugar caddies, tablecloths, napkins, menu holders, menus, vases, candles, and

candleholders.

6. Bar Supplies, including mixing glasses, bar strainers, cutting boards, liquor pourers, jiggers, corkscrews, bottle openers, storage bottles, wine and champagne stoppers, bar caddies, wine coolers, decanters, salt and sugar glass rimmers, slow pourers, and malt shakers.
7. Food Preparation Utensils and Tools, including hand utensils (spoons, spatulas, wisks, peelers, etc.), pastry and grill brushes, skimmers, knives, kitchen shears, cutting boards, strainers, colanders, shakers, dippers, measuring cups and spoons, thermometers, gloves, goggles, timers, scales, shaker baskets, salad spinners, lettuce crispers, sifters, pastry bags and tubes, mixing bowls, pot holders, kitchen towels, cheesecloths and kitchen staff uniforms.
8. Storage Supplies, including food containers, flatware sorters, dish containers and spice racks.
9. Service Items. These include pepper mills, cheese graters, bread boards, pitchers, squeeze dispensers, coffee pots, napkin receptacles, flatware, plate, glass, and mug storage racks, wait staff and self-serve trays, soup and salad bar trays and containers, bus tubs, tray carts, booster seats and wait staff uniforms.
10. Small Appliances, including iced tea dispensers, can openers, condiment pumps, individual food warmers, heat lamps, slicers, glass washers, electric knife sharpeners, blenders, juicers, and nonindustrial mixers. Small appliances do not include appliances that cost in excess of \$500.

Restaurants not already using the smallwares method, may switch to it, under IRS procedures that generally apply to an automatic change in accounting method (see Rev. Proc. 2002-9).

Revenue Procedure 2002-12.

CONGRESS PASSES TAX RELIEF FOR TERRORISM VICTIMS: Victims of Terrorism Tax Relief Act of 2001

... Leo Parmegiani, CPA and Antonio D. Pimenta, CPA

On December 20, 2001 Congress passed H.R. 2884, the *Victims of Terrorism Tax Relief Act of 2001* by unanimous consent. The Act provides tax relief for victims of September 11, 2001, Oklahoma City bombing, and anthrax attacks. President Bush signed the Act into law on January 23, 2002. At about the same time, IRS issued some preliminary guidance on the measure.

The *Victims of Terrorism Tax Relief Act* contains the following provisions:

Income tax relief: Subject to exceptions, the Act waives income tax liability for the year of death and the year prior to death for terror victims, and applies to victims of September 11, 2001, April 19, 1995 Oklahoma City bombing and post-September 11, 2001 anthrax attacks. If this provision results in less than \$10,000 in tax savings, then the victim is treated as having paid in his last tax year, \$10,000 less the amount, if any, that is forgiven.

Illustration: Smith, a busboy, died in the attack on the World Trade Center. The provision would not have saved him any tax because he owed no income tax in the year of death or the prior year. His family is eligible for a \$10,000 refund. Had the provision operated to forgive \$2,000 in tax, they would be eligible for an \$8,000 refund. The children who died in the Oklahoma bombing should qualify for the \$10,000 minimum refund. Although the provision may have been designed to help low-income workers, there is nothing in the statutory language that makes it unavailable to children or persons who had no income.

Statute of Limitations: A special rule extends the period of limitations to permit the filing of a claim for refund resulting from the forgiveness provision until one year after the date of enactment, if that period would otherwise have expired before that date. Refund requests must generally be made within three years of the due date of the tax return for the year for which the refund is sought. Thus, without the waiver of limitations provision, the families of victims of the Oklahoma City bombing would not be eligible for the income tax exemption.

The IRS has developed special procedures to expedite refund claims arising under the Act. The IRS points out that surviving spouses or executors of the Sept. 11 or anthrax victims may file amended tax returns for 2000 at any time until April 15, 2004, and may claim the tax relief

for 2001 when they file the decedent's return. Survivors or executors of those killed in Oklahoma City may file amended returns for '94 and '95 until Jan. 23, 2003.

Death benefits: Subject to exceptions, the Act provides tax-free treatment of death benefits paid by an employer to an employee who died as a result of the September 11, Oklahoma City bombing or anthrax attacks. This exclusion applies regardless of how the sums are paid (i.e., in a single sum or otherwise).

Estate tax relief: The Act provides estate tax relief by effectively shielding an amount which could be as approximately \$8.5 million of the estate from Federal estate tax. The relief applies to victims of the September 11, 2001, Oklahoma City bombing and anthrax attacks.

Charitable organizations and private foundations: Under the Act, payments made by a Code Sec. 501(c)(3) organization after September 10, 2001 because of the death, injury, wounding, or illness of an individual incurred as the result of (a) terrorist attacks against the United States on September 11, 2001, or (b) an attack involving anthrax that occurred on or after September 11, 2001 and before January 1, 2002, are treated as payments that are related to the organization's tax-exempt purpose or function, if the payments are made using an objective formula which is consistently applied. Thus, if a Code Sec. 501(c)(3) organization makes a payment because of an individual's death, injury or illness resulting from one of the terrorist or anthrax attacks described above, **the organization is not required to make a specific assessment of need for the payments to be related to the organization's tax-exempt purpose or function.** This rule applies only if the organization makes the payments in good faith using a reasonable and objective formula that is consistently applied.

For example, under this standard, a charitable organization that assists families of firefighters killed in the line of duty could make a pro-rata distribution to the families of firefighters killed in the attacks, even though the specific financial needs of each family are not directly considered. Similarly, if the amount of a distribution is based on the number of dependents of a charitable class of persons killed in the attacks and this standard is applied consistently among distributions, the specific needs of each recipient do not have to be taken into account. However, it would not be appropriate for a charity to make pro-rata payments based on the

recipients' living expenses before September 11, 2001 if the result generally is to provide significantly greater assistance to persons in a better position to provide for themselves than to persons with fewer financial resources. Although such a distribution might be based on objective criteria, it would not, under the statutory standard, be a reasonable formula for distributing assistance in an equitable manner.

The Act also allows employers to set up private foundations for the purpose of providing benefits to employees' families.

Discharge of Indebtedness: The Act provides that gross income does not include any amount realized from the discharge (in whole or in part) of indebtedness if the indebtedness is discharged by reason of the death of an individual incurred as a result of the September 11, 2001, attacks, or as a result of a terrorist attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002. In all cases, the provision applies only if the indebtedness is discharged because the individual died as a result of one the attacks. The provision generally applies only if the taxpayer was, or became, an obligor or co-obligor with respect to indebtedness of an individual who died as a result of one of the attacks (e.g., the surviving spouse or estate of the individual).

Disaster relief payments: Under the Act, for tax years ending after September 10, 2001, gross income doesn't include any amount received by an individual as a qualified disaster relief payment. A qualified disaster relief payment also isn't treated as earnings for self-employment tax purposes or as wages or compensation for employment tax purposes. A qualified disaster is:

- 1 A disaster which results from a terrorist or military action;
- 2 A Presidential declared disaster (as defined in Code Sec. 1033(h)(3));
- 3 A disaster resulting from an accident involving a common carrier, or from any other event, that is determined by IRS to be of a catastrophic nature; or
- 4 For payments by a Federal, State, or local government, or an agency or instrumentality of those governments, a disaster that is determined by the appropriate Federal, State, or local authority (as determined by IRS) to warrant assistance from the federal, state, or local government or their agencies.

Qualified disaster relief payments include payments, from any source, to, or for the benefit of, an individual to reimburse or pay reasonable and necessary personal,

family, living, or funeral expenses incurred as a result of a qualified disaster. Personal expense includes personal property expenses. It also include payments for reasonable and necessary expenses incurred for the repair of a personal residence, or for the repair or replacement of its contents, to the extent attributable to a qualified disaster.

The Act clarifies that any amount received as payment under section 406 of the Air Transportation Safety and System Stabilization Act is excludable from gross income. In addition, the Act provides a specific exclusion from income for qualified disaster relief payments. In addition, the provision is not intended to preclude the exclusion of other types of payments under the general welfare exception or other Internal Revenue Code provisions.

Victims' compensation fund: The Act provides tax-free treatment for any award made from the Victims Compensation Fund.

Tax deadline postponement: The Act expands IRS and DOL authority to postpone tax-related and pension-related deadlines for taxpayers affected by terrorist and military actions and Presidential-declared disasters for up to one year. The Act also clarifies that interest on underpayments may be waived or abated with respect to either a declared disaster or, a terrorist or military action.

Structured settlements: The Act creates a 40% excise tax on transactions in which structured settlement payments are sold for a lump sum unless the transaction is approved by a court as being in the victim's best interest. The 40% levy is on the excess of (1) the undiscounted amount of the payments being acquired, over (2) the total amount actually paid to acquire them.

Disability trusts: The Act reduces the taxation of disability trusts by providing a higher personal exemption amount. The Act provides that certain disability trusts may claim a personal exemption in an amount that is based upon the personal exemption provided for individuals rather than the \$300 or \$100 personal exemption provided under present law. The exemption thus increases to \$2,900 for 2001.

IRS disclosure rules: The Act allows IRS to share tax return and taxpayer information with Federal law enforcement agencies investigating terrorist attacks.

Golf Greens Can Now Be Depreciated!

... Joseph V. Bencivenga, CPA

Historically, for tax purposes the cost of developing greens on a golf course was part of land cost and, as such, not depreciable. Recently, however, in Revenue Ruling 2001-60, issued November 29, 2001, the IRS changed its stance on the issue by allowing the cost of building and re-building so-called *modern greens* to be depreciable over a fifteen or twenty-year life. The push-up or natural soil green constructed course remains non-depreciable.

Modern greens make use of technological changes in greens design and construction and they incorporate complex drainage systems. Typically, after general earthmoving, grading, and initial shaping in, under, and around the area, the builder puts in a network of subsurface drainage tiles or pipes; one or more layers of gravel or sand; a root-zone layer; and a variety of turf grass. Over time, for one or more reasons, elements of the modern green deteriorate and need to be replaced. The 'wear and tear' aspect of the modern green underlies the IRS ruling allowing depreciation. (By contrast, push-up or natural soil greens are landscaping affairs involving reshaping or re-grading of the land. Push-up greens might have limited irrigation systems, such as hoses and sprinklers near the greens, but they never have a subsurface drainage system.)

The new ruling applies prospectively for years beginning after November 29, 2001.

So that the figure to be depreciated would be readily available, a club would do well to arrange for a suitable cost breakdown from a contractor whenever extensive work is to be done that involves the construction and installation of a modern green.

A calendar year golf club would be putting the new ruling into effect for the year 2002. For years beginning prior to November 29, 2001, a taxpayer has the option to:

- (a) continue carrying the cost of the modern greens as non-depreciable land, or
- (b) apply for a change in accounting method. A change in accounting method in this instance is automatic but it must be applied for on Federal Form 3115.

The depreciable classification into which the modern green falls is 'land improvements' which carries a class life of twenty years.

In the Words of ...

Will Rogers: *I see a good deal of talk from Washington about lowering taxes. I hope they do get 'em lowered enough so people can afford to pay 'em.*

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a tax advisor. For more information, please contact Howard Pell or Leo Parmegiani at:

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