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YEAR-END BUSINESS TAX NEWSLETTER

Dear Valued Client and Colleagues;

November 15, 2010

2010--The year of change and uncertainty! Health care reform! What does that have to do with taxes? 1099s for everyone? What is that? Bush tax cuts expiring? How will that affect my business? More regulations on tax preparers? Does that matter to me? Red flag rule? What's that? Not to mention, our government faces a record deficit and the IRS is focused on closing what is perceived to be an estimated \$340 billion tax gap! This newsletter discusses many of the new laws, areas of interest, changes in the way we operate, etc. We encourage you to read the entire document as there could be unexpected items that apply.

Minimizing future tax bills will require a balancing act, but could also be a planning opportunity for taxpayers who have the ability to control the timing and/or nature of their income. **Your wisest move is to talk to your CPA as soon as possible to develop your best tax plan.** We, also, encourage you to share this letter with others so they, too, will be informed on the most recent tax developments. If you would like further information, please contact our office at (904) 880-3200 or through our website, www.dkbrierycpa.com.

IRS TARGET ISSUES

Shareholder compensation for Subchapter S Corporations—Shareholder salaries must be reasonable for the industry and the job duties and responsibilities. Some questions to consider are...What would you make if you were working for someone else? What would you pay a hired employee to do your job? Have you taken distributions in excess of your salary or paid for personal items from the company? What is reasonable for a return on investment? Are your profits strictly from your personal service? These are all things that must be resolved BEFORE December 31. If your compensation is unreasonable, you may be a target for an IRS audit.

Co-mingling of Funds—Do you pay your personal bills from your corporation? A corporation must keep its funds separate from its owners. Personal bills should not be paid from the business. If a charge card is used, a corporate card should be obtained and used ONLY for business purposes. If a personal card must be used, use one for nothing but business. Do NOT Co-mingle. All business revenue should be deposited into the business account. In the event of an IRS audit or a personal lawsuit, failure to act as a corporation could cause the corporate walls to be collapsed (i.e. treated as if it is NOT a corporation). This could substantially increase liability to you, the owner—whether it is tax liability of personal damages! It is good business practice to always keep the personal and business separate, regardless of the type of entity!

All Income Reported?—The IRS will be looking at whether **ALL** income was reported on tax returns. During an audit of a Schedule C or Limited Liability Company reporting as a Schedule C, E, or F, this

IRS TARGET ISSUES (continued)

is done by requiring identification of the source of **ALL** deposits. If it is a corporation or a partnership, a personal audit could be opened.

Independent Contractor vs. Employee—Are you positive that the contractor that is working for you, with NO tax withholding or other treatment as an employee, is TRULY an independent contractor? In 2010, the IRS commenced its “employment tax audit initiative” to audit up to 2,000 random employers per year for a 3-year period. The program is expected to lead to additional employment tax audits in the future. **Misclassification of workers can lead to SUBSTANTIAL tax bills!**

Focus on Payroll Tax Audits—The IRS will be focusing on the following four primary areas, in addition to the worker classification discussed above:

- a) *Fringe Benefits*—The IRS will determine whether the benefit can be excluded from employees’ wages or whether the company erroneously excluded the value from the employee’s wages—thus, failing to collect and remit payroll taxes.
- b) *Officer compensation*—Officer compensation may be deemed to be too high or too low! (see page 1) The IRS will review the facts and circumstances to determine what is reasonable.
- c) *Employee Expense Reimbursement Plans*—Reimbursements must satisfy the law’s exclusion from employee compensation. If it does not, the company may be required to increase the wages for payroll purposes and remit the related payroll tax. Basic requirements for the reimbursements to be excluded from gross income are that they must 1) be under an **accountable reimbursement plan**, 2) be connected with the business (not personal in nature), and 3) have adequate substantiation of the expense. Excess reimbursements must be repaid within a reasonable time.
- d) *Failure to File*—including not filing due to paying employees in cash with no reporting!

Travel, Meals & Entertainment, Gifts, and Automobile Expense—These have always been target areas, but are now coming under extra scrutiny because they are often easily manipulated and loosely documented. These deductions require very detailed support. Failure to do so can result in the deduction being disallowed.

Travel—Only the business portion is allowed (personal travel expenses must be omitted). Expenses for an accompanying non-employee spouse are not permitted.

Meals & Entertainment—Maintain all receipts, documenting dates, attendees, and business purpose. It would be helpful to enter a memo of the same on your books or check stub.

Gifts—Maintain receipts, documenting the recipient and the business purpose on each. *Gifts in excess of \$25 are not deductible.*

Automobile Expense—If the automobile is not owned by the corporation, actual expenses cannot be taken as a deduction. INSTEAD, USE BUSINESS MILEAGE REIMBURSEMENT. In both cases (whether owned by the corporation or personally), ***the total mileage AND the business mileage MUST be documented.*** A log should be maintained so that the data can be substantiated. In addition, personal use of a corporately owned automobile, must be reflected on the W2. Therefore, that information must be provided to the payroll service provider prior to the end of the year.

Shareholder Loans, Minutes, Annual Meetings—All major transactions and corporate business decisions must be documented in the minutes of the annual meeting of the shareholders, i.e. 1)

IRS TARGET ISSUES (continued)

shareholder compensation, 2) retirement plan contributions, 3) payment of health insurance for employees (including shareholders), 4) adoption of cafeteria (Section 125) plans, retirement plan, or high deductible insurance plan, 5) shareholder loans, 6) large asset purchases (buildings, vehicles, etc.), 7) long-term contracts, and 8) any other major event. A loan to the corporation should be documented by a signed promissory note with a reasonable interest rate and terms of repayment. If assistance is needed, please contact our office.

Record Retention—It is generally recommended to keep **all** receipts, invoices, bank statements, charge card statements and business records for a minimum of 7 years. A return is open for audit for 3 years after the later of the due date (including extensions) or date filed. In some cases, they can go back further. Other items such as tax returns, receipts for fixed assets (items on the depreciation schedule), real estate purchases, corporate and business formation documents, Subchapter S approval letters, federal and state identification numbers, etc. should be maintained **permanently**

PENALTIES ON TAXPAYERS AND PREPARERS

Accuracy Penalty—A 20% accuracy penalty may be assessed on both individuals and corporations for substantially understated tax where there is (or was) no **substantial** authority. This is defined as exceeding the greater of \$5,000 or 10% of the tax required to be shown on the return for that year.

Preparer Penalty—A tax return preparer is subject to a penalty equal to *the greater of \$1,000 or 50% of the fee billed (or to be billed) by the preparer* for any return or refund claim resulting in an understatement of liability due to a position that the tax return preparer knew (or reasonably should have known) of the position that resulted in the understatement.

IDENTITY THEFT RED FLAGS, DISCLOSURES, and E-MAIL SCAMS, ETC.

Identity Theft Red Flags and Notices of Address Discrepancy—These rules require “each financial institution and creditor that holds any consumer account, or other account for which there is a reasonably foreseeable risk of identity theft”, to develop and implement an Identity Theft Prevention Program. The Program must include reasonable policies and procedures for detecting, preventing, and mitigating identity theft. The Federal Trade Commission requires implementation by December 31, 2010. *Included in the definition of “financial institution and creditor” is any entity that defers payments, even in the normal course of a traditional billing process. Thus, if you bill monthly or quarterly, this would be considered to be an extension of credit that requires you to have an internal program subject to inspection and review, designed to detect, prevent and mitigate client identify theft.* Please contact us if you need assistance in this area.

Disclosures—Regulations have been issued regarding the disclosure and use of tax return information by tax return preparers without taxpayer consent. We do not outsource our services, nor do we provide any of your information to outside sources. However, we must acquire your permission to allow staff to handle your information. A notice concerning the use of information obtained in the process of preparing your tax return will be sent to you, along with a standard disclosure statement. These releases must be returned to us in order to provide the best services. Additionally, requested copies of tax returns delivered electronically must be sent to you through secure e-mail. Please contact our office for instructions on this process, if applicable.

IDENTITY THEFT RED FLAGS, DISCLOSURES, and E-MAIL SCAMS, ETC

Email, Phone and Preparer Scams—Scams that are becoming more common include:

- 1) Companies masquerading as Florida agencies are e-mailing Florida companies requiring annual minutes and a \$125 fee. Annual minutes are **not** filed with any state agency.
- 2) An entity called the “FL Online Corporate Annual Report Filings” is e-mailing businesses, inviting them to file their annual reports on their website. Businesses should only use www.sunbiz.org to file their annual reports.
- 3) **BEWARE OF PHISHING**—E-mails, tweets, faxes, phone calls claiming to be from the Internal Revenue Service are often a “phishing” tactic used to trick unsuspecting victims into revealing personal information. Often a phony website is used. The IRS site is correctly www.irs.gov. Currently, **the IRS does not contact taxpayers by e-mail, tweet or fax, and rarely by phone**. If you receive a phone call, do not release any information or agree to an appointment. Instead, request written correspondence. Take their name, phone number, and agent number and contact us.
- 4) The IRS has issued a warning about a fraudulent scheme targeting EFTPS (Electronic Federal Tax Payment System) users. The scheme sends an e-mail claiming that the user’s tax payment was rejected and directs the user to a website for additional information. The website contains malware that will attempt to infect the user’s computer. **The IRS does NOT initiate communication through e-mail**. If you receive a message claiming to be from the IRS or EFTPS, do NOT reply to sender, access links on the site or submit any information to them. **To report this or other phishing, email scams or bogus IRS websites, forward the email or URL information to the IRS at phishing@IRS.gov.**
- 5) Dishonest return preparers derive financial gain by skimming a portion or all of a client’s refund, charging fees based on the amount of refund, promising a given result, and/or creating phony deductions. This type of fraud often begins with a small business’s return—whether a Schedule C, a partnership, or corporate return. A dishonest preparer may also create false information and submit your return without your knowledge. Often, the refund from the false refund will go directly to the preparer’s account. **It is your responsibility to know what it is on your return. Maintain a copy of your return, review your return before signing, and actually sign either your return or authorization for electronic filing.**

NET OPERATING LOSS (NOL) CARRYBACK—There is no indication that the NOL Carryback for 3, 4, or 5 years that was available in 2009 will be available in 2010. Only the 2 year carryback will be available.

HEALTH CARE REFORM (A few current-year issues)

Healthcare Tax Credit—For 2010-2013, a credit is available to small employers that contribute at least ½ the cost of single coverage towards buying health insurance for their regular employees (one that works more than 120 days). The maximum credit is 35% of premiums for employers with 10 or fewer full-time employees with annual average wages of \$25,000 or less. The credit is completely phased out for employers that have 25 full time employees or more or that pay average annual wages of \$50,000 or more. The credit is scheduled to increase to 50% after 2013.

Excise Tax on Indoor Tanning—A 10% tax applies to indoor tanning procedures after July 1, 2010. The tax is collected from the customers and remitted on a quarterly basis using Form 720.

HEALTHCARE REFORM (a few current-year issues)—continued

Reporting of Employer Paid Health Insurance Although employers were originally required to report the amount of the health insurance premiums paid for each employee on their 2011 W2 as a **nontaxable** employer fringe benefit, this has been changed to “optional” for 2011.

Penalties on Non-Qualified Distributions from HSAs and MSAs to Double to 20% in 2011

EFTPS—The IRS has eliminated paper coupons for deposits of many taxes, including employment taxes, corporate income tax and estimated taxes, effective January 1, 2011. This effectively requires most taxes to be deposited electronically. If you are not already set up for this, please contact us to enroll you in EFTPS.

PAYROLL and PAYROLL TAX ISSUES

Florida Unemployment Tax—The Florida Department of Revenue will assess a penalty of the greater of \$50 or 10% of any tax due (up to \$300 per report) on any filed report that is erroneous, incomplete, or insufficient, beginning with the 3rd quarter 2010. Once within a 12-month period, the Department will waive this penalty if an accurate, complete, and sufficient report is filed within 30 days of the penalty notice date.

Employee vs. Independent Contractor—This subject was briefly discussed under IRS Target Issues, but because of the seriousness of this issue, we are addressing in more depth at this point. By filing a Form SS-8, either the employer or worker can ask the IRS for a determination as to the proper classification. Basic guidelines used by the IRS for determination are as follows:

- a. *Behavioral Control* covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means. If the “employer” has the right to control or direct not only what is to be done, but also how it is to be done, then the worker is most likely an employee. If the “employer” can control only the result—not the means and methods—then the worker is probably an independent contractor.
- b. *Financial Control* covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker’s job. (i.e.—who sets the pay?)
- c. *Type of Relationship* factor relates to how the workers and the business owner perceive their relationship.

1099 Forms—Beginning in 2012, all persons engaged in a trade or business will be required to send an information return, (Form 1099MISC), to **all** vendors (regardless of corporate status) that are paid \$600 or more. Although, this does not apply in 2010 or 2011, it is recommended that businesses begin to gather applicable information—including name of company, address, and either federal identification number or social security number. This information should be obtained through a completed Form W-9. Due to the significant recordkeeping this creates, there is a big push to eliminate this requirement. However, to date, this has been unsuccessful.

Form 1099K—Beginning with 2011, Form 1099K will be sent to those processing credit and debit card payments through merchant services, as well as other third-party payment processors such as E-Bay or PayPal. The Form 1099K will show credit and debit sales total by month and annually. These amounts may be used to verify reported revenue on income tax returns, sales tax returns, etc.

PAYROLL and PAYROLL TAX ISSUES—continued

Health Insurance—Although all fringe benefits are under scrutiny by the IRS, a key issue with shareholders of Subchapter S corporations is the proper treatment of shareholder group health insurance. If an S Corporation pays the health insurance of a 2% or greater shareholder, this must be reported in box 1 (gross income) of the W2. It is NOT taxable for FICA or MC, but it is for federal withholding. The shareholder can then take the deduction on his personal tax return as an adjustment of income before adjusted gross income, thereby, netting out the W2 income. Please advise our office if the corporation is paying health insurance premiums for its shareholders.

Hire Act—A credit is available for eligible employees hired after February 3, 2010 and before January 1, 2011 on wages paid between March 19, 2010 and December 31, 2010. It is created by eliminating the 6.2% employer social security tax on eligible hires. Employers can reduce their federal deposits throughout the quarter by the eligible employer social security amount or they can wait to claim the credit on the Form 941 return. If the employee is employed for a minimum of 52 consecutive weeks, the employer is then eligible for an additional tax credit up to \$1,000 per employee.

To re-iterate, a qualified individual is an eligible hire for the tax credits if **all** of the following requirements are met: 1) Hired between February 4 and December 31, 2010; 2) Has NOT been employed for more than 40 hours during the previous 60 days (and must sign an affidavit (Form W-11) attesting to this); 3) Is hired into a **new** position or replaces an employee that separated voluntarily or for cause; and 4) Is not a family member of the **majority (over 50%)** business owner, nor a household or government employee.

There is no minimum or maximum number of hours an employee can work to get the payroll tax exemption. As long as the employee meets the above requirements, the employee can be a seasonal employee who was previously laid-off and then rehired by the same or related employer. If the employer hires a high school, college or graduate student who has been in school for some or all of the 60 days preceding the start of his employment, they will still qualify as long as other requirements are met. There is no minimum age requirement for the HIRE Act (other than the Child Labor Laws). In addition, if a business uses the services of workers who are employees of a temporary agency, the temporary agency can claim the payroll tax exemption for its qualified employee working at a client's business. It will be determined based on when the employee begins work with the temporary agency.

SMALL BUSINESS JOBS BILL—The following provisions were passed in this bill in September 2010:

Expanded Expensing of Machinery and Equipment for 2010 and 2011—Up to \$500,000 of fixed assets can be expensed (vs. depreciating over time). Phase-out begins at \$2,000,000.

Qualified Real Property Expensing—For any tax year beginning in 2010 or 2011, a taxpayer can elect to treat up to \$250,000 of qualified real property as expensing-eligible property.

Revived Bonus Depreciation for 2010—50% of the asset cost may be taken as bonus first-year depreciation for qualifying property acquired and placed in service in 2010.

SMALL BUSINESS JOBS BILL—continued

Increased First Year Dollar Cap for Autos—First year depreciation for autos placed in service in 2010 **was** \$3,060 and \$3,160 for light trucks or vans, but for **2010 ONLY**, this been increased to \$11,060 and \$11,160 respectively.

Startup Expense Deduction Increased—For tax years beginning between January 1 and December 31, 2010, the deduction for startup expenses increased from \$5,000 to \$10,000.

100% Exclusion of Gain from Qualified Small Business Stock Held for Years—100% exclusion of gain from sale of stock acquired AFTER enactment date of this bill and BEFORE January 1, 2011.

Self-Employment Tax Break—For tax years beginning and ending in 2010, the deduction for self-employed health insurance costs can be deducted in computing net earnings.

Penalty for Failure to Include Reportable Transaction Information with Return—Reduced retroactively to penalties assessed after December 31, 2006 to relate to the tax benefit received.

Informational Reporting

Expenses for Rental Income Property—Persons receiving real property rental income must file information returns (forms 1099) reporting payments of \$600 or more during the year for rental property expenses. There are some exceptions to this. This is effective for payments made after December 31, 2010.

Penalty for Failure to Timely File Information Returns for Small Businesses

	Penalty			Calendar Year Maximum		
	1 st tier	2 nd tier	3 rd tier	1 st tier	2 nd tier	3 rd tier
Was	\$15	\$30	\$50	\$25,000	\$50,000	\$ 100,000
New Law	\$30	\$60	\$100	\$75,000	\$200,000	\$ 500,000

Tier 1—Corrected in less than 30 days, Tier 2—Corrected by 8/1, Tier 3—After 8/1

Penalty for Failure to Furnish a Payee Statement—Failure to provide a payee statement will be revised to provide tiers and caps similar to those for failure to file.

Retirement Plans

Governmental Plan—Allowed to include Roth accounts for tax years AFTER 12/31/2010.

Rollover of Distributions into Roth Accounts—After enactment date, distributions of 401(k), 403(b), and governmental plans could permit rollovers of pre-tax account balance into a Roth Account. If made in 2010, would be able to elect to pay tax in 2011 and 2012.

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Schedule your tax planning appointment today.

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