

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

About This Newsletter

This monthly Newsletter is a free service provided by Gregg Harvey, CPA. It is emailed every month to clients and to select members of the Rochester Regional Chamber of Commerce.

This Month's Contents:

This month's newsletter is a little different. Rather than a few longer notes, there is a larger number of small notes including updates on a variety of tax topics.

New Mileage Rate

Due to rising gas prices, the mileage rate will increase by eight cents to 58.5 cents a mile for all business miles driven from July 1 through Dec. 31, 2008.

The new rate for computing deductible medical or moving expenses will also increase by eight cents to 27 cents a mile.

The rate for providing services for charitable organizations is set by statute, not the IRS, and remains at 14 cents a mile. See news release IR-2008-82 and Announcement 2008-63.

Rebate Checks Being Diverted

About \$2 billion in economic stimulus rebate checks are being confiscated to pay overdue bills for child support, student loans and back taxes, the government says.

So far, 1.8 million rebate checks have been intercepted by Treasury Department computers showing that individuals owe money to federal or state governments.

The biggest beneficiaries: parents who are owed child support. The Internal Revenue Service has mailed 77 million checks worth \$64 billion — a little more than half the expected total.

The large take for unpaid debts is the result of an increasingly sophisticated debt-collection program started in 2001.

Today, most states and federal agencies send weekly lists of delinquent Americans to the Treasury Department. Before a rebate is mailed, it's run through a list that contains the names and Social Security numbers of people who owe money.

So far, nearly \$1 billion has been collected. Where it has gone:

- 55% for child support.
- 39% for federal debts such as student loans or farm loans.
- 6% for unpaid state taxes.

Taxpayers denied their rebate get letters explaining why they got a reduced payment or none at all.

The diverted money is sent directly to the family or government agency to which it was owed.

A few states, however, are losing out on millions of dollars available through the program.

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

Michigan doesn't get its delinquent state taxes collected. The reason: It hires private contractors to collect back taxes.

Also, Mississippi hasn't joined yet, and California doesn't submit the names of income tax debtors.

So while Maryland has collected \$6 million from rebate checks for unpaid state income taxes, California has received nothing.

Tax Alerts

If Your Business Receives a Missing W-2 Inquiry

Businesses receive notices from the Social Security Administration when the amounts reported on Forms W-2 do not match the appropriate employment tax records (i.e., Form 941, Form 944). The IRS website has information on how businesses should respond to a notice from the Combined Annual Wage Reporting program about a discrepancy in the amounts reported.

IFRS Is Coming

It's not too early for you to start preparing for the convergence to International Financial Reporting Standards (IFRS).

In May, the AICPA Council approved IFRS for non-public companies, and a decision from the SEC is expected shortly to say that registrants must file by 2013 (note that this would require two years of comparative financial statements), possibly with an earlier adoption allowed. IFRS brings

fundamental changes to financial accounting standards, including an emphasis on fair value rather than historical cost, less emphasis on the income statement, and more use of professional judgment in applying principles.

This has major implications for tax practitioners as well. As companies shift to IFRS, each accounting policy should be reviewed for tax implications. For example, LIFO isn't permitted under IFRS, and if the LIFO conformity rule continues, companies with older (lower cost) LIFO layers will have more income and related taxes.

The IRS is concerned that a significant number of taxpayers will make unauthorized changes in their tax accounting methods when GAAP is replaced by IFRS. Many taxpayers have tax methods that conform to book methods. If the latter change as a result of IFRS and drag tax methods along, IRS will be hard-pressed to find all the changes. For taxpayers who play by the rules and request permission to change their tax methods, that presents a different problem for IRS: a veritable flood of 3115's into a National Office already struggling with the current backlog.

Other IRS concerns include less detailed income statements, more schedule M items, and the lack of a FIN 48 disclosures for some uncertain tax positions.

One-Time IRA Transfer to an Health Savings Account

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

Notice 2008-51 provides guidance with respect to the effect of a qualified HSA funding distribution from an individual's IRA or Roth IRA to a Health Savings Account (HSA).

It describes how qualified HSA funding distributions work and the adverse tax consequences for failing to remain HSA-eligible throughout the application testing period. It addresses the pro-rata basis recovery rules for determining the basis in any amount remaining in the IRA, as well as the recapture tax under Code section 72. The funding distribution rules were added to the Code by the Tax Relief and Health Care Act of 2006. Several examples are included in the Notice.

Health Savings Account Contribution Limits

Notice 2008-52 offers guidance on calculating the maximum annual HSA contribution and the adverse tax consequences if the testing period is not satisfied. Major changes to the contribution limits for HSAs were added to the Code by the Tax Relief and Health Care Act of 2006. The statutory maximum for 2008 is \$2,900 for self-only HDHP coverage and \$5,800 for family HDHP coverage.

In addition, the "full contribution rule" permits individuals who are HSA-eligible on December 1 to make a full year's contribution (as if their coverage had been in effect all year).

Unusual IRS Notices Being Seen

Recently many practitioners have noticed a large number of forms CP-259s for various entities inquiring about un-filed prior year fiduciary returns on Form 2758. Form 2758 is an extension form and not a tax return. Most unusual is that none of the entities receiving this notice are trusts or estates. They are all partnerships, SMLLCs, LLPs, etc.

If you receive one of these, you should contact a tax professional for advise.

Top Concerns of Family Businesses

Accountants are all too familiar with the succession issues faced by accounting firms. But accounting firms aren't the only ones with succession issues.

In fact, closely-held and family-owned businesses across the nation are facing a succession crisis of their own. CPAs are well aware of the problems their business clients face and are devising strategies to help.

Some four in five CPAs see "developing a succession plan or exit strategy" as one of the most important issues facing family business today, according to our new survey.

Four out of five (81%) respondents to a recent Bay Street Group survey believe that developing a succession plan or exit strategy is the most important issue facing family businesses today. More than half (63%) of those surveyed believe that grooming the next generation of leadership is the most important issue.

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

Family businesses are also struggling with ways to maximize profits (54%), find and keep qualified staff (52%) and generate more revenue (43%), according to the survey.

Establishing — in writing — a succession plan is vital. Without an exit plan, a company could lose its vision and, ultimately, the company could peri

Top 10 Issues Facing Family Businesses:

1. Developing a succession plan or exit strategy
2. Grooming the next generation of leadership
3. Maximizing profits
4. Finding and keeping qualified staff
5. Getting more revenue
6. Tax burdens and complexity
7. Access to capital and financing
8. Managing expenses
9. Keeping up with technology
10. Government regulations and cost of compliance

Source: www.cpatrendlines.com

Perhaps one of the reasons why family-owned businesses have yet to create a formal succession plan is because the next generation for leadership may be, in

the eyes of some, ill prepared to take the reins or may not have the same work ethic or the same approach to business as their elders.

More Breaks For Members Of The Military

Congress gave soldiers more tax breaks, passing a tax relief package before going home for the Memorial Day recess. Several easings were added, and some apply retroactively.

Rebate rules for soldiers are now eased. If one spouse is a member of the armed forces during the year, the rule that both spouses must have valid Social Security numbers to get a rebate will be waived. This also goes for members of the Reserves. The Service will reprogram its computers and issue rebates.

News For The Self Employed

Flex plan balances can be paid to workers called to active duty. This lets them avoid forfeiting unused amounts in their health flex plans. However, the measure doesn't force employers to permit such distributions.

Bonus payments made by states to service members are tax-free. This is effective for all open tax years, so anyone who paid income tax on these payments can file a claim for a refund with the Revenue Service.

Makeup wages will be subject to payroll taxes, starting in 2009. These payments, intended to supplement the military pay of reservists called to active duty, are currently exempt from withholding and

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

FICA tax. But after 2008, retirement plans must treat these wages as compensation for benefit purposes, and IRA contributions can be made based on this pay.

Small firms that pay makeup wages will get a tax credit, worth up to \$4,000 per reservist...20% of the wages paid. To qualify, a business must employ an average of fewer than 50 workers a year.

Disabled retired veterans will have longer to file refund claims when the government reclassifies part of their taxable retirement pay as tax-free disability. They now have one year after the reclassification to file if the normal three year statute of limitations has expired.

This relief is retroactive. Refund claims for reclassifications made after Dec. 31, 2000 can be filed with the IRS before June 2009.

Military death gratuities can now be rolled over to Roth IRAs or Coverdell education savings accounts. This also applies retroactively to payments for death from injuries that occurred after October 6, 2001.

Three revenue raisers cover the cost of these easings:

Higher taxes on upper-incomers who renounce U.S. citizenship. As an example, expatriates will be deemed to have sold their assets and will be taxed to the extent that their gains are more than \$600,000.

Nailing government contractors that use foreign subsidiaries. They will owe

FICA taxes for U.S. employees hired by those affiliates.

And a hike in the minimum failure-to-file penalty to \$135, up \$35.

Good News For Small Business Owners With One-Person 401(k)s

The news? Pay-ins aren't subject to self-employment tax, the Service says.

Instead, SECA tax is calculated after 401(k) contributions are subtracted from the individual's income. The result is different for employees, who pay FICA tax on payins, even though they get an income tax exclusion.

One-person 401(k) plans can be a nice tax shelter for proprietors, who as individuals can put in up to \$15,500...\$20,500 if age 50 or older. And the firm can pay in up to 20% of net earnings from self-employment.

So on \$100,000 of net earnings, you can put \$35,500 into a solo 401(k), and \$40,500 if born before 1959. The comparable contribution to a Keogh plan would be \$20,000. The maximum total pay-in for this year is \$46,000.

W-2 and 1099 To Same Employee

If you give a W-2 and a 1099 to the same worker in one year you'll get extra scrutiny from the IRS during payroll tax exams.

That's a red flag signaling possible misclassification of employees as contractors. The Service is leery of

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

cases involving retired workers who quickly return to a firm doing the same job, but as a contractor.

You can beat the Service if an employee's status truly changes after returning. Be prepared to document that the firm had less control over the worker, he or she had different duties and worked fewer hours.

Restaurants With Tip Reporting Failures

Restaurants with tip reporting failures will soon feel audit heat from the IRS. It plans to go after employers that didn't file Form 8027, the annual tip information reporting return. Non-filers will be probed to determine whether they follow the rules for allocating tips to workers.

SEP-IRA sponsors

SEP-IRA sponsors are in for more audits. IRS suspects employers are making errors. Among them: Failing to contribute a uniform share of pay for all participants. Not updating plans to reflect changes made in pension law. And making excess contributions for high-paid workers.

Seniors With IRA's

Also under the microscope: Seniors with regular IRAs. The IRS believes many folks age 70½ and over don't take required minimum payouts. It plans to scrutinize Forms 5498 filed by IRA trustees to spot scofflaws. IRS will

notify delinquents, telling them to take catch-up distributions.

Mismatched Employee Names and ID Numbers

Coming: IRS spot checks on backup withholding required of firms that are notified of mismatched employee names and taxpayer ID numbers. Employers who receive such notices are supposed to start withholding tax at a 28% rate immediately and continue to do so until the error is fixed.

New Reporting Rule For Deferred Pay

IRS will delay till 2009 a new reporting rule for deferred pay: Tighter regulations for nonqualified plans mean that employers must report any amounts deferred in plans, whether they are taxed or not, on box 12 of the W-2 form, using code Y. IRS wanted reporting to start for 2008, but it realizes firms need more time to prepare payroll systems.

Firms That Self Insure

Firms that self-insure can let former execs keep health coverage if they pay the premiums on an after-tax basis after they leave, IRS says. But the executive must pay fair market value for the coverage.

Some firms that allowed ex-executives to maintain coverage indefinitely assumed they were OK as long as they were charging 102% of premiums. That is what COBRA regulations require rank-and-file workers to pay after leaving if they want to maintain

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

insurance on a temporary basis. But if that price is less than the going rate, the former executive must pay tax on the excess value of the medical coverage, the IRS says.

States Can Tax Out-of-State Bonds While Exempting Their Own Bonds

States can tax out-of-state bonds while exempting their own bonds, the Supreme Court says. Even though taxing bonds of other states is discriminatory, the extra tax burden is constitutional (Ky. v. Davis).

Bondholders had hoped the Court would nix taxation of out-of-state bonds. Protective refund claims filed by bondholders will be denied. The decision is good news for single-state municipal bond funds. If the Court had struck down state tax preferences for in-state tax-frees, there'd be no need to have these funds. That would hurt small issuers because single-state municipal bond funds are their primary purchasers.

State college savings plans are helped, too. The Court's ruling validates tax breaks for residents who contribute to their state's plan.

Recapturing Tax Breaks For Heavy SUV's

IRS can recapture tax breaks for heavy SUVs in later years. If business use falls below 50% in a year after it is bought, the excess of the write-offs claimed over straight-line depreciation is taxed as income, the Tax Court says (Birdsill, TC Summ. Op. 2008-55).

The recapture partially negates the allowable expensing deductions claimed on SUVs and pickups with loaded vehicle weights over 6,000 pounds. And it applies to 50% bonus depreciation on vehicles put in use in 2008.

The recapture period lasts five years, starting with the year the vehicle is put in use. Limit your personal use during that span.

State Tax Incentives For Business Relocations

Good news for relocating businesses from the Revenue Service: State tax incentives they get for moving are tax free, IRS says in a private ruling. The exclusion covers reductions in real estate taxes granted by municipalities, as well as tax credits for creating new jobs.

IRS did nix one tax ploy. Some firms are deducting the full bill for property taxes instead of the amount net of any relocation incentive. Then they report the subsidy as income but claim that it can be treated as a tax-free contribution to the firm's capital. The IRS shot that down.

Majority Owners of Family Firms Can Waive Dividends Tax Free

Majority owners of family firms can waive dividends tax free, the IRS privately rules. To qualify, no more than 20% of dividends paid can go to relatives of the waiving shareholders. And a business purpose, such as needing

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

to conserve the firm's cash, is essential for the waiver.

Installment Plans to Repay Back Taxes

IRS is overcharging taxpayers who enter into installment plans to repay back taxes, Treasury inspectors say. They calculate that for the Service to recoup the cost of providing installment plans, it needs to charge around \$88, a bit lower than the current \$105 fee.

Not surprisingly, the Service disagrees. By its calculations, taxpayers are being under-charged. It will raise the fee in a year or two.

Automatic Enrollment For 401(k)s

Employers have found a snag in automatic enrollment for 401(k)s: Proposed IRS regulations bar firms from adding the feature midyear because they require plans to be amended and participants to be notified about the addition of automatic enrollment prior to the plan year's start.

There's a decent chance that the Service will correct the problem when it issues final rules in a few months. Firms insist there's nothing in the law OK-ing automatic enrollment that mandates a Jan. 1 start date.

Avoid Losing A Deduction For Your SEP

Failing to make pay-ins for every employee kills the SEP deduction, the

Tax Court says (Brown, TC Summ. Op. 2008-56). Here, a married couple were the company's only two employees. But the firm made SEP pay-ins only for him. That doesn't bode well for their taxes (or their marriage).

Roths IRA's For Children

If your child or grandchild will be toiling at a summer job, then making a Roth IRA pay-in for him or her this year is a great idea.

The limit is \$5,000, but not more than the child's earnings. That sum counts toward the \$12,000 annual gift exclusion (\$24,000 for couples).

The Roth can grow into a tidy sum for the child. A 16-year-old with \$5,000 in a Roth IRA that earns 7% each year will have \$137,000 at age 65 and \$193,000 at age 70. If the child works for a few summers and annual contributions are made, future totals will be much larger.

Roths are tax favored, too. All payouts after 59½ are tax free. And since pay-ins, but not earnings, can be taken free of tax at any time, the child can pull them out in the future to help purchase a first home.

Some Reminders About Taxes For Students With Summer Jobs

They can escape income tax withholding from their paychecks if they did not owe any tax last year and don't expect to owe any in 2008. Students who can be claimed as dependents can avoid income tax withholding if unearned income is

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

\$300 or less and total income won't exceed \$5,450.

But if investment income is more than \$300, total income cannot top \$900. Students who qualify should write "EXEMPT" on line 7 of their W-4 forms.

Hiring Your Children Can Save Tax.

No Social Security tax is due when sole proprietors or husband-wife partnerships hire their children, as long as the children are under 18. FUTA isn't owed until they are 21.

If The Service Deposited Your Tax Rebate Directly To Your IRA

If the Service deposited your tax rebate directly to your IRA, the IRS will let you undo the deposit and give you an extra tax break in the process. Not only can you extract the funds tax and penalty free but you also needn't withdraw earnings attributable to the deposit, even if you previously put in the maximum for 2008.

Typically, earnings on excess contributions must be withdrawn, but the Service decided to waive this rule. You have until the due date of your 2008 return plus any extensions to take out the direct deposit. Thus, your IRA can get an additional earnings boost in the interim.

IRS Will Take Your Rebate Check If You Owe Them Money

Note that IRS will grab your rebate if you owe the feds money, applying it to your debt. This is true for folks who owe back taxes, have unpaid student loans or who have fallen behind on child support. The Service will even grab your rebate if you are repaying a tax debt in installments and you're current on those payments. The Revenue Service will send you what's left of the rebate after the debt is fully paid off.

But if you don't owe money and your rebate is still too small the Revenue Service may be the culprit. In the initial wave of direct deposits that were made in early May, the IRS sent about 1,500 to the wrong bank accounts. In addition, because of a processing mistake, another 350,000 or so rebates failed to include the extra \$300 per child allowed to parents.

Folks who were stiffed can expect to get paper checks in July containing the makeup payments. IRS says the number of glitches is tiny in proportion to the millions of rebate payments sent thus far. But that's small comfort to the thousands of filers who were shortchanged.

This Month's Question: Business Use Percent

Question - If a taxpayer has a Schedule C business in which he hauls heavy materials for customers using taxpayer's own dump truck but due to the slowdown in the economy, taxpayer goes to work as an employee for a trucking company and his truck sits idle, is the business use of his dump truck still considered to be 100%? In other words,

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com

Monthly Tax and Accounting Newsletter

Gregg Harvey, CPA

is using an asset for personal purposes the only thing that can bring down the business use percentage? Does sitting idle affect the use? Does it matter that if the taxpayer found independent work he would take it?

Answer - If it sits idle, and it's purpose is still business use, therefore 100% business. Think of it like a specialty machine used in a business. It's still 100% business use, even if you go for days, weeks or months without using it. As long as you don't use it for personal purposes, it's still depreciated at 100% business.

For More Information

For more information on anything covered in this Newsletter, please contact me. I provide tax, accounting, consulting, and other business services such as payroll and medical billing.

You can reach me at gregg@greggharveycpa.com, phone 248-650-2960, or cell 586-707-1077. You can also visit my website, greggharveycpa.com.

June, 2008

Phone 248-650-2960; website greggharveycpa.com, email gregg@greggharveycpa.com