

# 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:

The new Michigan Business Tax (MBT), new Michigan minimum wage rate, husband and wife partnerships, new (draft) form 990, and various tax deduction refreshers are included.

### Michigan Has A New Business Tax

On June 28th, the State House and Senate overwhelmingly approved enacting legislation for the Michigan Business Tax (MBT), moving the latest version of Senate Bill No. 94 onto the Governor's desk for approval.

Please contact me if you would like a complete copy of the Bill, but bear in mind it's 164 pages long.

Two-thirds of the MBT is based on gross receipts, while the remaining portion is a business income tax. Personal Property Taxes will be reduced by 12 mills for commercial property and 24 mills for industrial property.

Among the final changes made by the Conference Committee report included a full resolution of the concerns regarding unequal treatment of partnerships, LLCs and other flow-through entities.

The tax plan will replace the 29-year-old Single Business Tax (SBT), which expires Dec. 31. In the state Senate, the vote was 32-3. The vote in the House was 75-34.

The Michigan Business Tax is expected to produce the same revenue as the SBT -- about \$1.9 billion a year -- and give bigger tax breaks to businesses that invest in Michigan facilities and hire Michigan workers.

The MBT will reduce personal property taxes by up to 65% for manufacturers and by 23% for commercial businesses.

Manufacturers pushed hard for reducing the personal property tax, which they considered more onerous than the SBT. The state will reimburse cities and townships that lose revenue because of the personal property tax change.

Most analysts are viewing the final version of the MBT as a compromise to improve the state's business climate. But the state's most influential business lobby, the Michigan Chamber of Commerce, opposed the new tax, saying it left too many questions unanswered.

Insurance companies lobbied late, but unsuccessfully, for a bigger break under the new tax, which will tax them slightly more than the current system. They will pay a 1.25% tax on premiums they collect, instead of 1% tax, although they will retain tax credits they now receive.

The new plan will impose a 4.95% tax on business profits, plus a 0.8% tax on gross receipts minus deductions for purchases of goods and materials.

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Some smaller companies can choose instead to pay a 1.8% tax on profits.

Companies could cut their tax as much as 65% with credits for employee compensation, new facilities and research and development projects in Michigan.

In general, the tax aims to ease the burden on firms that make things and employ people in Michigan, while transferring more of the load to out-of-state firms that sell products and services here.

### **More On The MBT Coming Soon**

I serve on the Michigan Association of CPA's State and Local Tax Task Force. We have several events planned to analyze and explain the new tax law, and I will continue to provide updates in my monthly newsletters.

### **Michigan's Minimum Wage Going Up**

Michigan's minimum wage is increasing to \$7.15 an hour from \$6.95 an hour starting Sunday, July 1, 2007.

The increase is the second of three scheduled to take effect under legislation signed last year by Gov. Jennifer Granholm. The law initially bumped the wage to \$6.95 an hour from \$5.15 an hour in October.

The minimum wage is scheduled to rise to \$7.40 on July 1, 2008.

### **Husband and Wife Partnerships, Part 1**

Since this is a common and popular business arrangement, I will publish a series of short articles on this topic. Part 1 gives you the basic information. Subsequent updates will provide tax planning ideas and tips.

One of the advantages of operating your own business is hiring family members. However, the employment tax requirements for family employees may vary from those that apply to other employees. Below are some issues to consider when operating a husband and wife business.

A spouse is considered an employee if there is an employer/employee type of relationship, i.e., the first spouse substantially controls the business in terms of management decisions and the second spouse is under the direction and control of the first spouse.

If such a relationship exists, then the second spouse is an employee subject to income tax and FICA (Social Security and Medicare) withholding. However, if the second spouse has an equal say in the affairs of the business, provides substantially equal services to the business, and contributes capital to the business, then a partnership type of relationship exists and the business's income should be reported on Form 1065, U.S. Return of Partnership Income.

On May 25, 2007 the Small Business and Work Opportunity Tax Act of 2007 was signed into law and affect changes

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to the treatment of qualified joint ventures of married couples not treated as partnerships.

If spouses carry on a business together and share in the profits and losses, and file a joint return not be treated as a partnership for Federal Tax purposes. They should report the income on a Form 1040 Schedule C, Profit or Loss From Business in the name of one spouse as a sole proprietor

A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, and (2) both spouses materially participate in the trade or business, and (3) both spouses elect to have the provision apply.

All items of income, gain loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Thus, it is anticipated that each spouse would account for his or her respective share on the appropriate form, such as Schedule C.

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for Federal income tax purposes under the provision (i.e., in accordance with their respective interests in the venture).

This generally does not increase the total tax on the return, but it does give each spouse credit for social security earnings

on which retirement benefits are based. However, this may not be true if either spouse exceeds the social security tax limitation.

The effective date the provision is effective for taxable years beginning after December 31, 2006.

If your spouse is your employee, not your partner, you must pay Social Security and Medicare taxes for him or her. The wages for the services of an individual who works for his or her spouse in a trade or business are subject to income tax withholding and Social Security and Medicare taxes, but not to FUTA tax.

### **New Draft Form 990 for Non-Profits**

The Internal Revenue Service on Thursday released a new version of its Form 990 informational tax return, the primary tax document that charities file each year with the government.

The version released is a draft that charities, lawmakers, and other people will get to debate over the next few months.

Charities with \$25,000 or more in annual revenue are now required to file the form.

The tax agency said the new form would be easier for most charities to fill out while providing the IRS with additional and improved data to improve its enforcement of tax laws.

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The document has new questions for nonprofit organizations on such issues as employment taxes, executive compensation, overseas operations, justifications for tax-exempt status (such as details about free care provided by nonprofit hospitals), and joint ventures between hospitals and businesses.

The most controversial part of the proposed form may be a section that asks specific questions about whether organizations follow certain management and governance policies and practices. For example, charities are asked if they have policies on conflicts of interest, whistleblowers, and how long to keep documents and when to get rid of them.

The IRS hopes the questions will promote greater accountability among charities. Officials of the tax agency said they do not plan to impose penalties on organizations that lack such policies, but warn that charities without them run a greater risk of being audited.

The proposal to revise the form marks the first significant overhaul of the document since 1979.

The main part of the redesigned Form 990 consists of a 10-page document — what the IRS calls the "core form" — that all nonprofit organizations would complete.

The first page, a summary of the rest of the form, would provide a snapshot of a charity's key financial, compensation, governance, and operational information — including revenue, expenses, liabilities, and net assets — so that a person reading the form could quickly

see the size and key financial measures of the organization," the IRS said.

The summary page also would spotlight certain figures, such as a charity's fund-raising expenses as a percentage of the organization's total contributions or total expenses.

The main part of the form is accompanied by 15 supporting forms called schedules, one or more of which charities would be required to fill out, depending on their type and activities. The IRS said most organizations would only have to fill out a few of the schedules.

The current Form 990 for 2006 has a nine-page main part, two schedules, and 36 possible attachments.

During the next three months — through September 14 — nonprofit organizations and people interested in the form will have the chance to weigh in on the draft document and recommend changes to it before the IRS eventually makes the form final.

The IRS plans to require charities to start using the form for the 2008 tax year, which organizations would file in 2009.

The proposed document is available on the IRS Web site.  
<http://www.irs.gov/charities/index.html>

Organizations may send comments about the proposal to the IRS at [Form990Revision@irs.gov](mailto:Form990Revision@irs.gov).

The IRS also asked for comment on whether it should raise the revenue

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threshold for groups that file the Form 990 to \$50,000 from the current \$25,000

### Deduction Refresher – Vehicle Expenses

Ordinarily, expenses related to use of a car, van, pickup or panel truck for business can be deducted as transportation expenses. Use of larger vehicles, such as tractor-trailers, is treated differently and is not part of this discussion.

In order to claim a deduction for business use of a car or truck, a taxpayer must have ordinary and necessary costs related to one or more of the following:

- Traveling from one work location to another within the taxpayer's tax home area.
- Visiting customers.
- Attending a business meeting away from the regular workplace.
- Getting from home to a temporary workplace when the taxpayer has one or more regular places of work.

If a taxpayer uses a car while traveling away from home overnight on business, the rules for claiming car or truck expenses are the same as stated above.

It is important to note that costs related to travel between a taxpayer's home and regular place of work are commuting expenses and are not deductible.

Taxpayers can choose to use either the standard mileage rate or actual expenses to compute their allowable business

deduction. They may want to figure the deduction using both methods to see which provides a larger deduction.

The standard mileage rate may be used to figure the deductible costs of a vehicle that is owned or leased. If a taxpayer wishes to use the standard mileage rate for a leased vehicle, it must be used for the entire lease period. In other words, a taxpayer must use the standard mileage rate for the first year a vehicle is available for business use in order to use the standard mileage rate in subsequent years.

The standard mileage rate is adjusted annually by the IRS to reflect changes in the cost of operating a vehicle. In some situations it is adjusted during the year. The 2007 standard mileage rate is 48.5 cents per mile.

The standard mileage rate is used in place of actual expenses. Taxpayers who choose the standard mileage rate may not deduct actual expenses, such as depreciation, lease payments, maintenance and repairs, gasoline (including gasoline taxes), oil, insurance or vehicle registration fees.

Business-related parking fees and tolls may be deducted in addition to the standard mileage rate. Fees for parking at a taxpayer's main place of business or tolls related to commuting to and from that main place of business are personal expenses which are not deductible.

The standard mileage rate cannot be used if the taxpayer:

- Uses the car for hire (such as a taxi).

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- Uses five or more cars at the same time
- Claims depreciation or a section 179 deduction.
- Is a rural mail carrier who receives a qualified reimbursement.

Actual car or truck expenses include:

- Depreciation
- Lease payments
- Registration fees
- Licenses
- Gas
- Insurance
- Repairs
- Oil
- Garage rent
- Tires
- Tolls
- Parking fees

If business use of the vehicle is less than 100 percent, expenses must be allocated between business and personal use. Only the business use percentage of each expense is deductible.

For example, if, based on records maintained by a taxpayer, total actual vehicle expenses for a given year are \$2,500 and the vehicle is used 75 percent for business, the allowable deduction using the actual expense method is \$1,875 ( $\$2,500 \times 75$  percent).

It is important to keep complete records to substantiate items reported on a tax return. In the case of car and truck expenses, the types of records required depend on whether the taxpayer claims the standard mileage rate or actual expenses.

To claim the standard mileage rate, appropriate records would include documentation identifying the vehicle and proving ownership or a lease and a daily log showing miles traveled, destination and business purpose.

For actual expenses, a mileage log helps establish business use percentage. Taxpayers should also retain receipts, invoices and other documentation to show cost and establish the identity of the vehicle for which the expense was incurred. For depreciation purposes they need to show the original cost of the vehicle and any improvements as well as the date it was placed in service.

### **Gambling Income**

Taxpayers are usually not aware of the ease with which the IRS has successfully countered attempts to offset gambling winning with gambling losses.

Taxpayers typically think that they have enough losses to offset winnings, but the problem generally has been proving these loss amounts and your basis in them.

A common scenario involves a taxpayer declaring winnings based on a W-2G, and offsetting that with losses. On examination, if the taxpayer admits to any other gambling winnings, the IRS will assert that losses are used up against those winnings and thus are not available to offset the W-2G amounts.

It is up to the taxpayer to prove their losses. The best form of documentation is a diary or similar record (Revenue Procedure 77-29):

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1. Date and type of specific wager or wagering activity
2. Name and address of gambling location
3. Names of any other persons with the taxpayer
4. Amounts won and lost

What about slot machines? You need to document the date, time, and slot machine number.

A useful tip is that if you frequent casinos, consider doing all of your gaming using a 'Players Card' or similar. These cards can help you maintain your records.

### **IRS Correspondence Examinations**

The Service is increasingly relying on correspondence exams rather than face-to-face office or field exams. In a correspondence exam, the IRS asks the taxpayer to explain questionable items and send supporting documentation by mail. These types of exams increased 170% during 2002-2005, and now account for 70% of all audits.

If you receive a notice of such an exam, you should above all make sure you respond in a timely manner, and, make sure that you treat it with the same seriousness as you would a face-to-face examination.

### **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](mailto:gregg@greggharveycpa.com), phone 248-650-2960, or cell 586-707-1077. You can also visit my website, [greggharveycpa.com](http://greggharveycpa.com).

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