

tax report

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Your Midyear Tax Checkup

Smart tax planning requires some flexibility as the year unfolds. Midyear is a good time to assess how your tax picture looks and to identify appropriate planning strategies.

See Where You Stand

Look at the income you've earned to date, and estimate your anticipated earnings for the balance of the year. Also, will you be entitled to claim the same or a similar amount of tax deductions as last year? Have there been any major life changes that may significantly alter your tax picture?

Check Estimated Tax Payments

Generally, taxpayers must make four quarterly installment payments of estimated tax based on the amount of the "required annual payment" to avoid an underpayment penalty. (If you are employed, amounts withheld by your employer are remitted to the federal government and are generally deemed to be paid in equal amounts on each installment date.) The required annual payment is generally the lower of 90% of the tax shown on the current year's return or 100% (110%, for higher income individuals) of the tax shown on the prior year's return. If you receive significant income from sources other than your job, or if you are self-employed, you may be required to make quarterly estimated tax payments.

Adjust Withholding

If you are employed, check one of your recent pay stubs to see if your tax withholding is putting you well on your way to paying your 2011 tax. If too much or too little is being withheld, ask your employer's payroll department for IRS Form W-4 and complete it as soon as possible.

Account for Investment Gains

In conducting your midyear tax review, be sure to consider any capital gains realized as a result of the sale of appreciated capital assets, such as stock. Looking ahead to the balance of 2011, do you anticipate realizing any additional gain(s) from investment sales — or in the course of any other transactions? Remember, the maximum tax rate on net long-term capital gains and qualified dividends is 15% for 2011 and 2012.



Increase Plan Contributions

If you are contributing to a retirement savings plan at work, such as a 401(k) plan or 403(b) tax sheltered annuity, increasing your pretax contributions will reduce the amount of income tax you currently pay. Self-employed business owners who do not already have a tax-deferred retirement plan should consider starting one before year-end. Options to examine include a so-called "solo 401(k)" plan, a Simplified Employee Pension (SEP) plan, or a SIMPLE plan. We would be happy to discuss the advantages and limitations of each type. ■

Volunteer Work — Deductible?

Many Americans donate their time doing volunteer work for their favorite charities. While the value of a volunteer's services cannot be deducted, various out-of-pocket expenses incurred while volunteering may be deductible. Potentially deductible expenses include:

- Gas, oil, and other unreimbursed auto expenses incurred while performing services for a charity *or* 14 cents per mile, plus tolls and parking
- Travel, lodging, meals, and transportation costs associated with traveling on behalf of a charity
- Expenses associated with entertaining others on behalf of a charity
- The cost of uniforms worn while volunteering, but only if the uniforms are not suitable for general use

Volunteers can only deduct these expenses — along with charitable contributions — if they itemize their deductions. Out-of-pocket volunteer expenses cannot be deducted by individuals who claim the standard deduction.

short takes

Correspondence Audits on the Rise

In 2010, 78% of the 1.6 million audit notices sent to taxpayers were for correspondence audits to be completed through the mail. Only 22% of 2010 audits required a meeting with an IRS agent. Correspondence audits are less expensive for the IRS to conduct, and taxpayers usually only have to provide information about very specific items on their tax returns.

Tax Freedom Day

According to the Tax Foundation, in 2011, Americans will spend an average of 28% of their income to pay federal, state, and local taxes and work 102 days — until April 12 — to earn enough to pay their tax bill. The longest Americans have had to work to pay their taxes was 121 days in 2000.

Loan or Taxable Distribution?

In a recent case, taxpayers withdrew money from their wholly owned corporations' operating accounts to pay their own and their children's living expenses. The Tax Court rejected the taxpayers' claim that these amounts represented shareholder loans and concluded that the amounts were unreported constructive distributions that were taxable.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

Financial Pitfalls for Higher Income Retirees

If you're a retiree, you may want to think twice about your next investment decision. A sudden spike in income during retirement could lead to higher taxes on Social Security benefits or higher Medicare premiums. Financial moves such as selling appreciated stock, rebalancing your portfolio, or taking a taxable distribution from a qualified retirement plan or traditional individual retirement account (IRA) could have hidden costs.

Higher Medicare Premiums

If your income were to increase, so could your Medicare Part B premium and the amount you're charged for Medicare prescription drug coverage. In 2011, higher premium rates apply if the modified adjusted gross income* shown on your most recent federal tax return (generally, the return filed in 2010 for 2009) is more than \$85,000 (\$170,000 for married couples).



Taxes on Social Security

An increase in income could also mean you'll pay income tax on more of your Social Security retirement benefits. You won't have to pay taxes on Social Security benefits in any year your income** doesn't exceed \$25,000 (\$32,000 if married filing

In 2011, the Part B surcharge (paid in addition to the standard premium) ranges from \$46.10 to \$253.70 per recipient, per month. The additional monthly charge for Medicare prescription drug coverage in 2011 generally ranges from \$12 to \$69.10.

jointly). But once you go over the limit, as much as 85% of your benefits could be taxable.

You may be able to lessen the impact of these rules if you plan ahead. ■

* Adjusted gross income plus tax-exempt interest

** Adjusted gross income plus tax-exempt interest plus one half of Social Security benefits

Is Your Retirement Plan Up to Date?

A recent case* illustrates how important it is for plan sponsors to keep abreast of changes in the law. The case involved a one-person profit sharing plan that was inactive for a period of time, although it was not formally terminated. The plan was not amended to reflect recent tax law changes, and the IRS retroactively revoked the plan's tax-exempt status.

The court affirmed the IRS's action, rejecting the plan sponsor's argument that the plan's inactivity resulted in its termination. According to the court, a formal termination requires that a termination date be set, that plan participant benefits be determined based on the termination date, and that all plan assets be distributed in accordance with the plan as soon as administratively feasible after the termination date.

This case should serve as a reminder to keep your defined benefit, 401(k), profit sharing, money purchase, or similar plan up to date — or face the consequences. When the IRS disqualifies a plan retroactively, the tax consequences can be severe.

And you don't need to wait until the IRS audits the plan's 5500 (or 5500-EZ) to take action, as the plan sponsor did in this case. You have other options. The IRS offers a Voluntary Correction Program, so you can be proactive in amending your plan and getting up to date on any missed filing requirements. By taking this kind of action, you can ensure that your plan stays current and compliant with changes in the law. ■

* *Christy & Swan Profit Sharing Plan*, TC Memo. 2011-62

“Nexus” Can Create Taxing Issues for Businesses

Do you conduct business in more than one state? Although you may not have a traditional “brick and mortar” presence in states other than your primary location, you may sell your products or services to customers in other states. As a result, your business may face a variety of multistate tax issues.

A company’s activities in a state where it has a presence may give rise to a strong enough connection with the state — from the taxing state’s perspective — for the state to impose one or more types of tax. “Nexus” is a concept that is increasingly becoming an issue for companies with a multistate presence.

Sales and Use Tax

A state generally must have “substantial nexus” to a seller before it can require the seller to collect sales and use taxes. Generally, substantial nexus exists when a company has a physical presence in the state. This is determined by one or more factors, including the presence of a salesperson or a contractor or having a location within the state.

Gross Receipts or Other Business Taxes

Many states impose tax based on a seller’s gross receipts from the sale of products or services within the state, the value of a business’s transactions within the state, or some other modified base. These taxes imposed on sellers are separate from the sales and use taxes imposed on buyers, even though the same sales receipts give rise to both tax liabilities.

Income Tax

For a state to impose income tax, there generally must be a higher level of business activity than a level that would constitute nexus for sales-tax purposes. Typically, an out-of-state business is considered to have sufficient state income-tax nexus if it:

- Derives income from sources within the state
- Owns or leases property in the state
- Employs personnel who engage in activities that go beyond those protected under federal interstate commerce laws

Merely selling into a state should not be enough to cause nexus for income-tax purposes. Typically, a state may not impose a tax on an out-of-state taxpayer based on or measured by net income where the only activity connecting it to the state is the solicitation of orders for sales of tangible personal property — as long as such orders are approved and shipped from outside the state trying to impose the tax.

However, businesses should closely monitor their potential exposure to income tax as it relates to solicitation for the sale of intangible property, real estate, or services.

Franchise Tax

Generally, franchise tax is exacted on a business entity for the privilege of doing business in the state. The tax is typically imposed based on non-income factors, such as net worth or apportioned capital. If a business has substantial nexus for purposes of sales and use taxes, it may well have exposure to a state’s franchise tax.

Can We Help?

As many states confront budget deficits and consider additional revenue-raising measures, nexus is increasingly a means by which they seek to impose tax. Not all states impose the taxes described above. Also, keep in mind that even if your out-of-state business activities do not result in exposure to one type of tax, that does not necessarily mean those activities aren’t sufficient for the state to impose other taxes. We can help you determine whether your company may have multistate tax obligations. ■

Calendar of Filing Dates



AUGUST

1 Employee Benefit Plan Sponsors:

File 2010 Form 5500 Annual Return/Report of Employee Benefit Plan. If your plan is not a calendar-year plan, file the form by the end of the seventh month after the plan year ends. Plans with “one participant” file Form 5500-EZ.

1 Employers: File Form 941, Employer’s Quarterly Federal Tax Return; quarterly deposit due.

10 Employers: Extended due date for Form 941, if timely deposits were made.

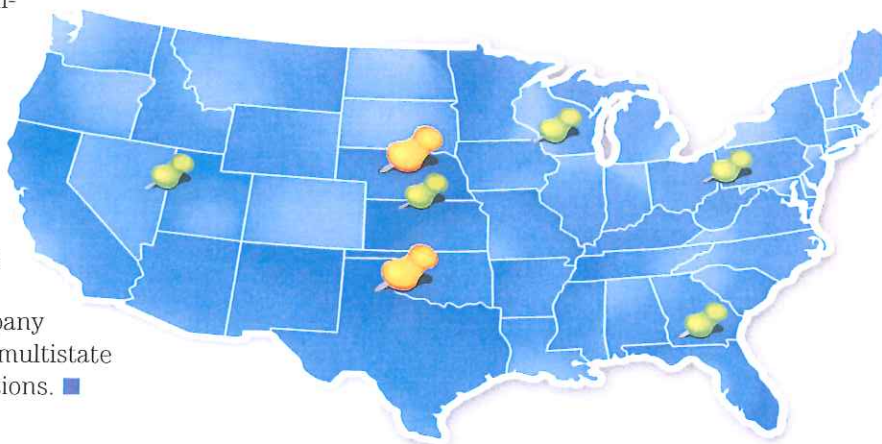
SEPTEMBER

15 Individuals: Third installment of 2011 estimated tax due; file Form 1040-ES.

15 Partnerships: Last day for filing 2010 return (Form 1065) by a calendar-year partnership that obtained a five-month extension.

15 Corporations: Last day for filing 2010 income-tax return (Form 1120, 1120-A, 1120S) by a calendar-year corporation that obtained an automatic six-month filing extension.

15 Corporations: Due date for depositing the third installment of estimated income tax for 2011 for calendar-year corporations.



Giftting a Home — with Strings Attached

When properly structured, lifetime gifts can remove property from a person's estate and reduce potential estate taxes. But many taxpayers are hesitant to part with their property completely — and that can lead to unexpected tax problems.

Let's say, for example, that Mom gives the family home to her children but retains the right to live in the home rent free for her lifetime. When she dies, the full value of the property will be included in her gross estate.

What if Mom simply transfers ownership of the home without any formal agreement that she may continue living there? If she does indeed continue to occupy the home for life, the IRS may still insist that the home's full value be included in her estate on the grounds that there was an *implied* agreement between her and the children regarding her continued use of the home.

Establishing a landlord-tenant relationship between child and parent can help bolster the argument against estate inclusion. But this is a contentious area. If you'd like to go over the rules in more detail or discuss your particular planning situation, please contact us. ■

Expanded 1099 Reporting, Free Choice Vouchers Eliminated

Many states and the federal government are gearing up for and implementing certain aspects of the Patient Protection and Affordable Care Act. However, certain other provisions of the health care reform law are not going into effect because they have either been repealed or their effective dates have been delayed.

Form 1099 Reporting

The health care reform law mandated additional Form 1099 reporting beginning in 2012. The existing requirement that business taxpayers report payments of nonemployee compensation, interest, rents, royalties, etc. totaling \$600 or

more was expanded to include payments made to corporations other than tax-exempt corporations. In addition, payments for goods and other property were to be reported (where payments to a single recipient totaled \$600 or more during the calendar year). These new reporting requirements promised to burden businesses with substantial additional recordkeeping. Now there's good news: The new 1099 rules have been repealed. (The requirement that rental property owners report certain payments to service providers on Form 1099 starting

in 2011 also has been repealed. This provision was originally included in the Small Business Jobs Act of 2010.)

Free Choice Vouchers

Under the health care reform law, starting in 2014, employers that offer health care coverage to their employees were to provide "Free Choice Vouchers" to

certain employees. Basically, the vouchers would have allowed qualified employees to use the funds their employer would have contributed toward employer-sponsored insurance to buy other (presumably more affordable) insurance on a federally supervised

marketplace for health insurance policies (exchanges). Now, the requirement to provide these vouchers has been repealed.

W-2 Reporting of Health Coverage

The health care reform law requires that the cost of employer-sponsored health insurance coverage be reported on Form W-2. The new requirement was to take effect starting in 2011, but the IRS has made it optional for all employers for the 2011 Form W-2. And for eligible small employers, the new requirement will be optional through at least 2012. ■

