

**“THE NEWSLEDGER”**

## **FEDS JOIN STATE TO ATTACK SUBCONTRACTOR STATUS**

The IRS is now collaborating with 29 state work-force agencies to combat perceived schemes and actions established to avoid employment and related employment taxes. This new initiative, known as the Questionable Employment Tax Practice, allows the IRS and state employment officials to share results of employment tax audits, exchange audit plans, plan and conduct audits jointly and cooperate on education and outreach efforts to employers. The IRS and 29 states have entered into this new “Memorandum of Understanding” which legally allows them to share information. This “MOU” supposedly protects the information from improper disclosure and is the first step needed for sharing your private information. The concept here is that the MOU will increase compliance with employment tax filing, subcontractor’s status initiatives and payment rules, while reducing the tax gap at both the federal and state levels. It is believed that the MOU will ensure that businesses are all competing on a level playing field by having each business pay its proper share of employment taxes. The true hidden initiative here is the future MOU focus on classifying workers. It is believed that as many as 15 percent of workers may be misclassified. It is felt that too often workers are surprised to find that they were treated as independent contractors. It is considered vital that employers pay their taxes and employees get their coverage – even if it bankrupts the employer!

## **ESTATE PLANNING - “WHERE ART THOU”!**

Presently estate planning is an accountant’s nightmare! The next four years of estate taxation resembles a yo-yo. For 2007 and 2008 the individual federal estate exemption is \$2 million. In 2009, the exemption increases to \$3.5 million. For the year 2010 the federal estate tax is eliminated! In 2011 the exemption reverts back to \$1 million. Under these circumstances the only good estate tax planning appears to result in death in 2010. What is the problem here? Blame the politicians! When the Republicans controlled the House and Senate, there was a push to permanently raise the exemption to \$5 million and cut the tax rate to 15% for estates of \$30 million or less and to 30% for larger estates. When the Democrats took control that plan was torched. The present Democratic controlled Congress is in no hurry to cut taxes for perceived high-incomes. Presently the exemption issue is at a standstill. Most professionals propose that the best bet scenario is a permanent continuation of the 2009 \$3.5 million exemption rules. Right now, other than utilizing the annual \$12,000 tax free gift rules, long-term estate planning is at best unpredictable.

## **COURT DENIES IRS ACCESS TO ACCOUNTANTS WORKPAPERS**

In a very important recent case the IRS suffered a major setback in its attempt to secure tax accrual workpapers. In the past it has been IRS’s policy to request workpapers

when a taxpayer claimed a tax benefit from a listed transaction. When there were multiple investments the IRS demanded all relative tax accrual workpapers. Practitioners have always objected to these demands, often refusing to turn over accounting details. Now the Court has sided with the practitioners. However, the IRS refuses to take this decision lying down, in fact the IRS Chief Council has vowed to continue the IRS policy of demanding tax accrual workpapers. He stated, “The court’s analysis is incorrect. We are not going to change anything because of this court case!” In fact, the IRS immediately filed suit against another taxpayer in another circuit in order to obtain their tax accrual workpapers. IRS is anticipating a different result in this Circuit! If not watch for an appeal!

## **TAX RETURN PREPARATION NOW “MORE LIKELY THAN NOT” GUESSING GAME**

The IRS has recently announced that tax practitioners will now be held to their new controversial more-likely-than-not return reporting standards. Now a tax preparer may not sign a return unless he reasonably believes the tax position would more-likely-than-not be sustained on its merits. Moreover, a practitioner may not advise a client to take a position on a return that does not satisfy the more-likely-than-not standard. This new standard covers all return preparers for all types of tax reports, not only income tax returns. The new practitioner penalties for first time offenders begin at the higher of \$1,000 or 50 percent of the income derived by the preparer. Repeat offenders and those who demonstrated willful or reckless conduct, are subject to a penalty of the higher of \$5,000 or 50 percent of the income derived by the preparer.

## **ONLINE AUCTION SELLERS MUST SEND UNCLE HIS XMAS PRESENTS**

In recent years online auctions have exploded in popularity – however Uncle Sam has his eyes on those taxable transactions. Auction and consignment sale income is generally taxable. Such income is subject to the same taxes as income derived from any other retail or service business. Included are employment, sales and federal income taxes. Any individual engaged in an auction or consignment sale must include such income on his or her personal income tax returns. Auction sellers can generally deduct ordinary and necessary business expenses. Also an auction or consignment seller may be able to deduct expenses for business use of his or her home. Be careful however, if you lose money the IRS will attempt to classify your transactions as a hobby, and the loss will not be deductible.

## **CONGRESS TELLS IRS – HELP HOMEOWNERS FACING FORECLOSURE**

Congress is putting the IRS under tremendous pressure to be helpful to homeowners facing mortgage foreclosure, rather than simply be the enforcer of laws – over which the IRS itself has no control. The IRS, as usual, is attempting to pass the buck by admitting that the relative tax laws are too

complex for individuals to go it alone – stating that taxpayers need to get professional assistance. This posture is a dramatic departure from the normal IRS position that they provide all the information that a taxpayer needs to pay the least amount of tax. In addition the IRS has established on its IRS.GOV website an information center, which contains a group of facts, answers and questions, with example worksheets, useful in determining debt cancellation income and gain on foreclosure computations. The potential problems to homeowners are that if a lender forgives any portion of the principal of a mortgage loan, there is a cancellation of debt, which generally results in taxable income. In the end the IRS admitted that they have no power to eliminate the income tax on debt cancellation gains and requested that Congress step in and appropriately change the Tax Code.

### **CONTRACTORS BEWARE – IRS IS WATCHING YOU**

The IRS wants contractors to know “Uncle is watching you”! In a recently published Fact Sheet the IRS reminded employers in construction; especially small businesses and independents, about proper tax reporting and accounting of business income as it relates specifically to construction industry activities. The construction industry is being reminded and warned about the following facts:

**INCOME** – Contractors, subcontractors and individual workers must report all income earned from all work performed, including side jobs and work performed for cash, credit on a bill and in exchange for services or goods.

**ACCRUAL ACCOUNTING** - Construction companies that use the accrual method must report income in the year earned and expenses in the year incurred.

**CASH ACCOUNTING** – The cash method requires that cash receipts be recorded as income when received and expenses reported when paid, on a consistent, year-to-year basis.

**EXPENSES** – Deductible expenses common to the construction industry include: utilities and rent, advertising, supplies, car and truck expenses, trade association dues, business licenses, small tools, and continuing education among others. Expenses for business assets expected to last more than one year must be capitalized.

Remember “Uncle is watching you”!

### **IRS’S “UNIQUENESS” TESTS TAXPAYER NERVES**

The IRS Code allows miscellaneous itemized deductions only to the extent that they exceed two percent of adjusted gross income for estates, trusts and individuals. The adjusted gross income of estates and trusts is computed in

the same basic manner as an individual. The problem here is determining which costs are direct fully deductible costs and which are limited miscellaneous costs. The IRS has proposed regulations that seek to clarify and create a uniform bright-line rule for determining what estate and trust expenses are subject to the two-percent floor rules. The IRS distinction would depend on whether the costs are unique to the estate or trust: if they are unique then they are fully deductible. The regulations define unique costs as costs that could not be incurred by an individual in connection with property that is not held in an estate or trust. At present the hot issue is whether fees for investments advice should be fully deductible. The Circuit Court concluded that advice costs were not subject to the two-percent floor rules, while several U.S. Courts of Appeal have concluded that advice costs are subject to the floor. The IRS’s new regulations state that advisory fees would be subject to the two-percent floor. While the IRS can not make new laws by issuing interpretive regulations, the courts customarily accord them substantial weight and are generally valid as long as they are reasonable constructions of the underlying law. What else would we expect from the IRS and its partner the Tax Court?

### **HOME DESTRUCTION DISASTER – CALL IRS BEFORE ALERTING FIRE DEPARTMENT!**

When a taxpayer sells a primary residence, which has been held for at least two years, a special income exclusion exists of up to \$250,000 for an individual and \$500,000 for married taxpayers. The IRS Code also provides for this exemption if the residence is destroyed, stolen, seized, requisitioned or condemned. However, the IRS has determined that in order to qualify for this exclusion, the residence must be completely destroyed. The IRS declared that in order for the exclusion to apply the taxpayer’s primary residence must be damaged to such an extent that the remaining structure could not feasibly be used to restore the property and the costs of repair must substantially exceed the fair market value of the taxpayer’s home before the damage. If these requirements are not met, any gain must be recorded as capital gain income on your personal income tax return.

### **IRS TIRED OF PLAYING OWNERSHIP GUESSING GAME**

The IRS recently released drafts for its new Form 1065, U.S. Return of Partnership Income, and Form 1120, U.S. Corporations Income Tax Return. The new and improved forms will include new in-depth questions regarding ownership. Form 1065 changes add questions to the existing Schedule B relative to information about cancelled debt and like-kind exchanges involving the partnership. Schedule K-1 changes require a partnership to identify contributions and distributions of built-in gain or loss property and to identify the maximum percentage of a partner’s share of profit, loss and capital in cases where those amounts change during the year. Form 1120 changes

require corporations to identify entities that own ten percent or more of the corporation and individuals who own fifty percent or more of the corporation. You must also identify any foreign or domestic corporation in which it owns ten percent or more of the total stock voting power, any disregarded entity it owns and any foreign or domestic partnership or trust in which it owns ten percent or more.

### **NATIONAL TAXPAYER ADVOCATE FIGHTS FOR TAXPAYER RIGHTS**

The Congressionally appointed IRS National Taxpayer Advocate, Nina Olsen, has established an ambitious 2008 program. Her goals include seeking improved IRS taxpayer services, challenge the IRS's private debt collection initiative, and an attempt to make the offer in compromise program more reasonable and accessible. She continues to criticize the IRS for its movement away from face-to-face taxpayer meetings and is fighting to prevent the closure of may existing taxpayer assistance centers. Nina maintains that the IRS can collect the same revenue as private debt collectors with more efficiency and with less risk to taxpayer rights. She also believes that the twenty percent maximum payment requirement recently enabled by Congress, is pricing potential offer in compromise participants out of the program. Nina maintains that too much emphasis is presently attached to "closing the tax gap". She feels that these very efforts are causing tremendous additional taxpayer stress and difficulty! What ever happened to the kinder, gentler Internal Revenue Service?

### **SMALL TAX EXEMPT ORGANIZATIONS BEWARE!**

Small non-profit organizations need to scrutinize their mail deliveries for a new IRS educational mailing. More than 650,000 small tax exempt organizations are being contacted to establish if they need to file a new annual notice. The Pension Protection Act of 2006 requires certain small exempt organizations to file e-Postcards, Form 990-N, Electronic Notice For Tax Exempt Organizations not Required To File Form 990 or 990-EZ in 2008. In the past small tax exempt organizations with gross receipts of \$25,000 or less were not required to file any reports. Under the new rules the IRS can now revoke the tax-exempt status of any organization that fails to meet its annual reporting requirements for three consecutive years. The new e-Postcard requires small organizations to provide a legal name and any other names used, mailing addresses, website addresses, annual tax period, employer identification number, name and address of a principal officer and a statement confirming that the organizations annual gross receipts are \$25,000 or less. The e-Postcard must be filed electronically.

### **IRS GOES ELECTRONIC – NOW YOU MUST TOO!**

On September 17, 2007, it became mandatory for all mid-sized corporations to file all required IRS returns electronically. Mid-size corporations are defined as those corporations with assets between \$10 million and \$50 million.

### **LOAN TO SELF NOT SELF SERVING**

The IRS recently agreed that a taxpayer could borrow funds from his self-directed IRA to assist his closely held business. In addition a life insurance policy purchased by the IRA to secure the note was not considered a prohibited investment transaction. In this specific situation the taxpayer made a loan from his self-directed IRA to his non-profit business. The IRA received a 5 percent 20-year promissory note, which was secured by a collateral assignment of a permanent life insurance policy insuring the taxpayer's life. We can only hope this "reasonable" IRS position is an indication of a future more reasonable overall IRS!

### **LAST MINUTE CONGRESS ACTION SAVES MILLIONS FROM AMT**

On December 11, 2007 Congress agreed to spare more than 20 million taxpayers from the alternative minimum tax for 2007. President Bush has agreed to sign this "patch" bill, which will ensure that millions of middle-class households will not be subjected to the Alternative Minimum Tax. Under this legislation, most of the four million taxpayers who paid the AMT last year will pay it again. The AMT was originally passed by Congress in 1969 to guarantee that wealthy households pay at least some tax. However, the measure, which allows fewer deductions than ordinary tax rules, has never been adjusted for inflation. As a result a growing number of American households have been forced to pay the AMT. This new bill adjusts for inflation.

### **ZIMMERMAN & ASSOCIATES EVENTS**

Z&A CHRISTMAS CRUISE – The entire Z&A staff took their better halves on the fantastic Lady Baltimore Christmas cruise. The Lady Baltimore, which is docked at the beautiful Baltimore Inner Harbor, took our rowdy group for a four hour long sight seeing tour of the amazing Baltimore skyline. The food was great, the drinks were ..... OK who remembers the drinks? Diamond studded Z&A pinky rings were exchanged between all spouses ----- and permanent wonderful memories were etched in our festive minds! This was truly a Christmas event to remember!

Z&A would like to take this opportunity to introduce our new bookkeeping, software, and small business expert to our readers. Patricia Geisendaffer comes to us with a substantial experience background. She has been a bookkeeper, office manager, accounting manager, small business owner, and operator of her own small bookkeeping and accounting firm. Pat has extensive experience with various computer accounting systems. Z&A has found

themselves a highly experienced and effective professional!  
Join us in welcoming Pat to our Z&A team!

Z&A's list of clients has been expanded to include the following group of fantastic businesses:

WHITE PROPERTIES, LLC  
VISIONARY JUGGERNAUTS, INC.  
STEELE CONSULTING SERVICES, INC.  
METRO GROUP, LLC  
METROPOLITAN INVESTMENTS, LLC  
HOTEL CHARLES, LLC  
METROPOLITAN DEVELOPMENT, LLC  
METROPOLITAN COMMERCIAL SERVICES, INC.  
JIM MCDONALD HOME IMPROVEMENTS, INC.  
LIVING SOLUTIONS, INC.

Thank you all for choosing our great Z&A accounting and tax team!

The holidays are so full of hustle and bussle that we rarely have the time to stop and remember all of the wonderful people that make our lives worth living. Our spouses, our children, our relatives and our friends give us day to day love, life and appreciation, that allows us to step above the crowd and achieve the here-to-fore thought unachievable. We here at Z&A ask that you, upon reading this letter, stop and ponder this year of your life. Learn from the bad, love and cherish the good, and open your hearts and minds to a forgiving, loving, enchanted 2008!

Merry Christmas, Happy Holidays – We love and appreciate you all!

**FOOD FOR THOUGHT**

When first we begin to perceive; our understanding is lost in thought!