

“THE NEWSLEDGER”

THINGS TO PONDER DURING 2008:

- Home builders are getting special audit attention from the IRS. Agents are looking for inappropriate deferrals by contractors using the completed-contract method of accounting. Among the targets are developers who sell lots, but don't report income until common improvements are done, and those contractors using a subsidiary to build all houses in a project.
- IRS has reinstated its random audit program. The IRS will select 13,000 random returns a year. Agents will look for unreported income and overstated deductions or tax credits. Unincorporated small businesses will be a major focus.
- IRS says that contracts saying workers aren't employees have no effect. IRS will still reclassify independent contractors as employees if the firm has substantial control over them.
- IRS continues its attack on independent contractors. The IRS has unveiled an electronic matching system to identify firms that issue 1099's with payments of at least \$25,000, to five or more workers who don't have any other sources of earned income. The IRS suspects that in such cases the contractors may be employees. Businesses meeting these criteria will see employment tax audits in their future.
- The Social Security wage base is \$102,000 for 2008. Anticipated to be \$106,800 in 2009, \$111,600 in 2010, \$116,100 for 2011, and \$121,500 for 2012.
- The IRS has received its first wave of Forms 8919, which taxpayers file with their returns, to tell IRS that they believe their employers incorrectly classified them as contractors. A flood of these forms have been received! The filing of this form allows an individual to avoid paying self-employment taxes to the IRS.
- More independent contractor problems are on the horizon! The Democrats are pushing for a high profile probe into alleged intentional misclassifications by BIG government contractors, increasing the chances for new laws that would strengthen IRS' hand during exams. The bill would allow IRS to require reclassification of contractors as employees prospectively and end industry practice as a way for firms to avoid reclassification.
- The limit on expensing capital assets is increasing to \$250,000 for 2008. The full expensing can be claimed up until \$800,000 of assets are placed in service during the year.
- Congress is pressuring the IRS into allowing the expensing of cell phones as a tax free fringe benefit.
- IRS interest rates will fall again. The service will now charge 5%. For corporations that owe the IRS more than \$100,000 in back taxes the rate will be 7%. The IRS will pay 5% to individuals and 4% to corporations on refunds. However corporation refunds in excess of \$10,000 will only get 3.5%.
- The IRS has secured help from 33 states in auditing for independent contractor vs. employee status. The IRS and these states will now share data from payroll tax examinations. Federal and state agents will train together and even conduct joint audits.
- Undervaluing inventory can now draw stiff tax penalties. IRS can now assess back taxes for all years since inventory valuation errors were made. Even if the years are closed by statute; the IRS has the right to adjust the firm's income under the change in accounting method doctrine.
- Uncle Sam is cracking down on contractors who owe back taxes. New rules now force bidders on federal contracts to disclose unpaid federal taxes or outstanding tax liens if the amounts exceed \$3,000. They must also

divulge tax judgments of more than \$3,000 that have been issued against them in the past three years.

- If you owe back taxes the IRS can now slap a levy on your pension plan; however the IRS can not force you to take distributions from the plan to satisfy the tax debt. If you are eligible to start taking payouts, but choose to wait, the IRS must wait with you.
- The IRS now has a secure Internet portal that allows taxpayers to access their data by computer. Taxpayers can now view and print out three years of tax returns and other account information.
- Some good news for diligent businesses that made a late tax deposit. If a business has made timely tax deposits for at least the past three years, it can get a late deposit penalty abated simply by notifying the IRS. Businesses with less than perfect deposit records can get relief as well, but they will have to demonstrate reasonable cause for delay.
- The IRS announced that it is raising the standard mileage deduction from 50.5 cents a mile to 58.5 cents a mile. This new optional rate goes into effect on July 1, 2008.

THE FOOD, CONSERVATION AND ENERGY ACT OF 2008

The recently enacted farm bill (the Food, Conservation and Energy Act of 2008) has more than \$1.7 billion in tax relief and tax incentives. The farm bill's tax incentives include:

- Exclusion of conservation reserve program payments from self-employment income for retired or disabled farmers:
- Tax credit for production of cellulose fuels;
- Tax credit for securing pesticides and fertilizers;
- Like-kind exchanges for mutual ditch, reservoir and irrigation company stock;
- Timber-related provisions;
- Extension of enhanced conservation easements;
- New forestry conservation bonds; and
- Temporary tax relief for the Kansas Disaster Area.

To finance these tax incentives, the farm bill will limit excess farm losses, reduce the current tax credit for ethanol production, raise corporate estimated tax payments for three months in 2012 and codify certain farm-related information reporting requirements. The bill also modifies the farm and non-farm optional methods for reporting self-employment earnings.

PRESIDENT BUSH SMIRKS WHILE SIGNING THE MILITARY TAX RELIEF BILL

On June 17, 2008, President Bush signed into law the Heroes Earnings Assistance and Relief Act of 2008. The Military Tax Relief Act passed unanimously in the House and by voice vote in the Senate.

- The law authorized the Treasury and IRS to issue economic stimulus payments to military couples filing joint returns so long as one spouse has a valid Social Security number and is a member of the U.S. Armed Forces.
- Reservists are permanently allowed, if called up to active duty, to make penalty-free withdrawals from retirement plans and also gives reservists enhanced access to flexible spending arrangements sponsored by their employers.
- Survivors are now permitted to contribute military death benefits and military insurance proceeds to Roth IRA plans without regard to dollar limitations.
- The law creates a temporary differential tax credit for small employers (20% of differential pay up to \$20,000).
- Adoption Taxpayer Identification Numbers are now treated as valid identification numbers for purposes of the economic stimulus payments.
- Tax-free combat pay will now be considered as earned income for the Earned Income Credit.
- The law gives retired veterans more time to claim tax refunds after disability determinations.
- The law enhances Supplemental Security Insurance for veterans.
- The first-time homebuyer mortgage bond exception is extended for veterans.
- Finally the law clarifies the tax treatment of bonuses paid by states to veterans and first responders.

These benefits are to be paid for with tax incentives by treating foreign subsidiaries of U.S. companies as American employers for purposes of Social Security and Medicare taxes. Revenue of more than \$800 million over 10 years is expected to be collected from this change. Additionally the law imposes a market-to-market tax regime on wealthy individuals (generally individuals with a net worth of \$2 million or more) who renounce their U.S. citizenship. This tax incentive is expected to garner more than \$400 million over the next 10 years.

KICK'EM WHEN THEIR DOWN IRS – CREDIT CARD INTEREST NOT DEDUCTIBLE BUT FORGIVENESS TAXABLE

The Tax Court recently required a married couple to report all amounts forgiven in settlement of a credit card account as discharged indebtedness income and, therefore part of their gross income. The court held that, even though all of the amount forgiven may have been back interest charges, the purchase money debt reduction exception did not apply and therefore the discharge of interest was considered discharge of indebtedness.

Under the Mortgage Forgiveness Debt Relief Act of 2007, homeowners whose mortgage was partially or entirely forgiven during 2007 could exclude forgiven debt in connection with up to \$2 million of mortgage indebtedness secured by the principal residence. This is not so, however, for credit card debt. Talk about an unfair rule! Steal from the down and out and give to the stupid home buyer! That's how Uncle Sam envisions Robin Hood!

NEW VEHICLE DEPRECIATION LIMITS

The IRS recently released the new depreciation limits for business automobiles, trucks and vans placed in service during 2008. The inflation-adjusted limits are slightly lower than 2007 amounts. The revenue procedure also includes the additional first-year depreciation deductions provided by the Economic Stimulus Act of 2008.

The maximum depreciation amounts for passenger automobiles first placed in service during 2008 are:

- \$2,960 for first year (\$10,960 for vehicles qualifying for the 50% first-year depreciation);
- \$4,800 for the second year;
- \$2,850 for the third year; and
- \$1,775 for each tax year thereafter.

The IRS allows higher depreciation deductions for light trucks and vans due to the higher purchase price of these vehicles. These amounts for 2008 are:

- \$3,160 for the first tax year (\$11,160 for vehicles qualifying for 50% first-year bonus depreciation);
- \$5,100 for the second year;
- \$3,050 for the third year; and
- \$1,875 for each year thereafter.

ADMINISTRATORS OF DEFINED CONTRIBUTION PLANS BEWARE

The Supreme Court recently handed a huge victory to employees when it unanimously ruled that participants in defined contribution plans can sue the administrative/employer for losses to their individual retirement savings accounts that arise from breaches of fiduciary duties.

ABANDONMENT TEST FOR LOSS IS WORTHLESS!

After the Internet meltdown of a few years ago, many individuals were left holding stock with little or no value. Some taxpayers tried to abandon their shares to secure an ordinary rather than a capital loss. IRS did not agree. Generally a security must become totally worthless to result in a deductible loss. New IRS regulations establish that the abandonment of a security will now result in the security being considered worthless. The taxpayer would be required to have permanently surrendered and relinquished all rights in the security and received no consideration for said security. The regulations declare that a loss that is a capital asset is treated as a loss from the sale or exchange of a capital asset on the last day of the year.

IRS ABUSES DISCRETIONS IN DENYING INNOCENT SPOUSE RELIEF

In a very unusual ruling, the generally IRS friendly Tax Court has found that the IRS abused its discretion in denying a taxpayer innocent spouse relief from a joint income tax liability. The Tax Court found that the IRS failed to consider all of the factors that must be assessed to properly determine relief. The taxpayer's victory here is significant in that the Tax Court has exclusive review jurisdiction in Innocent Spouse Relief cases. The Tax Court rebuffed the IRS's attempt to limit the court's review to only evidence presented in the administrative record. The determination as to whether innocent spouse relief is warranted is a fact-intensive assessment. When evaluating whether an individual is entitled to equitable relief the IRS must consider threshold factors. Those factors include spousal abuse, economic hardship, and knowledge of an understatement, deficiency or failure to pay taxes. This list is nonexclusive, allowing the IRS – and the Tax Court in its review capacity – to consider additional factors as well.

NON-COMPETE AGREEMENT VS GOODWILL – WHO IS THE TAX LOSER?

A federal district court found that non-compete agreement payments received by a taxpayer were actually ordinary income for future services to be rendered to the business. The taxpayer attempted to claim that the payments were actually goodwill, however the court rejected this contention. The court said that the taxpayer failed to show by "strong proof" that, despite the non-compete agreement's express terms, the parties intended for the \$1 million payment to be a purchase by the acquiring corporation of the taxpayer's personal goodwill. The court stated that the language of the non-compete agreement expressly prohibited the taxpayer from diverting business from the company and soliciting employees to leave the company; the purpose of which was to protect the company's goodwill. DUMB!!! WHERE DID THE GOODWILL COME FROM THAT HE IS PROTECTING?

ZIMMERMAN & ASSOCIATES EVENTS

Z&A's company picnic has been expanded to include all of the tenants of the Z&A Professional Building. Z&A CPA's were joined by Wolverine Construction and Mustang Construction employees in our summer blast. Our Texas Chinese Luau included a whole grilled pig, steaks, crabs and various Chinese delicacies! We imbibed on beer, wine, frozen drinks, and; there may have been some sodas and water available! Z&A sponsored the hugely popular slot machine! Every guest received 5 chances to win the jackpot of \$100. Two lucky attendants won! Other activities included video games, volleyball, swimming, saunaing, badminton, horseshoes, hot tubing, basketball, soccer, croquet, ladder golf, bocce ball and billiards. All this and great friends too! A special thanks to the Zimmerman's for hosting this tremendous summer event!

Z&A offices will soon have an exciting new look! We are in the process of renovating our offices, making space usage more efficient, effective and beautiful. Our new set-up includes an employee lounge and work-out center – and new bathrooms with a shower.

Bob & Carol Zimmerman invited Dave and Rich to join them and their family to celebrate their daughter Jamie's 21st birthday in Key West, Florida. They rented a beautiful five bedroom, five bath house with swimming pool and hot tub – only two blocks from Duval Street! Did you know that there are 363 bars in Key West? Define fun – KEY WEST!

It took three tries but the Z&A golf team finally got to play in the 11th annual Firebirds Golf Tournament. After two rain postponements our team of Rich Brunner, Lloyd Smith, Doug Dillon and Todd Warren pounded the links. We can only hope that the Track Club has more success than our golf dream team!

A new major player has been added to our ever expanding staff of professionals. Ryan Yoder comes to us after ten years of professional financial analyst success. Ryan, a graduate of "Notre Dame" – the Fighting Irish, - is already fighting the "Big Ten" war with Bob Zimmerman, a graduate of "Penn State" – the Nittany Lions! The truth is they are great friends and Ryan is being personally trained by Bob to eventually take over his responsibilities at Z&A.

Z&A brought another young aggressive winner to our professional team. Brian Gill comes to us from the University of Baltimore; and an internship with a small local CPA firm. Brian has strong analytical and problem-solving skills. He is hardworking and intense; outgoing and friendly!

Z&A is proud to announce our acceptance of the following quality companies to our client list:

CONTROL TECHNOLOGIES, INC.

KSN INSTALLS, INC.
HOT ROD CHARTERS, LLC
KL VENTURES, LLC
THE GUILDHALL, LLC
CUSTOM CONSTRUCTION, INC.
R&D EQUIPMENT, LLC
LONG GREEN PROPERTIES, INC.
JEFF BIRD OC, LLC
JEFF BIRD, LLC
H&H KINGDOM
DA MANAGEMENT, INC.
SAFE HARBOR CHRISTIAN COUNSELING OF
SOUTHERN MD, INC.
THE ERIN GROUP, LTD
WAYNE DAVIS PLUMBING, INC.
ED INDUSTRIES, INC.
ED MECHANICAL, INC.
A&C PLUMBING SERVICES OF SOUTHERN
MD, LLC
PERSONALIZED TOUCH CATERING, LLC
INNOVATIVE STEM SOLUTIONS, LLC

FOOD FOR THOUGHT

When aggressively climbing up the business ladder of success; few think about the trepidations of carefully climbing back down – to a successful retirement.