

Newsletter

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Hot Tax Topics

I've just returned from attending a two-day tax seminar. While we are still awaiting final tax laws for 2010, there are still items I wanted to share.

Corporations & Sole Proprietors

Again this year there is an increased focus on Schedule C (Profit or Loss from a Business) as a source of the "tax gap." IRS statistics show that individual tax returns with a Schedule C have a higher audit rate than other returns. "S" corporations are also facing higher scrutiny.

Typical items for examination are as follows:

1. A Schedule C that reports a hobby activity with no profit motive.
2. Unreported income – cash deposits versus sales, depositing business income into personal accounts and not reporting it.
3. Co-mingling business and personal activity in one bank account.
4. Personal deductions reports on business returns such as:
 - a. Personal telephone and cell phone costs,
 - b. Travel expenses for a spouse,
 - c. Personal insurance,
 - d. Meals and entertainment,
 - e. Furniture and equipment that ended up being personal.
5. Worker classification – employee versus independent contractor. A Senate committee found that as many as 30% of businesses misclassified employees as independent contractors. The Department of Labor has hired more investigators to pursue misclassifications.
6. Lack of substantiation for automobile usage. You must keep a mileage log!
7. A difference between the amounts of income reported on a loan application versus the tax return's income.
8. Round numbers are a tip off that there is a lack of business records.
9. Unlikely business expense such as new "toys" like a Wii or a flat screen TV.
10. Large miscellaneous or "other" deductions. The more information or details you provide; the fewer questions the IRS may have.

New Requirements - January 1, 2011

The Housing Assistance Act of 2008 requires banks and other processors of merchant payment card transactions to report a merchant's annual gross payment card receipts to both the IRS and the merchant. (Be sure your credit card processor has your federal tax identification number or they will withhold 28% for tax.)

While this new ruling will allow matching of credit card sales, of particular interest to the IRS are businesses and individuals who receive most of their income in cash.

The most significant indicator that income has been underreported is a consistent pattern of losses or low profits. Other indicators are:

1. A lifestyle or cost of living that can't be supported by the income reported.
2. A business that continues to operate despite losses year after year with no apparent solution to correct the situation.
3. Unusually low annual sales for the type of business.

Electronic Filing

Included in the Worker, Homeownership and Business Assistance Act of 2009 was a provision that enables the IRS to require tax preparers to file individual tax returns electronically. We will have to comply with this ruling and file all returns electronically.

Most businesses are required to pay all taxes by EFTPS beginning 2011. Be sure you are enrolled before January 1st. We can assist you in the application process.

Education Credits & Tips

Hopefully the American Opportunity Tax Credit, Lifetime Learning Credit and the Higher Education Expense Deduction will be extended. Did you know that if a "third party" (i.e. Grandma) makes a payment for tuition costs for the taxpayer, spouse, or a claimed dependent, the student (or taxpayer claiming the student) is treated as receiving the payment and then paying the tuition for purposes of the AOTC, Hope or Lifetime Learning Credits?

Some helpful web sites:

www.fafsa.gov to fill out the FAFSA form

www.fafsa4caster.ed.gov to estimate your financial aid

www.savingforcollege.com for information on 529 Plans

www.fastweb.com – free, searchable scholarship database that locates sources of financial aid suitable to the student and also for scholarships www.scholarshipexperts.com

Itemized Deductions

While it is often difficult to deduct medical expenses due to the 7.5% adjustment for adjusted gross income. There are often overlooked items that may allow you to take this deduction in years when you have high medical bills. According to the IRS Publication 502 some other medical expenses you can deduct include:

Acupuncture, Ambulance, Annual Physical Exam, Artificial Teeth, Birth Control Pills, Breast Reconstruction Surgery, Capital Expenses (Widening doors, installing railing or smoke detectors), Chiropractors, Contact Lenses, Crutches, Dental Treatments, Eyeglasses, Eye Surgery including Laser Surgery, Fertility Enhancement, Lab Fees, Lodging, Oxygen, Pregnancy Test Kits, Psychiatric Care, Therapy, Weight Loss Program (as treatment for specific disease such as obesity, diabetes). Medical mileage is also deductible at 16.5¢ per mile.

Charitable Contributions

There continues to be misinformation concerning the deductibility of cash and noncash contributions. For cash contributions, taxpayers must have a statement from the charity showing the name of the charity, the date of the contribution, and the amount given. There is **NO dollar threshold** for the recordkeeping requirement.

In a report to the U.S. Senate in May of 2009, it was reported that individual taxpayers overstated the deductions they took for donating cash to charities by an estimated \$13.8 billion! Therefore the IRS is looking more closely at charitable contributions.

For cash donations less than \$250, a bank record (i.e. cancelled check) or written communication from the charity is required.

For noncash donations, a receipt or other written record showing the name of the organization, the date and location of the contribution, and a reasonably detailed description of the property is required.

For contributions of \$250 or more (cash or noncash) at one time – contemporaneous written acknowledgement from the organization is required. A cancelled check by itself is not sufficient.

Client News

We will be mailing our year end tax organizer the first week of January. The organizer helps you gather the necessary information for us to prepare your tax returns and helps us keep our fee at its reasonable rate. Tax appointments will begin February 1, 2011. We are grateful for your referrals.

Office News

Thank you again for your continued support of our business. We appreciate each of you. Please contact us if you have questions or need additional information on these items or tax laws. We look forward to seeing you in the New Year.

Sincerely,

Bob & Alice Reeves
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