

November 8, 2010

YEAR-END TAX PLANNING LETTER



It is time to begin year-end tax planning for you and your business. **This letter is to remind you of the actions you must take, before year-end in many cases, to properly report certain items in order to claim deductions for them, avoid problems with the IRS, and to avoid substantial penalties.**

Not all of the items mentioned below necessarily apply to you. Select and address the items that are applicable to you. However, you will want to look over other items mentioned, in case your circumstances have changed. The numbers next to the bullet points refer to the number of the attachment that follows this letter:

1. **Company Owned/Leased Vehicles** - if your company deducts any expenses connected with owned or leased vehicles you need to read this section.
2. **S Corporation Health Insurance Paid for Shareholders** (including LLC that has elected to be an S corporation) if your company has paid health insurance for its shareholders and their family members you need to read this section.
3. **S Corporation Shareholder(s)' Compensation** - you MUST read this if you own an S corporation.
4. **Issuance of Form 1099-Misc** - if you have a business, including a corporation or a partnership, or own a rental property you should read this.
5. **Expense Reimbursement Plans** - if you reimburse or advance money to your employees, including giving them auto allowances, read this section.
6. **Travel, Meals & Entertainment Deductions** - read this if you are deducting any travel/lodging, meals or entertainment expenses.

This list is not all-inclusive, but addresses the most often overlooked items that create problems for businesses in the form of lost deductions and the IRS penalties.

Finally, we wanted to make you aware of the tax incentives passed in recent tax legislation. Also included in this letter is a summary of only some of the more-applicable items.

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We hope this information is helpful. If you would like more details, please contact a Kerkering Barberio professional tax advisor at 941-365-4617.

#1 – Company Owned/Leased Vehicles

Company vehicles include all leased or owned vehicles. The tax laws state that the value of the personal use of a company vehicle is a taxable fringe benefit. This benefit is additional compensation and is subject to the typical payroll rules. These rules require the withholding of federal income tax, social security and Medicare taxes, along with proper reporting. The IRS allows employers to adopt any 12-month period that ends between October 31 and December 31. We suggest that all clients take advantage of a special IRS rule that allows the calculation of the fringe benefit to be based upon a **fiscal year ending October 31, 2010**. The necessary worksheets can be prepared now so that you can fulfill all filing and depository requirements by year-end.

The steps that you should take are as follows:

1. Total your auto logs for each vehicle for a twelve-month period through October 31, 2010.
2. Have each applicable employee complete and sign the enclosed vehicle information questionnaire. Please make additional copies for each vehicle owned or leased.
3. **Send the completed questionnaires to our office before November 30, 2010. We will determine the value of the fringe benefit from the information you provide.**
4. By December 15, 2010, we will contact you regarding the fringe benefit value and we will calculate the required Federal tax deposit. **If you were using a leasing or a payroll company, you need to contact them with this information.**
5. By January 31, 2011, you will need to notify each affected employee that you used the special October 31st accounting rule and that only social security and Medicare taxes will be withheld from wages for the upcoming year. A copy of the required notification is attached. Please notify the employees, (including shareholder employees) and have them sign the notification form.

A taxpayer must maintain adequate records or other corroborative evidence to support the business portion of auto expense. The IRS generally disallows any deduction unless the taxpayer can substantiate by adequate record or sufficient evidence the (1) amount of an expenditure (or mileage for vehicles), (2) time and place of use, (3) business purpose, and (4) business relationship. Failure to comply with this requirement can result in loss of the deduction. The Tax Court has also disallowed the deduction because of the taxpayer's failure to maintain a mileage record. Under the IRS regulations, the taxpayer may substantiate vehicle expenses by maintaining both:

1. An account book, diary, or similar record; trip sheets; expense reports; or other corroborative evidence.
2. Documentary evidence including receipts, paid bills, and similar information.

#1 – Company Owned/Leased Vehicles

VEHICLE INFORMATION QUESTIONNAIRE

Employer: _____

VEHICLE INFORMATION

If there is more than one vehicle, please complete a questionnaire for each vehicle

Make: _____ Model: _____ Year: _____

Options: _____

Mileage as of **October 31, 2009**: _____

Mileage as of **October 31, 2010**: _____

Date placed in service: _____

TO BE COMPLETED BY EMPLOYEE

Employee Name: _____

Employee Social Security Number: _____

Total miles driven through _____, 2010 (Date): _____

Total business miles driven through _____, 2010 (Date): _____

Was vehicle used for commuting? (Y or N): _____

What is the average daily round trip commuting distance? _____

Was the vehicle available to the employee in off-duty hours? (Y or N): _____

Was another vehicle available to the employee for personal use? (Y or N): _____

Do adequate records or sufficient evidence exist to justify the deduction for business use? (Y or N): (If no, all use is considered personal.) _____

Are the records written? (Y or N): (If no, all use is considered personal.) _____

Was this vehicle out of service for any portion of the year? (Y or N): _____

If so, how many days? _____

Did employer provide fuel? (Y or N): _____

If yes, do you want to value the fuel for this vehicle at 5.5 cents per mile or actual cost? _____

If actual cost, enter total fuel cost for this vehicle. _____

* Please complete one form per auto. If you leased or purchased an auto in 2010, please send us a copy of your invoice or agreement.

I HEREBY ATTEST THAT THE INFORMATION LISTED IN THE EMPLOYEE'S PORTION ABOVE IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE.

Employee's Signature

Date

#1 – Company Owned/Leased Vehicles

Required Notices Involving Auto Usage

Instructions: The following memo, as adapted, can be distributed to notify employees of the business's use of a special accounting period and election not to withhold federal income tax.

January , 20

TO: ALL EMPLOYEES PROVIDED WITH COMPANY AUTOS

FROM:

RE: INCOME TAX IMPLICATIONS OF USE OF COMPANY AUTOS

The tax laws and IRS regulations impose stringent rules regarding the tax effect of the personal use of employer-provided autos and require recordkeeping to document the business use of such autos.

The following is a general discussion of the personal income tax considerations associated with the use of the company auto provided to you. We recommend that you consult your personal tax adviser regarding any specific questions you may have.

COMPANY POLICY

1. For 2010, in accordance with IRS Ann. 85-113, the corporation adopted an October 31 cutoff date for gathering information to report the income related to your personal use of a company auto on your 20__ Form W-2. The corporation calculated the amount of income added to your Form W-2 by using the Vehicle Information Questionnaire Corporate Auto Mileage Statement on which you indicated the total miles and business miles driven in your corporate auto from November 1, 20__ to October 31, 20__. Included with your Form W-2 will be an individualized statement showing the income calculation.
2. For 2010, in accordance with IRC Section 3402(s), the corporation elects to not withhold federal income tax on the taxable portion of your use of a company auto or on the value of any corporate-paid gasoline costs. Any social security and Medicare (FICA) withholding needed as a result of your personal use of the auto will take place in the final 2010 pay period.

SUGGESTIONS ON HOW TO SUBSTANTIATE BUSINESS USE

1. You must keep your own records of business use of the company auto. We suggest that you keep a log showing the date, amount, and business purpose of each use or cost associated with it. To determine your nonbusiness use, simply calculate your total miles and then subtract your business use miles for the period beginning November 1 and ending October 31.
2. Failure to maintain adequate records may result in the entire value of the auto being treated as taxable income to you. Such treatment could result in an assessment of back taxes, penalties, and interest that could create a significant financial burden for you. Proper documentation will ensure that the corporation reports the proper amount (no more—no less) of income from personal use to you on your Form W-2.
3. You should keep your records for at least the three years after the current year so your documentation will be available in the event of an IRS audit.

#2 – S Corporation Health Insurance Paid for Shareholders

Accident and health insurance premiums paid by an S Corporation (including any LLC that elected to be treated as an S corporation) on behalf of any shareholder (or family member) that owns more than 2% of the stock, **under an established medical plan**, is NOT deductible as a health insurance expense. The spouse, children, grandchildren, and/or parents of a more-than-2% S shareholder-employee are also considered more-than-2% S shareholders for this purpose. To be deductible by the entity, it must be treated as wages for income tax withholding purposes **and MUST be included in the shareholder's or family member's W-2.** These premiums are gross wages, but are not subject to Social Security or Medicare (FICA) or Unemployment (FUTA) taxes.

Actions to take before year end

- If you are preparing your own payroll tax returns, the additional compensation is included in Box 1 (wages) of the Form W-2, but would not be included in Boxes 3 or 5 (Social Security or Medicare wages) of Form W-2. In addition, it must be reported on all applicable payroll tax returns such as Form 941.
- If we are preparing your payroll tax returns, please provide us the amount of 2010 health insurance premiums paid for shareholder(s) and/or any of their family members.
- If you are using either a leasing company or a payroll company to do your payroll, please contact them to make sure that they properly report health insurance premiums on all affected 2010 W-2's,

Although this is additional paperwork, it is VERY IMPORTANT in order for us to maximize your deductions and reduce your taxes. Without reporting the health insurance premiums in this manner, you will likely get NO tax benefit for this expense.

#3 - S Corporation Shareholder(s)' Compensation

S corporations **must** pay reasonable compensation to a shareholder-employee in return for services that the shareholder-employee provides to the corporation before non-wage distributions may be made to the shareholder-employee. If it is determined that reasonable compensation is not being paid, distributions and other payments made by an S corporation to a shareholder may be treated as wages to the extent of the underpayment of reasonable compensation for the services rendered. The amount of the reasonable compensation will never exceed the amount received by the shareholder either directly or indirectly.

Several court cases support the authority of the IRS to reclassify other forms of payments to a shareholder-employee as wages and subject such payments to employment taxes and possibly to various penalties and interest.

Here are some factors in determining reasonable compensation:

- The amount of personal service by the shareholder involved in generating revenue
- Training and experience
- Duties & responsibilities
- Time and effort devoted to business
- Payments to non-shareholders
- Timing and manner of paying bonuses to key people
- What comparable businesses pay for similar services
- Compensation agreements
- The use of a formula to determine compensation
- History of distributions

IMPORTANT NOTE: Due to increased IRS scrutiny, we may not be able to sign your 2010 S corporate return if the compensation to the shareholder(s) is not reasonable or missing all together. Restating distributions or other payments as wages and filing or amending appropriate payroll tax returns may be necessary and may result in significant late filing and late payment penalties and interest.

Contact us ASAP if you have any questions or concerns about this issue.

#4 – Issuance of Forms 1099-Misc

If your business pays \$600 or more a year for services from any individual, partnership or LLC, you are required to issue Form 1099-Misc reporting the total dollar amount that you have paid them during a year. To do this properly, each service provider must give you a signed Form W-9 stating his or her name, address and employer identification number or social security number before you make a first payment to this provider. If you do not have a Form W-9 and do not issue the 1099, the IRS WILL hold you responsible for not withholding 28% tax on the amount paid and assess penalties for not issuing required Form 1099-Misc. Note: Form 1099-Misc also applies to payments for legal services and medical services, even if the payments were made to a corporation.

IMPORTANT NOTE:

To pay for various benefits passed under recent tax enactments, much harsher penalties will apply for failure to comply with Form 1099 reporting rules for returns that should be filed in 2011 for payments made in 2010. We have every reason to believe that the IRS will vigorously pursue the enforcement and collection of the penalties for failure to comply with these rules.

To make you aware for this coming year:

Rental Property Owners Must Issue 1099s to Service Providers.

Under the recently passed tax act and starting with payments made in 2011, owning a rental property will generally be considered a business for purposes of the Form 1099 information return reporting requirements. Therefore, rental property owners will generally be required to file a 2011 Form 1099 for any service provider that is paid \$600 or more during 2011 (for things like yard care, painting, and accounting). Also, a copy of the Form 1099 (a so-called payee statement) must be provided to each payee. This means that you may have to get signed Forms W-9 from service providers, before you make any payments to them in 2011.

If you need a form W-9, go back to our Home Page at www.kbgrp.com and find it under Current Insights or you can Google "W-9" and select the IRS.GOV site.

#5 – Expense Reimbursements

If your plan meets the requirements for an accountable plan, expense reimbursements to employees are deductible by the employer as business expenses. These reimbursements are excluded from the employee's gross income, **not reported** as wages or other compensation on the employee's Form W-2, and exempt from employment taxes. An accountable plan is as the name would indicate, a plan that reimburses the employee only after documentation of the actual expenditure is presented. If the plan is nonaccountable (i.e., does not meet all requirements for an accountable plan), the employer deducts employee expense advances or reimbursements as compensation rather than business expenses. The payments are included in the employee's gross income, **reported as wages on Form W-2**, and subject to federal income tax withholding and employment taxes when paid.

#6 – Travel, Meals & Entertainment Deductions

Strict substantiation rules apply to the following expenses incurred for either business or investment purposes: (1) travel, including meals and lodging while away from home overnight or long enough to require rest and sleep; (2) meals or entertainment and recreation activities, including expenses incurred for a facility used in such activities; (3) local transportation expenses; and (4) gifts. These rules disallow a deduction unless the taxpayer substantiates the following items by maintaining adequate records or by providing other sufficient corroborating evidence:

Element to Be Proved	For Travel Expenses	For Entertainment Expenses	For Business Gift Expenses
Amount	Amount of each separate expense for transportation, lodging, and meals unless per diem rate used. Incidental expenses may be totaled in reasonable categories such as taxis, daily meals for traveler, etc.	Amount of each separate expense. Incidental expenses, such as taxis, telephones, etc., may be totaled on a daily basis.	Cost of gift.
Time	Date taxpayer left and returned for each trip, and number of days for business.	Date of entertainment or use of a facility for entertainment. For entertainment directly before or after a business discussion, the time spent discussing business.	Date of gift.
Place	Name of city or other designation.	Name and address or designation of place or use of a facility for entertainment. Type of entertainment if not otherwise apparent. Location of business discussion if entertainment is directly before or after a business discussion.	Not applicable.
Description	Not applicable.	Not applicable.	Description of gift.
Business Purpose	Business reason for travel or nature of business benefit gained or expected to be gained from travel.	Business reason or nature of business benefit gained or expected to be gained from the entertainment. Nature of business discussion or activity.	Business reason for making the gift or nature of business benefit gained or expected to be gained.
Business Relationship	Not applicable.	Occupations or other information—such as names or other designations—about persons entertained that show their business relationship to taxpayer. If all people entertained did not participate in business discussion, identify those who did.	Occupation or other information—such as name or other designation—about recipient that shows business relationship to taxpayer.

CAUTION

- A credit card statement is not sufficient documentary evidence of a lodging expense. Instead, a hotel bill showing the components of the hotel charge is required.
- No deduction is allowed for club dues paid to any club organized for business, pleasure, recreation, or other social purpose.
- Deductions for business gifts are limited to \$25 per year per individual donee.

2010 Small Business Jobs Act

The 2010 Small Business Jobs Act that was signed into law on September 27, 2010 had a variety of tax breaks and incentives for small businesses. These items were paid for with an assortment of revenue raisers. We have summarized below the most applicable of the tax changes in the new law.

There are new incentives for purchasing fixed assets and some relief from paperwork:

Increased Section 179 Expensing Election: For years beginning in 2010 and 2011, taxpayers can expense up to \$500,000 of qualifying property placed in service during those years. The \$500,000 is reduced (but not below zero) by the amount by which the qualifying purchases exceeds \$2,000,000. This is the investment ceiling. This is an increase from the previous limits of \$250,000 and \$800,000. Qualifying property is generally machinery, equipment and certain software. For 2010 and 2011, there was an expanded change to the definition of eligible property.

Certain Real Property Eligible for Expensing: Up to \$250,000 of the \$500,000 limitation can be qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

Another Year of Bonus Depreciation: The bonus 50% first-year write-off of the cost on qualifying property was extended to property placed in service in 2010. As in the past several years, this allows a business to more rapidly deduct capital expenditures of most new tangible personal property and certain other new property. It should be noted, as in the past, it must be new property, not used. In addition, many states have not adopted this part of the federal tax law and therefore, there could be differences between federal income and state income.

Additional Depreciation for Autos: Because of the reinstatement of the bonus depreciation, depreciation for a new passenger auto or light truck used in business has increased by \$8,000 for 2010 only. A new passenger car's maximum depreciation is now \$11,060, and for a light truck or van, it is now \$11,160.

Cell Phones Are No Longer Considered Listed Property: This means that cell phones can be deducted or depreciated like other business property without IRS mandated onerous recordkeeping requirements.

Two pieces of good news for those with general business credits:

Carryback of General Business Credits for 2010 Expanded: Under the new law and beginning in 2010, eligible small businesses can carry back unused general business credits for five years instead of the rule of one year carryback and then forward. Eligible small businesses consist of sole proprietorships, partnerships and non-publicly traded corporations with \$50 million or less in average annual gross receipts for the prior three years.

General Business Credits Are Not Subject to AMT: Eligible small businesses, as defined above, can use all types of general business credits to offset their AMT in tax years beginning in 2010.

Contractors: For contractors with long-term contracts and using percentage of completion method of accounting, the new law provides that in determining the percentage of completion, bonus depreciation is not taken into account as a cost. This prevents the bonus depreciation from having the effect of accelerating income.

Self Employed Taxpayers: Business owners, doing business as sole proprietor, can now deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

2010 Small Business Jobs Act (Continued)

New Businesses: Taxpayers can now deduct up to \$10,000 in trade or business start-up expenditures for 2010. The amount that a business can deduct is reduced by the amount by which start-up expenditures exceed \$60,000. The previous limitation for this deduction was capped at \$5,000, subject to a \$50,000 phase-out threshold.

But, there are revenue raisers, as in all tax bills to offset the incentives:

Issue of 1099's have new rules and penalties:

Rental Property Expense Payments will be Reported on 1099: Owning real estate will be considered a trade or business for 1099 reporting purposes after 2010. What this means is real estate owners will now be required to issue 1099's to all service providers for those paid \$600 or more for payments made after December 31, 2010, just like other business owners. Exceptions are provided for individuals renting their principal residences on a temporary basis, taxpayers whose rental income doesn't exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regulations).

Increased 1099 Return Penalties: For 1099's required to be filed after December 31, 2010, there are harsher penalties for failing to file the required forms and sending copies to the payees. In most cases, the penalties are doubled, so it could be \$200 per occurrence.

These are only the highlights of the new act we felt were most applicable for our clients. There are more incentives and penalties, so if you would like further details about any aspect of the new legislation, please do not hesitate to call.

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