Ideas On Taxes

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taxolutions℠

What To Do When The IRS Calls (Or Writes)

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This may be the year that you hear from the IRS. It's hard to ignore the latest IRS proclamations that they will be contacting more taxpayers this year. After several years of declining audit rates, the IRS has vowed to increase examinations and has narrowed their focus to what they believe will be more productive audits.

Besides what the IRS includes in their broad definition of "abusive schemes and shelters," they will target what they term "high-risk, high-income taxpayers," high-income non-filers, and unreported income.

Don't be surprised if you fall into one of these categories. The IRS definition of "high-income" may be what many of us think of as middle-class. The IRS has also recently intensified their analysis of K-1 matching. This could result in questions regarding your reporting of partnership or S corporation income.

The Service has also implemented a new information-gathering exam. More intrusive than regular examinations, these audits gather data to be used in the selection of future returns for audit. These National Research Program (NRP) audits have already started. They are designed to address major issues rather than dwell on meaningless details, which was the case under the now defunct Taxpayer Compliance Measurement Program.

Information obtained from these audits will help the IRS make decisions about resources and strategy, education efforts, and (perhaps most importantly) determine which types of returns should be selected for examination.

What Are Your Odds?

How likely is it that you'll be audited? Audits of the 50,000 sample NRP returns will continue throughout 2003. The IRS anticipates that for 8,000 returns, there will be no contact from the IRS at all. Correspondence audits will be conducted for 9,000 taxpayers; 30,000 will undergo limited-scope examinations; and 2,000 will undergo line-by-line scrutiny.

The IRS isn't saying how many returns will be subjected to regular audits – only that the number will increase. So your chances of being audited are greater… particularly if you are in one of the targeted groups. If you are contacted for an audit, don't panic. Give us a call immediately and allow us to handle the examination.

(Continued on page 4)

Inside This Issue

Keep 'Em Happy…Develop Creative Compensation Strategies

For a business owner, concern about compensation is three-pronged – your own compensation, employee compensation, and the business' bottom line. It may seem like these are competing concerns. But, creative compensation planning can benefit all parties.

Compensating The Business Owner

If you own a closely held or family owned business, you may feel that you are always last in line when it comes to compensation. After trimming your pay in early or lean years, you deserve to be rewarded when money is a little looser. Here are some ideas for increasing your take from the business:

Create incentive compensation plans. A written compensation formula that rewards you based on profits, or certain measuring events, can go a long way toward making sure you're entitled to more in the good years (and help reduce IRS reclassification as dividends).

Make sure your compensation is "reasonable." The IRS is skeptical of large salaries paid to business owners who are, in effect, setting their own compensation. We can help you lay the groundwork for reasonable and supportable compensation.

Get paid for everything you bring to the table. Are you providing something that is not really covered by your regular compensation? Do you have know-how, a patent, formula, or other intangible that the business is using? If you have some intangible, which is benefiting the business, talk to us about whether some additional form of payment might be appropriate.

Determine whether personal expenses are actually company expenses. In a few situations, the IRS may actually approve the company picking up the tab for expenses that have some personal benefit. For instance, business succession planning for a family owned business is intertwined with the owner's estate planning. Because these can be tricky determinations, talk to us before deciding that you have an expense which should be paid by the company.

Make the most of retirement plans. Take advantage of all company-sponsored retirement plans and contribute the maximum possible. Explore whether a combination of plans would increase your allowable contribution.

Employ your spouse or children. This simple strategy allows you to move some company profit into your family's hands (possibly at lower tax brackets). Plus, they can take advantage of fringe benefits, and sole proprietorships may save on payroll taxes.

The form of your business (corporation, S corporation, partnership, LLC, or sole proprietorship) can affect compensation and fringe benefits for owners. So check with us before implementing any of these ideas. Generally, a C corporation offers the most opportunity to provide fringe benefits and retirement plans to owners.

Compensating Employees

A well-thought-out compensation package can appropriately reward employees and makes good business sense. Don't forget… business owners are entitled to these too (depending on your business structure).

Fringe benefits may be better than cash. Many fringe benefits are not taxable to the employee, but are deductible by the company. Increasing compensation by providing more of these non-taxable benefits may make the employee happy with a lesser amount. So, besides getting the deduction, the corporation might have a smaller cash outlay. The company can also save on payroll taxes by "compensating" with flexible spending plan benefits and fringe benefits, which aren't subject to payroll taxes.

Make sure you've considered all of the different benefits your company can provide. These might include: insurance (health, life, disability, and long-term care), flexible spending accounts, the new health reimbursement arrangements, certain education costs, and possibly some financial and tax planning costs.

Employees like choices. Planning can help you structure compensation favorably and as individually as possible.

Let employees share in the profits. This strategy can be used effectively through incentive compensation, a phantom stock plan, and non-qualified deferred compensation. Also consider the power of incentive compensation based on the company's profits. Employees who share in the profits have a vested interest in working toward a profitable bottom line.

Have effective expense reimbursement plans. Re-evaluate the company's business expense policies to ensure that you are getting as much reimbursement as possible and that the plan conforms to IRS requirements.

As you can see, creative and effective compensation planning can be a win/win situation. Now is the time to make any changes for 2003.

We can help by reviewing your current compensation structure and analyzing how these strategies could work in your business. ▲

Practical Uses For Practical Trusts

Here's the shocking truth… unlike what you've always thought, trusts are not just for the wealthy. Many average taxpayers will find practical uses for trusts in planning for their investments, retirement, children's education, and their estates. Yes, there are some complicated estate planning and charitable trusts out there. But, this article will focus on some types of trusts that may be just right for you.

Estate Planning Trusts For "Everyman"

You may have heard that creating a revocable trust avoids probate of your assets at death. You may also be aware that married couples can use revocable trusts to maximize their use of lifetime exemption amounts from federal estate tax (currently $1 million).

Here are a few of the trusts which can be used to benefit most taxpayers' estate planning:

- Revocable trust to maximize use of the unified credit exemption amount (becomes irrevocable at death). Assets transferred to the trust are not subject to probate upon your death. This saves time and money, and preserves some privacy.
- Revocable trust to maximize use of the unified credit exemption amount. Assets can be left for the benefit of the surviving spouse, while still utilizing the first spouse's unified credit exemption amount.
- Life insurance trust. Insurance proceeds can push you into estate tax. Policies held by a properly drafted trust are not included in the insured's taxable estate. This type of trust is a must for anyone with a sizable insurance policy.
- Qualified residence trust. With real estate values increasing significantly over time, your appreciated residence may be another estate tax trigger. Putting your home in a trust reduces the potential estate or gift taxes on your personal residence.

Trusts aren't just used for estate planning. There are other situations where the use of a trust may help you achieve your objectives. For instance…

Education Trust. If you'd like to help fund your grandkids' college education, you know how frustrating it can be to determine how much each grandchild will need. You could simply give money directly to your children, with instructions for them to use the money for that purpose, but that doesn't guarantee that the money would be available when your grandchildren needed it. To ensure this objective, consider establishing a trust and give the trustees (possibly your children or a financial institution) discretion to allocate the funds among your grandchildren as appropriate to provide incentives for them to pursue their higher education. The trust could even invest in Section 529 college savings accounts, which would be income-tax-free to the extent they are used to pay education expenses.

Creditor Protection. Many parents have had the unfortunate experience of making large gifts to a married child who subsequently gets divorced and much of those assets go to the former in-law. In other instances, the child may be subject to claims from a lawsuit. A trust can be an excellent vehicle for making gifts to your children in a way that makes the assets available for their use but prevents them from being depleted to satisfy the claims of potential creditors.

Spendthrift Protection. You may have a child or relative who needs your financial support, but cannot effectively manage the assets. They could simply be too young, or the responsibility is more than they can handle by themselves. A trust can be established that will assure both you and your intended beneficiary that the funds will not be wasted and will be available when they are truly needed. The trust can be structured to distribute assets when the beneficiary reaches a certain age; or to allow the beneficiary to become a co-trustee so that they may participate in, but not have sole responsibility for, management of trust assets.

Medicaid/SSI "Supplemental Needs." If your child has disabilities that may qualify for governmental assistance, the receipt of an inheritance or gift normally will disqualify them from such benefits until the gift is "spent down" until only exempt resources remain. In that situation, it's critical to leave assets in a carefully drafted discretionary trust that permits the trustee to expend needed resources for the child's benefit in a manner which supplements, but does not replace, governmental resource payments.

As you can see, there are numerous ways for those of more modest means to use a trust in their estate planning and normal life circumstances. Please contact us to discuss whether establishing a trust is right for you. ▲

(Continued from page 1)

What To Do When The IRS Calls (Or Writes)

Notices And Correspondence

Sometimes the IRS chooses to conduct examinations by correspondence. Or, you may receive a notice that purports to correct an error on your return. Although these situations are generally not as time-consuming or stressful, time and effort can still be saved by engaging a tax professional who can present information in a manner that meets the IRS requirements. Government oversight studies have also found that a significant number of "automatic" adjustment notices are wrong, and that many taxpayers simply pay the notices, assuming that they are correct.

Please contact us whenever you receive a notification of any kind from the IRS. Even if the notice is correct and doesn't require communication with the IRS, we will need to update our files so that we have your corrected tax information.

Collection Matters

We can also help with IRS collection matters. We can determine if any penalty or interest waivers apply, assist in presenting financial information to the IRS, and help in negotiating payment terms. In some situations, an "offer in compromise" is appropriate. This procedure offers the IRS a reduced amount in order to settle the matter.

In all collection matters, a determination should be made that any, and all, tax law arguments have been exhausted. Sometimes there is a remedy under tax law, which reduces or eliminates the amount due.

Appeals

Whether you have an examination or a collection matter, you do have the right to appeal. But you must follow specific procedures. If you wait too long in the process, you may miss your chance to have reconsideration at an appellate level.

Get Us Involved

If the IRS calls, writes, or worse – just shows up at your door, call us immediately. We can help make the IRS encounter less painful. We can handle most of the interaction, can determine what information is appropriate to provide, and how to proceed most efficiently and effectively. ▲

Bush's 2003 Economic Growth Plan

Amid much controversy, President Bush unrolled an economic stimulus package containing more than $670 billion in individual and business tax cuts over 10 years. Not all of these cuts will make it through Congress, but we will probably see a new tax law in 2003. Here are the highlights:

- The ***individual income tax rate cuts*** scheduled to take effect in 2004 and 2006 would be made retroactive to January 1, 2003. The individual rates for 2003 would be: 10%, 15%, 25%, 33%, and 35%. Withholding tables would be adjusted so that wage earners would see an immediate boost in take-home pay.
- Beginning in 2003, the ***10% bracket would be expanded*** so that it applies to the first $7,000 of taxable income for single filers (up from $6,000), and $14,000 for married filers (up from $12,000). These amounts would be indexed for inflation beginning in 2004.
- ***Tax relief for married taxpayers*** would be accelerated. In 2003, the standard deduction for married filers would be twice that for single filers. The top dollar amount of the 15% bracket for married couples filing jointly would be double that for single filers in 2003.
- The ***child tax credit*** would be set at $1,000 per child in 2003 (up from $600). Advance refund checks for the increased amount of $400 per child would be sent out this summer.
- To keep these tax cuts from throwing more people into the ***Alternative Minimum Tax,*** the individual AMT exemption amount would be increased by $8,000 for joint filers and $4,000 for single filers through 2005.
- The proposal would ***exclude dividends from taxation*** at the individual level if those dividends come from income that was taxed at the corporate level. This exclusion for only "double taxation" dividends would mean more record-keeping for corporations and wouldn't apply to stock in retirement accounts.
- The ***expensing limit for depreciable business assets*** would be "supersized" from $25,000 to $75,000. The investment limitation phase-out would also increase from $200,000 to $325,000, with the amount phasing out dollar-for-dollar up to $400,000. The $75,000 and $325,000 amounts would be indexed for inflation beginning in 2004.
- Qualifying persons would receive $3,000 in ***a personal re-employment account*** for job training, childcare, transportation, or other expenses. Unemployment benefits (which had expired in December 2002) are also extended. ▲