JENNIFER A. JONES, CPA, LTD.

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2013 Cost-of-Living Limits

IRA Contribution Limit $5,500
IRA 50 & Over Catch-up Contribution $1,000
401(k) Deferral Limit $17,500
401(k) 50 & Over Catch-up Contribution $5,500
SIMPLE Deferral limit $12,000
SIMPLE 50 & Over Catch-up Contribution $2,500
Annual Compensation limit $255,000
Defined Contribution IRC Sec 415 limit $51,000
Compensation limit for SEP eligibility $550
IRC Section 179 $500,000
Estate Tax Exclusion $5,250,000
Gift Tax Annual Exclusion $14,000
Social Security Wage Base $113,700
2013 & Prior Years' Limits

2013 Standard Mileage Rates:

Business mileage rate **$0.565**
Medical & Moving mileage rate **$0.24**
Charitable mileage rate **$0.14/mile**

TO CONTACT US:

Jennifer A. Jones, CPA, Ltd.
10615 Judicial Drive, Suite 701
Fairfax, Virginia 22030

Phone: 703-352-1587
Fax: 703-352-1927

VISIT OUR WEBSITE AT:
http://www.jajonescpa.com/

TO EMAIL US:
Jennifer A. Jones, Certified Public Accountant
Patricia (PA) Moss, Enrolled Agent
J. Randolph Shull, QuickBooks Certified Professional Advisor

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Newsletter Topic

Affordable Health Care: Need health insurance for your small business employees or know someone who needs an individual policy? Thanks to the Affordable Care Act, more Americans now qualify to get coverage that fits their needs and budgets. Visit the Health Insurance Marketplace at www.HealthCare.gov or call 1-800-318-2596 to get more information. HealthCare Law information can be found in IRS Pub 5093 which provides links to assist you in determining your responsibilities as an employer and for individuals. **All employers with one or more employees and gross revenue of at least $500,000 are to subject to the requirement to provide a notice to all employees by 10/1/13.** The DOL has developed Model Notices for employers to use. Click on the links here for a Model Notice for employers who offer a health plan to some or all their employees, or Model Notice for employers that do not offer health plans.

Simplified Home Office Deduction: A new, simplified option for claiming a home office deduction reduces paperwork and recordkeeping, but restrictions apply. Learn more by watching this new YouTube video or at Simplified-Option-for-Home-Office-Deduction

VA Withholding Tax Reports: Effective July 1, 2013, all employers are to file the annual withholding reports as well as quarterly, monthly, and semiweekly returns using an electronic medium in a format prescribed by the Tax Commissioner. To view the 2013 Legislative Summary click here.

VA Sales Tax Increased July 1, 2013: Effective July 1, 2013, the Retail Sales and Use Tax rate for most purchases increased to 5.3 percent statewide. In addition to the statewide increase, there is a 0.7 percent increase in the localities that make up the Northern Virginia and Hampton Roads regions. The tax on purchases of qualifying food for home consumption remains unchanged. The regional rate increase in Northern Virginia applies to the Cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park, and the Counties of Arlington, Fairfax, Loudoun, and Prince William. Along with the rate changes, the factors for calculating the Dealer's Discount for timely filing and payment have been adjusted. The new factors will be used on returns beginning with the return for the month of July 2013 (for quarterly filers, the return for the quarter ending September 30, 2013).

Beneficiary Form Cautions: Beware who you designate as a beneficiary for your bank, brokerage or retirement account. Even if you have a will, these designations override the will. There are advantages to this separate designation process - just be sure you know what you are doing. When you open one of these financial accounts, you have the option of designating a beneficiary, someone who may or may not be included in your will. The advantage is that upon your death, the assets pass directly to these beneficiaries, bypassing the probate process. This is a nice feature, but just make sure those prior designations continue to reflect your current wishes. If you intended, at the time of making a will, to have your entire estate pass equally to your children, a prior designation of a sibling on a retirement account, for example, will still be in effect unless it is changed. The funds in the retirement account, in that situation, would go to the sibling, not your children.

Tips for Employers That Outsource Payroll Duties: Many employers outsource their payroll and related tax duties to third-party payers such as Payroll Service Providers (PSPs) and Reporting Agents (RAs). In this fact sheet, the IRS offers steps that employers can take to protect themselves from "unscrupulous third-party payers." First, employers should continue to use their own address as the address on record, since this ensures they will continue to receive bills, notices, and other account-related correspondence from the IRS. It also gives employers a way to monitor the third-party payer and more easily spot any diversion of funds. Next, employers should make sure the PSP or RA uses the Electronic Federal Tax Payment System (EFTPS) to make tax deposits. This gives employers safe and easy online access to their payment history and allows them to make any missed deposits themselves. Finally, employers should contact the IRS about any bills or notices as soon as possible, especially those involving a payment the employer believes was made or should have been made. IRS Fact Sheet FS-2013-9.

Sub S Corporations' Payroll Tax Avoidance Tactics: The Internal Revenue Service is armed with several favorable legal decisions to back its pursuit of unreasonably low compensation paid via S corporations. S corporation owners can be tempted to set their compensation unreasonably low to save on payroll taxes. Congress is currently evaluating the role S corporations play in the tax code as part of its push for a comprehensive overhaul. S Corporation owners should monitor these developments. For more

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Beginning in 2014, the mandatory health insurance coverage provisions of the Patient Protection and Affordable Care Act (ACA) go into effect. But the law does not require everyone to have health insurance, nor are all of the coverage requirements applicable to all types of health insurance.

Are you exempt from the health insurance mandate? Most U.S. citizens and legal residents are required to have health insurance beginning in January 2014 or face a penalty tax that can be as high as 1% of taxable household income exceeding the taxpayer's federal income tax filing threshold (increasing to 2% in 2015, and 2.5% in 2016). You can avoid the penalty tax if you already have health insurance for the entire year, and the coverage is obtained from one of the following:

- Medicare
- Medicaid or the Children's Health Insurance Program (CHIP)
- TRICARE (for service members, their families, and retirees)
- The veteran's health program
- Employer-provided health coverage
- A policy you purchase on your own that's at least at the Bronze level
- A plan that is grandfathered (in existence prior to the enactment of the ACA that meets the requirements of grandfathered plans under the law)

However, certain groups are not required to be insured and thus are not subject to the penalty tax. The ACA specifically excludes people who are members of an exempt religious sect or division, members of a health-care sharing ministry, Native Americans, undocumented immigrants, incarcerated individuals, people whose income is so low that they don't have to file federal income taxes, and people eligible for a hardship exemption (when the cost of insurance after employer contributions and federal subsidies exceeds 8% of their income).

What types of insurance are not affected by the health-care reform law?

The health-care reform law does not apply to automobile insurance, homeowners insurance, and umbrella liability coverage, even though they provide some health-related coverage. Also not subject to the law's provisions are life, accident, disability, long-term care, and workers' compensation insurance. Medi-Gap (Medicare supplement) insurance is generally not covered by the ACA if it's sold as a separate plan and not as part of a comprehensive health insurance policy. In addition, retiree-only plans are exempt from the ACA's provisions. These plans are group health insurance plans with fewer than two participants who are current employees.

For more consumer information about enrolling in a health insurance plan, government subsidies, and tax credits, visit the U.S. government's website, www.healthcare.gov.

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Unclaimed Property Determined as of June 30th: Businesses holding unclaimed property are required to file annual reports and remit the property to the state. Given the current environment, many states may see unclaimed property as an untapped revenue source. Businesses should therefore be aware of the applicable laws, which vary considerably by state. Unclaimed property compliance may be a challenge, but it can be mastered. Early tracking and notification, along with diligent record-keeping, will ensure that issues are resolved before they attract the attention of a state administrator. All states have statutes that require all businesses holding items deemed to be unclaimed property to file annual reports and remit the property to the state**. In our area, the due date is generally November 1st.** Any financial asset, tangible or intangible, that remains unclaimed for a certain length of time is considered to be unclaimed property. Typical examples include:

- **Uncashed vendor checks**
- **Uncashed payroll checks**
- **Uncashed refund checks to patients/customers**

Unredeemed gift certificates

Failure to comply with state statutes can result in huge audit assessments, significant interest accumulations, and civil and criminal penalties. These ramifications are not limited to a single state if a company has vendors, customers, or shareholders in multiple states. It is estimated that only 10% to 20% of businesses currently comply with unclaimed property laws. The others are at substantial risk, because states facing revenue shortfalls recognize this as an easy source of untapped revenue, and the penalties for noncompliance can be steep.

For more information on the local laws, see:

Virginia	http://www.trs.virginia.gov/UCP/overview.aspx
Maryland	http://compnet.comp.state.md.us/Compliance_Division/Unclaimed_Property/
DC	http://cfo.dc.gov/cfo/cwp/view,a,1326,q,590684,.asp

It is recommended that you review your policies and procedures to be sure you have a system established and properly utilized to insure compliance with these state laws. Some states recommend or require filing the annual report even when there is no unclaimed property to turn over to the state.

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Doing Business in Another State? It's harder to tell than you may think. Most states don't offer companies clear guidance in this area. With state budgets strained, states are facing greater pressure to crack down as they struggle to close significant budget gaps. States are looking into businesses that have a presence in their state and are subject to state and local income and sales taxes. Companies have been found liable for state corporate tax "when the only connection to that state was that they had an employee telecommuting in that state."

In March 2010, for instance, the Tax Court of New Jersey ruled that a company whose main offices are in Maryland was "doing business" in New Jersey because an employee telecommutes from there. The company, TeleBright Software Corp., is appealing the decision, arguing that having one employee in the state who develops software from home falls short of the statutory definition of "doing business." The company asserted that it doesn't solicit customers or make sales in New Jersey.

Just how much of a tax hit companies face depends on state rules. Some impose income tax based on an out-of-state company's sales in the jurisdiction. Others also take into account the company's payroll and property in the state. However they figure the bill, lots of states seem to be on the same page as New Jersey. In a survey issued in April, 35 states, the District of Columbia and New York City said an employee who telecommutes from a home in the state would create "nexus"—a connection that warrants imposing income tax on an out-of-state employer.

A potential solution has been offered by advisors: Have the telecommuting employee resign, form a C or S corporation and invoice the ex-employer for work. The former employer would have to pay the former employee more to cover new expenses and lost benefits. And, although it would be a challenge, states could still make a case for taxing the former employer.

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Sub S Corporations' Payroll Tax Avoidance Tactics: Payroll tax collection continues to vex the Internal Revenue Service despite several court cases that have resulted in rulings favorable for the IRS regarding unreasonably low compensation. A recent high profile case was *David E. Watson, P.C. v. United States* on which the Eighth Circuit ruled in 2012. Watson was an indirect partner in a CPA firm, practicing through an S corporation that paid him *$24,000* of salary per year and between $175,000 and $203,000 in profit distributions. The court adjusted his compensation to $93,000.

It isn't hard to see why shareholders of S corporations attempt to justify wage levels below what the IRS considers "reasonable compensation" (assuming the understated compensation is below the FICA wage base). Both the S corporation and employee save the 7.65% FICA and Medicare taxes on the wages not reported.

Another recent case is *Herbert v. Commissioner*. Herbert received between $24,000 and $29,000 of wages for the years 2004 through 2006. In 2007, he received $2,400 of wages. Although the Tax Court noted that the corporation lost money or earned very little income in each of the years, and the corporation closed down in 2009, the Court increased the taxable

compensation for 2007. The IRS wanted to reclassify all of the draws from the S corporation for 2007 as additional wages (i.e., an additional $52,600). Ultimately, the judge averaged the petitioner's wages for 2002 through 2006 to arrive at $30,445 as a reasonable wage. (The business was owned by someone else in 2002 and 2003.)

It didn't help matters that Mr. Herbert used the draws to pay corporate expenses personally. He lost, misplaced or never kept receipts for many corporate expenses he paid with cash. The Court accepted Herbert's testimony that he in fact paid significant corporate expenses with cash using funds received from the corporation. Nonetheless, the judge also believed that the wages of $2,400 were too low.

The result? Herbert was found to have under-reported his wages, even though the amount of cash drawn out of the corporation covered corporate expenses. If he had maintained a better set of books, paid all of the corporate expenses with corporate (rather than what became to be personal) funds, he wouldn't have had distributions from the corporation to himself.

Although the wages were quite low, the fact of the matter is the business was failing. There wasn't an adequate cash flow to pay wages and expenses. By shuffling funds and taking money personally, Mr. Herbert created a payroll tax liability where such liability shouldn't have existed.

Payroll tax reduction or avoidance is, perhaps, a major reason for the popularity of S corporation status for an operating entity, even though the formation of an LLC under state law provides similar liability protection for the sole proprietor. The IRS projects that 4.6 million Forms 1120-S will be filed for 2012, compared to 3.6 million Forms 1065 (partnership).

As part of its tax reform efforts, Congress is evaluating the continuing treatment of the bottom-line S corporation as not subject to payroll taxes or self-employment tax. The AICPA will be closely monitoring any developments and keeping you up to date through its tax reform page and other communications.

Chris Hesse, CPA, Partner, CliftonLarsonAllen*. Chris is with CliftonLarsonAllen's Federal Tax Resource Group serving all offices of the firm. FTRG is a firm wide group that assists all offices of the firm on federal income tax matters, in addition to drafting CPE material for in-house presentation. Chris is also chairman of the S Corporation Technical Resource Panel for the AICPA.*