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▶ Inside this issue

Why it's important to keep an eye on your company's cash **2**

Summertime can be tax-saving time **2**

To incorporate or not? That's the critical business question **3**

New job? What to do with your 401(k) plan **4**

Tax & Business letter

SUMMER
2011

Unemployment Benefits *Are they taxable?*

Unemployment compensation can provide a welcome buffer while you're transitioning to a new job. But with the help comes a tax effect, because the benefits provided under federal or state laws are usually includable in your income in the year you receive them.

As a result, you may want to complete Form W-4V, Voluntary Withholding Request, to have federal income tax withheld from your benefits. You can also ask the unemployment office to withhold state income tax. Alternatively, you can adjust or begin making quarterly estimated tax payments.

If you receive and repay benefits in the same year, you can subtract the repayment from the total you received. However, if you make repayments in a year following the receipt of the benefits, the tax treatment depends on how much you repay, and can be claimed either as an itemized deduction or a credit against your current-year tax.

Please contact us if your employment situation changes. We can help with tax and benefit related issues such as severance pay, retirement account rollovers, and deductions related to job hunting. ♦

New law repeals expansion of Form 1099 reporting rules

On April 14, 2011, President Obama signed legislation – the *Comprehensive 1099 Taxpayer Protection and Replacement of Exchange Subsidy Overpayments Act of 2011* – repealing expanded reporting rules for businesses and landlords that had been created by laws passed in 2010.

■ Business reporting

The Form 1099 reporting rules were changed by the 2010 health care legislation. Under the *Patient Protection and Affordable Care Act of 2010*, every business, charitable organization, and governmental unit was required to file a Form 1099 for payments to any vendor or supplier of goods or services (other than a tax-exempt organization) totaling \$600 or more for the year. Both the vendor and the IRS had to receive a copy of the Form 1099. These rules were scheduled to take effect for payments made after December 31, 2011.

Before the passage of the health care law, payments to corporations were generally exempt from the Form 1099

reporting requirements. The law just signed by President Obama completely repeals this expansion of business reporting requirements, and the reporting rules return to what they were before health care legislation.

■ Rental property reporting

Similarly, new Form 1099 reporting requirements were recently imposed on landlords. Under the *Small Business Jobs Act of 2010*, owners of rental properties were generally required to file a Form

1099 for rental-related payments to any provider for services totaling \$600 or more for the year. These reporting rules were to be effective for payments made after December 31, 2010.

The new law repeals these expanded Form 1099 reporting rules

for landlords. As with the repeal for business reporting, it's like the requirements never existed.

Repeal of the expanded business and rental property expense reporting rules will eliminate a flood of paperwork for most small business and rental property owners. ♦





Why it's important to keep an eye on your company's cash

Do you regularly monitor your company's cash accounts? You should. Even if you leave the job to your bookkeeper or accountant, you should stay aware of where the cash is going and how the spending is approved. Along with inventory "shrinkage," theft or improper expenditures of cash are among the chief sources of loss for small companies.

Periodically, you hear about a huge loss caused by an employee who's been quietly embezzling cash for years. But many smaller cases are never noticed. And it's not always employees at fault. In fact, the vast majority of employees

are scrupulously honest and loyal. Outsiders can be stealing your cash too, by submitting false or inflated invoices that are paid without proper review.

How to reduce risk of loss

What can you do to reduce the risk of losses? The textbook answer is "internal controls." This refers to things such as standard procedures for approving and paying bills. It includes segregation of duties – having more than one person involved in preparing, signing, and reconciling checks. Unfortunately, many small companies don't

implement proper controls – either because there's not enough staff or because they think it's too much trouble.

Regardless of the size of your business, here are some steps you can take:

- Maintain a strict rule that all invoices must have an approval signature before being paid. Nothing focuses a person's mind like having to sign his or her name on something.
- Have a policy that all employee expense reports must be signed off by a higher-level employee.
- Make it a rule that the person who prepares a company check can't sign that check.
- Ask your bookkeeper or accountant to give you a signed note each month affirming that the bank statement has been reviewed and balanced.
- Follow up personally to make sure that these procedures are being followed.
- Every few months, ask to see the bank statement and canceled checks for the prior month. Review them in detail. Not only will this increase your chances of spotting fraud, but it will also remind you just what the company's cash is being spent on.

Please contact our office for details or for assistance in improving controls over your company's cash. ♦



Summertime can be tax-saving time

Summertime fun can be made even more enjoyable by adding tax savings. Here are some tax-saving ideas to consider.

- If you have summer travel plans and the primary

purpose of your trip is business, you can deduct all the travel costs to and from your business destination and all other business-related costs even if you add on a few extra days for pleasure. You can't deduct costs related to the pleasure portion.

Including a spouse or friend on your trip is permissible, but you can't deduct the additional costs for that person.

- If you itemize your deductions, you can deduct the

mortgage interest and property taxes paid for your vacation home. A boat or RV can qualify as a vacation home if it has sleeping quarters, cooking facilities, and a bathroom. If a retreat also serves as rental property, you can control your tax deductions by changing the number of days you use it for vacation.

- If you and your spouse work, the cost of sending your children to a summer day camp may qualify for the child care credit.
- If you own a business, consider hiring your child for the summer. Your child can earn up to \$5,800 tax-free this year, and your business is entitled to a deduction for the wages paid. You must pay your child a reasonable wage for the work performed. If your business isn't incorporated, a child under 18 is not subject to FICA taxes. ♦



To incorporate or not? That's the critical business question

One of the first decisions you face as a new business owner is whether or not to incorporate the business. The biggest advantage of incorporating is limitation of your liability. Your responsibility for debts and other liabilities incurred by a corporation is generally limited to the assets of the business. Your personal assets are not usually at risk, although there can be exceptions to this general rule. The trade-off is that there is a cost to incorporate and, in some cases, tax consequences.

■ Should you incorporate?

You might not need to incorporate. Depending on the size and type of your business, liability may not be an issue or can be covered by insurance. If so, you could join millions of other business owners and operate as an unincorporated sole proprietor.

If you do decide to incorporate, you'll face a choice of corporate forms. All offer limitation of your liability, but there are differences in tax and other issues.

■ C corporation

The traditional form of corporation is the C corporation. C corporations have the most flexibility in structuring ownership and benefits, and most large companies operate in this form. The biggest drawback is double taxation. First the corporation pays tax on its profits;

then the profits are taxed again as they're paid to individual shareholders as dividends.

■ S corporation and LLCs

Two other forms of corporation avoid this double taxation: S corporations and limited liability companies (LLCs). Both of these are called "pass-through" entities because there's no taxation at the corporate level. Instead, profits or losses are passed through to the shareholders and reported on their individual tax returns.

S corporations have some ownership limitations. There can only be one class of stock and there can't be more than 100 shareholders, none of whom can be foreigners. State registered LLCs have become a popular choice for many businesses. They offer more flexible ownership than S corporations and certain other tax advantages.

Whether you're already in business or just starting out, choosing the right form of business is important. Even established businesses change from one form to another during their lifetime. Some companies use more than one type of corporation – for example, an LLC to hold the business's real estate and an S corporation for other operations.

Consult our office and your attorney for guidance in selecting the form that is best for your business. ♦

What to consider

Your choice of business entity is a decision you should revisit periodically. There's no single "correct" choice that is best for every business at all stages of its life. Among the questions to consider are –

- How many owners or shareholders will the business have, now and in the future?
- How great is the need for protection against liabilities?
- How do you want profits to be taxed?
- How do you want to allocate profits and losses among owners?
- Do you want to provide retirement and fringe benefits to owners?
- What are the plans for future growth?
- What are the annual costs to maintain the business entity?

"Tax Freedom Day" came later in 2011

"Tax Freedom Day" fell on April 12 in 2011, three days later than in 2010. According to the Tax Foundation, all the money earned by taxpayers in the first 102 days of 2011 will go to pay their federal, state, and local taxes.

Another statistic from the Tax Foundation: If the government were to collect enough taxes to fund all spending for 2011 (with no deficit), Tax Freedom Day would be May 23, 2011. That's 41 more days of work to provide the additional \$1.48 trillion of revenue needed.

IRS raises threshold for imposing tax liens

The IRS recently announced that it will moderate its use of tax liens to collect back taxes. A federal tax lien gives the IRS a claim on a delinquent taxpayer's property for unpaid taxes.

This change means the IRS won't use a tax lien unless at least \$10,000 in back taxes is owed; the previous threshold had been \$5,000.

In addition, the IRS says it will "withdraw" more tax liens once the back taxes have been paid. A withdrawal removes the lien from the taxpayer's credit record, whereas a lien "release" as previously used left the lien on the credit record for at least seven years. Having a tax lien on a taxpayer's credit record can knock 100 points off the individual's credit score.

The IRS estimates that the new rules mean that "tens of thousands of people won't be burdened by liens." ♦

New job? *What to do with your 401(k) plan*

Changing jobs can be a stressful event. A new boss, new co-workers, and new benefits to sign up for. These days you might well have one more decision to make – what to do with your 401(k) plan.

You'll have several choices. Unfortunately, the easiest choice is the worst choice: that is, to take a distribution from the old plan and put it in the bank. It may be tempting, because who couldn't use some extra cash. But if you do, you'll owe taxes on the balance and usually a 10% penalty as well. You'll lose the benefits of future tax-deferred growth on your savings. And if you spend the money, you'll have to start from scratch in saving for retirement.

Instead, consider the following three options:

▶ Ask your new employer whether you can roll your balance into the new company's plan. If you can, arrange a direct transfer between plans. You may have to

complete a probationary period before you can join your new company's plan.

▶ Explore whether you can leave your balance in the old plan, at least for a while. That removes the pressure for an immediate decision. Later you may be able to transfer to your new plan or follow the third option.

▶ Roll over your balance into an individual retirement account (IRA). This avoids immediate taxes and lets your savings continue to grow tax-deferred. It also gives you maximum flexibility for future investments. You even have the flexibility to later convert into a Roth IRA. Be sure to ask for a "trustee-to-trustee" transfer to avoid any short-term tax risk.

The bottom line: Do all you can to keep your savings in a tax-favored account. You'll be glad you did when you reach retirement age.

Please call our office if you're facing this situation. We'll be happy to advise you. ♦



June 15 – Second quarter 2011 individual estimated tax is due.

June 15 – Second quarter 2011 estimated tax is due for calendar-year corporations.

August 1 – 2010 retirement and employee benefit plan returns are due for calendar-year plans.

September 15 – Third quarter 2011 individual estimated tax is due.

September 15 – Third quarter 2011 estimated tax is due for calendar-year corporations.

September 15 – Deadline for filing 2010 calendar-year tax returns for corporations with extensions of the March 15 deadline.

September 15 – Deadline for filing 2010 partnership returns with extensions of the April 18 deadline. ♦

NOTE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

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