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Quarterly Wrap

Accounting & Payroll Taxes

All monthly & quarterly accounting clients must file payroll tax returns by the November 1st deadline (since October 31 falls on a Sunday). This means we need to receive your monthly or quarterly data as soon as you receive your bank statements, usually between the 5th and 10th of the month. Since penalties are imposed for failure to file timely payroll tax returns, it is imperative that you provide us with ample time to review, compile, determine the appropriate amount to pay, complete the returns, and get your signature. Thus October 15th is our deadline for receiving your files and information.

Seminars & Conventions

- I attended the H.D. Vest Investment Services Annual Convention held in Providence, Rhode Island, back in June.
- I will be attending the National Association of Tax Professionals (NATP), GA Chapter Meeting in Dillard, Georgia on September 26th – 28th, so the office will be closed on a Monday and Tuesday. I will be accessible, however, as the office phone will be forwarded to my cell phone, and I will have my trusty laptop to check e-mails. Pam, my administrative assistant, will be away on her honeymoon (she is getting married on September 25th).
- I will be attending the NATP 1040 & 1040 EXTRA Workshops in Atlanta on October 29th and 30th. Thus the office will be closed on Friday, October the 29th; however, as usual I will be accessible through the office line. Pam, my administrative assistant will also be attending the 1040 Workshop on October 29th.

Personal Tax Planning

The months of November and December are the last chance for personal tax planning. If you are not a corporate client, and want to be proactive regarding your taxes, I would encourage you to contact me for this service. What I need is your latest pay stub(s) and any projection of expenses over and above last year. My projections are based on your prior year return and any new information, which you provide. There is an hourly fee for this service, and most clients pay an average of \$25-\$50. It is not necessary to make an appointment for this service, as it is most efficiently handled by fax or email, however, personal appointments are available.

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Prior issues available at: <http://4-serenity.com/news.htm>

Individual Tax Issues

Tax Audits . . . What are the Chances?

A report issued by the Treasury Inspector General for Tax Administration (TIGTA) provides statistical data for IRS examinations for audits conducted from October 1, 2002, through September 30, 2003, for returns filed in calendar year 2002. This report also indicates the areas where the IRS focused these audits.

Close to 130 million returns were filed in calendar year 2002 with 849,296 of them being audited during fiscal year 2003, or about 0.65% of the total individual returns filed. The prior year audit rate for individual returns was 0.57%. Of the returns audited in 2003, about 54.5% of them involved returns with total positive income (TPI) of less than \$25,000.

Of the individual audits done in 2003, 76% were done by tax examiners and compliance centers through correspondence. Revenue agents, tax auditors, and tax compliance officers conducted the remainder.

The following table shows the percentage of audits in 2002, and audited projections for fiscal year 2003:

Entities	Percentages of Returns Audited	
	2003	2002
Individuals/Nonbusiness (TPI)		
Under \$25,000 (1040A)	0.51%	0.71%
All other returns by size of TPI		
Under \$25,000	1.09	0.64
\$25,000 to under \$50,000	0.30	0.23
\$50,000 to under \$100,000	0.41	0.28
\$100,000 and over	0.98	0.75
Individuals filing Schedule C showing gross receipts as indicated		
Under \$25,000	3.00	2.67
\$25,000 to under \$100,000	1.33	1.18
\$100,000 and over	1.47	1.45
Individuals filing Schedule F showing gross receipts as indicated		
Under \$100,000	0.57	0.47
\$100,000 and over	0.78	0.72
Fiduciary (estate and trust income)	0.17	0.18
Corporation (based on assets)		
Under \$10,000,000	0.58	0.63
\$10,000,000 and over	12.08	14.17
S Corporations	0.30	0.39
Partnerships	0.35	0.26
Estate tax	6.38	5.84
Gift tax	0.66	0.63

A report issued by the Inspector General indicates that the IRS plans to hire additional audit personnel in 2004 and 2005. To allow time for new hire training by experienced examiners, the report cautions that the impact of these new hires will not immediately be apparent – but it's coming.

Check 21 Awareness

The New Way Banks Will Process Checks

The “Check Clearing for the 21st Century Act” is a new law that revolutionizes the way banks process checks. Rather than routing checks back to the check writer’s bank physically, it will be done electronically. The bank where the check is deposited will create a digital image of the check and transmit it electronically for payment.

The tragic events of September 11, 2001, were key in prompting the Act. Air traffic was halted for days, and as a result, those paper checks being transported via air didn’t move. In the 21st century, transporting physical checks is not required when digital images and electronic clearing are possible. So, Check 21 was passed and slated to go into effect as of October 28, 2004.

The new law will affect consumers in that they will no longer be able to receive their original, cancelled paper check. Instead, a “substitute check” will be provided by their financial institution. A substitute check will serve as valid proof of payment.

It’s also important to note that checks will clear in the matter of hours, rather than days. This means that deposits will be credited to the recipient’s account more quickly, but funds are also debited from the check writer’s account faster, too. As always, be sure there are available funds in your account when you write a check.

Small Business Tax Issues

Employment Taxes Paid Timely . . . Employer Penalized

From 1999 through 2001, F.E. Schumacher Company, Inc. paid its payroll taxes by physically submitting the payment to a local bank. Under the bank deposit method used by Schumacher Co., all of the payroll funds were within the government's control no later than their respective due dates.

Under §6656, a penalty is imposed for failure to make deposits as required by the Code or regulations. During the 1999-2001 period, Schumacher Co.'s payroll deposits for each year exceeded \$200,000, which required Schumacher Co. to deposit its payroll taxes by way of electronic funds transfers (EFT) under the Electronic Federal Tax Payment System (EFTPS) [Reg. §31.6302-1(h)].

According to Rev. Rul. 95-68, a taxpayer required to deposit taxes by EFT is subject to the failure to deposit penalty if it either: 1) Deposits the taxes by other means, or 2) Deposits by EFT after the deposit due date.

The IRS imposed a 10% underpayment penalty on Schumacher Co. for failure to deposit its payroll taxes by EFT. Schumacher Co. disputed the penalty, claiming that the penalty was improper because no underpayments ever existed, given that Schumacher Co. paid its payroll taxes by their due dates.

A district court agreed with the IRS's assessment stating that the penalty was triggered by Schumacher Co.'s failure to use the prescribed EFT system, not the timeliness of the payroll tax deposits.

F.E. Schumacher Company, Inc. v. U.S. 93 AFTR 2d 2004-829

My Comments: Federal Payroll Tax Deposits must be paid through an authorized bank or electronically. Even if your company is not required to pay electronically the IRS encourages that you do so. I would also encourage you to do so because it is the most accurate and secure way to make payments to the IRS. If you are not doing so already, please talk to me about getting you set up. Setting up an EFTPS account is simple and can be done from my office. All I need is your banking information from the account that will be debited. We also intend to file all payroll tax forms electronically from here on. This requires a two-stage process in which we submit the application, and then the IRS sends you a letter to sign and mail back within 10 days. If you did not complete the process please let me know so I can re-apply.

Self-Rental . . . Does Not Equal Passive Income

S & C Dent Corp. is a C corporation wholly owned by Dolores Beecher. Cal Interiors, Inc. is a C corporation wholly owned by Gary Beecher. The Beecher's are husband and wife, both of whom work full-time in the business of the corporations. Each corporation's business office is located in the Beecher's home and each pays rent to the Beecher's for use of the office space.

On their 1997, 1998, and 1999 federal income tax returns, the Beecher's reported income and expenses of six rental properties. Of the six properties, one was the office that reported income in each of the three years. Each of the other five rental properties reported a net loss, such that the losses exceeded the income from the office each year.

The IRS determined that the Beecher's net income from the rental of their office was nonpassive income under Reg. §1.469-2(f)(6) because the Beecher's materially participated in the business activity of the corporations. As a result of this determination, the net income from the office could not be offset by any of the losses from the other rental properties. The Beecher's disputed the IRS determination citing that the recharacterization rule was arbitrary and contrary to the statute, and the rule improperly negates their "bona fide business purpose" for renting the office to the corporations.

The Tax Court disagreed with the Beecher's assertions, stating that several cases have been tried elaborating on the definition of "activity" and "material participation," and "requiring net income or gain from a passive activity to be treated as not from a passive activity" under §469(l). Furthermore, the Court found nothing in the statute that requires the secretary to condition the recharacterization on the absence of a bona fide purpose for a self-rental. In fact, the secretary was authorized by Congress to apply the recharacterization rule to all self-rentals in which there is material participation by the taxpayer [*Krukowski v. Commissioner*].

The Tax Court found the Beecher's arguments to be without merit and held that the recharacterization rule is valid in this case.

T.C. Memo 2004-99

My comments: I do encourage self-rental for company's that operate from home, because of the fact that such income is not subject to social security taxes. This is a way to decrease the officer's salary requirement, and to claim a portion of home utilities and related expenses. This issue will only affect clients who are claiming self-rental and also own other rental properties. It will not affect "Professional Real Estate Investors", those whose main business involves real estate. It does not mean that you cannot claim self-rental, but rather that you cannot offset self-rental income with losses from other rentals.

Mileage Log (Revisited)

What's needed at tax time? The total miles placed on the vehicle for the year, the number of business miles, the number of commuting miles, and the number of personal miles. Any one of these factors is a product of the other three. This data is required even if you are taking the actual expense method, since the amount of business over total mileage determines the percentage of actual expenses that are deductible.

If you are an independent contractor, all of your business related mileage from the time you leave your home is deductible at \$.375 per mile in 2004. If you are a corporate officer, or employee, your commuting mileage to and from your office is not deductible, however any travel from work to client sites, or business meetings is deductible unless you are reimbursed. If you have more than one job, your mileage from the first job to the second is deductible.

If you own a business, and your vehicle is company owned, you may choose either the standard mileage rate, or the actual expense method in 2004. If you have taken the Section 179 write-off, you have elected the actual expense method; therefore, you must keep up with all costs associated with gasoline, repairs, insurance, and registration costs. The best way to keep up with actual costs is to either use a debit or credit card.