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**Quarterly Tax News**

**3rd Quarter 2005**

Volume 05:03

**Re: New Mailing Address (above)**

**Re: This Quarter's Major Due Dates**

- July 8-15<sup>th</sup> – Monthly & Quarterly clients submit bank statements, canceled checks, credit card statements, and other records for 2<sup>nd</sup> quarter accounting and financial statements.
- July 15<sup>th</sup>
  - Monthly Payroll Tax Deposits due.
- July 31<sup>st</sup> – Quarterly Payroll Tax Returns due.
- August 15<sup>th</sup>
  - Personal Income taxes or final extension due.
  - Non-Profit returns deadline.
- September 15<sup>th</sup>
  - Corporate tax due date.
- July, Aug., Sept. 20<sup>th</sup> – Sales & Use Tax Returns.

**Re: Recordkeeping - Common Requirements for Business Income**

We previously explained the importance of keeping records so that your tax return can be properly prepared and so that claimed items can be backed up in the event of an audit. Here, we focus on common records that are needed in connection with taxes on your business income. We also want to advise you of the opportunities and pitfalls

in the IRS's recent guidance on electronic storage of records.

Keep records of all of your gross receipts. They are needed so that you can properly report gross income from the business activity. Examples are invoices, electronic records, receipts, HUD-1's, deposit slips, and bank statements.

You must keep proper track of all expenses that are potentially deductible. To this end, keep track of compensation paid to employees and independent contractors, repairs, rents, taxes and licenses, bank charges, business insurance, utilities, postage and shipping charges, and travel and entertainment expenses, among other items.

On the subject of travel and entertainment expenses, there is some good news. For expenses paid or incurred after September 30, 1995, documentary evidence of business travel and entertainment expenses is not necessary for expenditures under \$75. The old threshold was just \$25. For purposes of the \$75 rule, each separate payment is treated as a separate expenditure and you can treat a tip as a separate expenditure.

Although you no longer need documentary evidence for many travel and entertainment expenses under \$75, you still must comply with other recordkeeping requirements to substantiate deductions, such as keeping records of the time, place and date of the business travel, and business reason for the travel, etc. Also, you still need bills and receipts for any lodging expense regardless of its amount.

Keep permanent records of assets that you depreciate. Keep receipts of how much you paid for the property and records showing when you placed assets in service or changed them from personal to business use. Also, keep records of capital improvements.

If you use your car in business, whether you base your deductions on actual expenses or you use an IRS standard mileage rate, there are a number of records that you must keep. They include records of business miles and total miles, records showing when you started using your car in business and its basis, records of actual expenses if you do not use the standard mileage rate, and a number of other items regardless of which alternative you use.

Similarly, very specific and detailed recordkeeping is required when you use a portion of your home in your business. Records must show the part of the home that is used for business and that such use is exclusive. Records also are needed to show the depreciation and expenses for the business part of the home.

The IRS has issued a revenue procedure applicable to taxpayers who maintain books and records using an electronic storage system. The IRS defines an electronic storage system as a system that prepares, records, transfers, indexes, stores, retrieves and reproduces records by either imaging hardcopy records or transfers computerized books and records to an electronic storage medium. The IRS has issued guidelines to insure the integrity of the system and governing controls, inspections and quality assurance.

Please contact us if you have any questions about these or other recordkeeping requirements, including those for any employment tax obligations that may arise in connection with your business.

## **Re: Recordkeeping for Individuals - General Requirements**

Gathering together all of the pertinent information and records that are needed to prepare a tax return can be quite annoying and boring. But it is essential that you compile the right information so that your return can be prepared properly.

Maintaining records also is critical so that if the IRS later audits the return, you will be able to withstand the challenge. Sometimes, you even need to retain records to fend off potential challenges on returns for years subsequent to the year of the return to which the records directly relate. And records are a first line of defense against many penalties.

What are the basics? While your records must be accurate, the Internal Revenue Service generally does not require any particular form of recordkeeping. One of the best records of having paid a particular expense is a canceled check. Keep your canceled checks that relate to any items that you need or even only think will be needed to prepare any tax return that you may have to file.

You also should retain receipts, sales slips, and invoices referring to items that might be included on a return. Of course, once your return has been prepared and items have, in fact, been included in the return as deductions or in some form or another it is imperative that you keep records supporting the claimed tax treatment.

In addition to keeping records to support deductions, you will also need to keep records to keep track of what income you will need to report on your tax return. These include Forms W-2 showing wages from employment and Forms 1099 showing compensation from any independent contracting work you performed. Apart from Forms 1099, separate accounting books and

records are needed for independent contracting jobs. There are a whole series of other Forms 1099 showing interest, dividends and other types of income, which you should keep, along with financial statements from brokerage houses. Of course, you should also keep copies of your tax returns. Also, keep copies of related schedules and attachments with the returns.

Another question that arises with respect to recordkeeping is how long you need to keep the records. The short answer is you need to keep them for as long as the IRS can potentially challenge you on the item to which a particular record relates. This period generally is 3 years from the date you file your income tax return or, if later, 2 years from the time you pay the tax. If you file your return before the due date, the IRS gets to measure the 3-year period from the actual due date. Sometimes, the so-called limitation period is 6 years. There is no limit for the IRS to bring an action against someone who has filed a false or fraudulent return.

In some cases, you should keep records longer than the regular limitations period. For example, you should permanently keep records of your basis in property. Basis is the yardstick for measuring tax gain or loss and usually is the amount you paid for property and major improvements to it. Note: Although many homeowners may no longer need to keep track of basis for selling their principal residences due to the 1997 Taxpayer Relief Act's exclusion of \$250,000 of gain from the sale of a principal residence (\$500,000 exclusion for married taxpayers), most homeowners of higher-priced homes should keep records since the chance remains that inflation may push them above the \$250,000 threshold at some future date.

You also should permanently retain certain documents. For example, keep trust documents, wills, partnership agreements,

business contracts, divorce decrees, leases and the like.

### **Re: 2005 Planning: IRA Contributions**

As you may be aware, the maximum contribution amounts for traditional and Roth IRAs were recently increased.

For your 2005 tax year, you may contribute up to \$4,000 to your Roth or traditional IRA. This amount remains at \$4,000 for 2006 and 2007, and increases to \$5,000 starting in 2008. In addition, if you will be at least 50 years old before the end of this year, you may make additional "catch-up" contributions to your traditional and Roth IRAs. For 2005, the maximum catch-up contribution for IRAs is \$500. This amount will increase to \$1,000 starting in 2006. Contributions for 2005 for both traditional and Roth IRAs can be made until the due date of your return, which is April 15, 2006.

### **Re: Paying the IRS - Offers in Compromise**

The IRS Restructuring and Reform Act of 1998, along with the negative publicity on the IRS coming out of the Congressional hearings that preceded the new law, has created an unprecedented opportunity for taxpayers with tax liability problems. At no time in the history of tax collection has the IRS been more willing to compromise on tax liability rather than to go through collection procedures that might create bad press for an agency already on the outs by many in Congress. Although the IRS is still not willing to "give away the store" to anyone with an outstanding tax liability, those who have genuine trouble paying now have a better chance than ever of striking some sort of compromise with the IRS if certain procedures are followed.

Often, the compromise that the IRS is willing to make takes the form of installment payments to pay off the tax

liability over time. This is particularly useful because it prevents the IRS from liquidating major assets, such as a home or a retirement fund, which can be devastating, both financially and emotionally, to the taxpayer. Terms can be rather generous. But if a taxpayer can't swing an installment deal with the IRS, his or her financial situation may be such that an "offer in compromise" may prove to be an even better alternative.

An offer in compromise actually lowers the total amount of liability outstanding, usually in return for a commitment to pay this reduced amount over a period of years. In addition, offers in compromise have also become a preferred way for the IRS to avoid litigation expenses when a taxpayer has at least some argument under the tax law as to why a tax liability is not owed, in part or in full. Whether an offer in compromise is based on "doubt as to collectibility" and "doubt as to liability," the rationale behind the IRS's seemingly generous spirit is that, under the new rules on collection, it may be better off accepting something now than risking getting nothing in the future. Further, the IRS is now under a Congressional mandate to make offers in compromise generally more accessible to taxpayers.

If you decide to make an offer through the IRS's Offers in Compromise program and the IRS accepts, you end up paying the lesser amount in full satisfaction of your tax liability. The IRS cannot collect the additional tax from you. It can accept an offer only if there is doubt whether the tax liability exists or doubt whether the tax can be collected. A doubt as to collectibility must be supported by a Collection Information Statement (IRS Forms 433-A or B) which requires disclosure of a taxpayer's assets. It also requires a nonrefundable \$150 fee, designed primary to discourage frivolous claims from clogging up the pipeline for taxpayers with legitimate problems. The offer in compromise itself is made on a separate form.

The IRS Restructuring and Reform Act of 1998, in addition to putting the heat on the IRS to tone down its collection tactics, requires the IRS to develop employee guidelines for determining whether a proposed offer in compromise is adequate and should be accepted to resolve a dispute. These guidelines form the official rules of conduct for IRS agents in offers in compromise situations. They include rules for the consistent application of national and local allowances under which IRS employees may determine the basic living expenses of a taxpayer entering into a compromise. Moreover, an IRS agent is now prohibited from rejecting an offer from a low-income employee, and others, solely on the basis of the amount of the offer.

A preliminary consideration for someone making an offer is whether to use assets to make estimated tax payments that are due rather than holding the assets to increase an offer. This is because the IRS cannot accept an offer in compromise if tax returns are not current or if tax liabilities aren't being paid as they accrue.

Of course there are some disadvantages to making an offer. For example, you make it easier for the IRS to identify property that it can seize and levy upon (although the 1998 legislation prohibits the IRS from levying against property while a compromise offer is pending). Further, the offer usually operates to extend the statute of limitations. Still, in many situations, the offer in compromise route may be the only way to go.

### **Re: New Employee**

Faune McHellen is the newest member of the 4-Serenity team. Faune has several years of experience with accounting/tax and financial service firms. If you have a question regarding a tax refund, accounting issue, due date, or other matter, don't hesitate to speak with her directly.