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We are pleased to provide you with our online informational newsletter, which we believe you will find of interest. Every month, brief articles on relevant topics are included, along with a tax calendar for the current and following month.

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February 2008

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Cafeteria Plans Benefit Employees and Employers

The Tax Code allows employers to offer a substantial benefit to their employees by providing employee benefits through a cafeteria plan. Cafeteria plans, also referred to as *Section 125 plans*, are written plans that allow employees to choose among a menu of cash and qualified benefits and pay for these benefits with pretax dollars.

Why Are Cafeteria Plans So Popular?

Cafeteria plans are a popular way of providing employee benefits because both employers and employees alike find them advantageous. Employers benefit by maximizing tax deductions, as well as reducing payroll taxes. Employees, on the other hand, are able to increase take-home pay by paying for benefit coverage on a pretax basis.

What Type of Benefits Can Be Offered?

Cafeteria plans can be structured in a variety of ways. One of the simplest options is a premium only plan (POP), which is funded solely by insurance. In these plans, employees enter into a salary reduction agreement for an amount equal to their portion of the premium cost. POPs can provide group-term life insurance, dental, disability income, vision care, accidental death and dismemberment, and/or health care coverage.

Other levels of cafeteria plans are also available. At the other end of the spectrum is a *full cafeteria plan* offering employees a wide variety of benefits and choices where employees can create their own benefit package.

The following benefits may be offered on a pretax basis under a cafeteria plan:

1. Accident or health coverage (i.e., medical coverage), including accidental death and dismemberment coverage.
2. Up to \$50,000 of group-term life insurance on the life of an employee. (Benefits in excess of \$50,000 can be provided, but employees may be taxed on the excess coverage.)
3. Long-term disability coverage. However, to the extent employees pay premiums on a pretax basis, benefit payments received are taxable.
4. Dependent care assistance up to \$5,000 per year.
5. Flexible spending arrangements (FSAs) for medical expenses, dependent care assistance, or adoption assistance.
6. Health savings accounts (HSAs) for qualified medical expenses.
7. Contributions to a 401(k) plan. (However, due to the complexity and cost involved in meeting IRS requirements, this option may not be a good one.)
8. Adoption assistance benefits.

Elective paid vacation days may also be provided. However, this benefit is taxable to the employee and the vacation days must be used or cashed-out before the end of the year.

What Benefits Cannot Be Offered?

The following benefits may not be offered under a cafeteria plan, even though they may be nontaxable when provided outside of the plan:

1. Scholarships and tuition reductions.
2. Educational assistance.
3. Nontaxable work-related fringe benefits; including no-additional-cost services; qualified employee discounts; working condition fringe benefits; employer-operated eating facilities; *de minimis* fringe benefits; qualified transportation benefits; qualified moving expense reimbursement benefits; and on-premises athletic facilities.
4. Meals and lodging furnished for the employer's convenience.
5. Contributions to an Archer medical savings account.
6. Long-term care insurance.
7. Long-term care services.
8. Group-term life insurance on the life of any individual other than an employee.
9. Certain health reimbursement arrangements (HRAs).
10. Elective deferrals to a Section 403(b) plan.

What Is Required to Receive Special Tax Treatment?

To qualify for special tax treatment, a cafeteria plan must meet very specific requirements. The plan must be in writing and contain certain information that is set forth by the IRS. This information includes a specific description of each of the benefits available under the plan, eligibility rules governing participation, procedures for participant selections, and the maximum salary deferral employees and maximum contribution employers can make. In addition, specific nondiscrimination requirements must be met by the cafeteria plan. Also, 2% or greater stockholders of an S corporation are not permitted to participate in cafeteria plans.

Summary

With the upward trend in rising health care costs, cafeteria plans can be a solution to providing employee benefits at a greatly reduced cost to the employer and employee. If you have questions or want additional information on cafeteria plans, please don't hesitate to call.

Gift Taxes – IRS Tax Tips

If you gave any one person gifts in 2007 that are valued at more than \$12,000, you must report the total gifts to the Internal Revenue Service and may have to pay tax on the gifts. The person who receives your gift does not have to report the gift to IRS or pay gift or income tax on its value.

Gifts include money and property, including the use of property without expecting to receive something of equal value in return. If you sell something at less than its value or make an interest-free or reduced-interest loan, you may be making a gift.

There are some exceptions to the tax rules on gifts. The following gifts generally are not taxable and do not count against the annual \$12,000 limit:

- Tuition or medical expense that you pay directly to an educational or medical institution for someone's benefit.
- Gifts to your spouse
- Gifts to a political organization for its use
- Gifts to charities

If you are married, both you and your spouse can give separate gifts of up to the annual limit of \$12,000 to the same person without making a taxable gift. Gifts can be made from a joint account, provided each spouse signs a separate check.

Alternatively, with consent from your spouse, you can make a gift of up to \$24,000 (\$12,000 x 2) to the same person without making a taxable gift. This is commonly known as splitting gifts between spouses. Essentially, it means a gift by you or your spouse to a third person can be considered as made one-half by each of you provided there is consent by both spouses. This gift splitting technique requires filing of a gift tax return (Form 709), even though no tax will be due.

Welcome to Investor Nirvana (for some falling within the income limitation); zero tax on long-term capital gain and dividend income

Beginning this year and continuing through at least 2010, a zero tax rate applies to most long-term capital gain and dividend income that would otherwise be taxed at the regular 15% rate and/or the regular 10% rate (last year, a 5% rate applied to such income). The amount of income taxed at 0% depends on the interplay between an individual's filing status, his taxable income, and how much of that taxable income consists of long-term capital gain and dividends.

Where the zero tax rate applies

The zero tax rate is available only for a noncorporate taxpayer who has a net capital gain and/or qualified dividend income. Net capital gain generally is the excess of net long-term capital gains over net short-term capital losses, subject to certain netting rules. Qualified dividend income generally is dividend income received from domestic corporations and qualified foreign corporations.

For tax years beginning after 2007, a 0% tax applies to so much of the net capital gain and qualified dividend income that doesn't exceed the excess (if any) of:

1. the amount of taxable income that would be taxed at a rate below 25% (without taking the special capital gains rates into account), over
2. taxable income reduced by the adjusted net capital gain.

The balance of the taxpayer's adjusted net capital gain is taxed at 15%.

The amount of taxable income that would be taxed at the regular tax rate below 25% (in (1), above) is the amount that would be taxed at 10% or 15%, since those rates are the only regular tax rates that are below 25%. As a result, the amount in (1) for a particular taxpayer can't exceed the "top" (also known as the break-point) of the 15% rate bracket for his filing status. For 2008, the amount is:

- \$32,550 for single taxpayers and married taxpayers filing separate returns;
- \$65,100 for married taxpayers filing joint returns and surviving spouses; and
- \$43,650 for heads of households.

Honda Hybrid Vehicle Credit Phases Out

The Alternative Motor Vehicle Credit for hybrid vehicles is phased out once the manufacturer sells 60,000 qualifying vehicles. The IRS recently announced that Honda Motor Company sold its 60,000th credit-qualified hybrid vehicle and the credit will begin to phase-out for vehicles purchased on or after January 1, 2008. Vehicles purchased from January 1, 2008 through June 30, 2008 will be eligible for 50% of the original credit. Those purchased from July 1, 2008, through December 31, 2008, will be eligible for 25% of the original credit. Honda vehicles purchased after December 31, 2008, will no longer be eligible for the credit.

Alternative Fuel Tax Credit for Propane-powered Forklifts

Congress has enacted legislation providing for a 50¢ per gallon tax credit for companies using propane in forklifts and airport tugs. Although forklifts are normally exempt at the time of purchase from the federal excise tax on propane, they are still eligible to claim the full 50¢ per gallon credit for business use.

This credit could be a nice benefit for a warehouse or manufacturing operation using propane-powered forklifts. As an example, a warehouse operator consuming 3,000 gallons of propane annually is eligible for a \$1,500 (3,000 x \$.50) tax credit. Keep in mind that a tax credit, unlike a deduction, offsets your tax liability on a dollar-for-dollar basis. So, every dollar of credit is one less dollar you will pay in taxes.

FEBRUARY 2008

February 28

The government's copy of Form 1099 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to March 31.

February 29

The government's copy of Form W-2 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to March 31.

March 10

Employees who work for tips. If you received \$20 or more in tips during February, report them to your employer. You can use Form 4070.

March 17

Corporations. File a 2007 calendar year income tax return (Form 1120 or 1120-A) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporations. File a 2007 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporation election. File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation beginning with calendar year 2008. If Form 2553 is filed late, S treatment will begin with calendar year 2009.

Electing large partnerships. Provide each partner with a copy of Schedule K-1 (Form 1065-B), Partner's Share of Income (Loss) From an Electing Large Partnership, or a substitute Schedule K-1. This due date is effective for the first March 17 following the close of the partnership's tax year. The due date of March 17 applies even if the partnership requests an extension of time to file the Form 1065-B by filing Form 7004.

March 31

Electronic filing of Forms 1098, 1099, and W-2G. File Forms 1098, 1099, or W-2G with the IRS. This due date applies only if you file electronically (not by magnetic media). Otherwise, see February 28. The due date for giving the recipient these forms was January 31. For information about filing Forms 1098, 1099, or W-2G electronically, see Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically.