

# Cohen Smith & Company, P.A.

## NEWSLETTER



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### September 2010

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#### **IRS FAQs Shed Additional Light On 2010 Payroll Tax Exemption And Retention Credit**



IRS has issued additional frequently asked questions (FAQs) on the 2010 payroll tax exemption for hiring unemployed workers and the tax credit for retaining such workers. These payroll tax breaks were enacted by the Hiring Incentives to Restore Employment Act

(HIRE Act, P.L. 111-147). The new FAQs carry important guidance on payroll tax exemption topics such as rehiring employees on furlough status, whether self-employment counts for purposes of employment during the 60-day lookback period, and when employment begins. Important guidance on the new hire retention credit includes what constitutes wages, what counts as employment during the qualification period, and whether the credit can offset the alternative minimum tax (AMT).

There are big dollars at stake. A Treasury Department press release dated August 2, says that an estimated \$6.2 billion in payroll tax savings could be generated by the payroll tax exemption for workers hired through June, with another \$4.2 billion to be saved through the retention credit if three-quarters of those newly hired workers are employed for 52 weeks.

**Background.** The HIRE Act carried two valuable incentives for employers that boost payroll this year: a payroll (FICA) tax exemption for employers that hire unemployed workers; and an up-to-\$1,000 tax credit for keeping such new hires on the payroll for at least one year.

Under Code Sec. 3111(d), qualified employers are exempted from paying the employers 6.2% share of Social Security (i.e., OASDI) employment taxes on wages paid in 2010 to a newly hired qualified individual. The payroll tax relief applies only for wages paid to qualified individuals from March 19, 2010 (the day after the HIRE Act was signed into law by the President) and ending on December 31, 2010.

A qualified employer is any employer other than the U.S., a state, or a political subdivision of a state (i.e., a local government, or an instrumentality). (Code Sec. 3111(d)(2)(A)). However, a public institution of higher education is a qualified employer even though it is a government instrumentality. (Code Sec. 3111(d)(2)(B))

A qualified individual is one who:

1. begins employment with the employer after February 3, 2010 and before January 1, 2011;

2. certifies by signed affidavit, under penalties of perjury, that he or she hasn't been employed for more than 40 hours during the 60-day period ending on the date employment begins with the qualified employer (use Form W-11, Hiring Incentives to Restore Employment (HIRE) Act Employee Affidavit, or its equivalent);
3. does not replace another employee of the employer (unless that other employee left voluntarily or for cause); and
4. is not related to the qualified employer in a way that would disqualify the individual for the work opportunity tax credit (WOTC) under Code Sec. 51(i)(1). Code Sec. 3111(d)(3))

*Note: A qualified employer can not apply the payroll tax exemption and claim the work opportunity tax credit (WOTC) for the same employee. An employer that wishes to claim the WOTC for a qualified employee may not apply the payroll tax exemption with respect to any wages paid to that employee from March 19, 2010, through December 31, 2010.*

In addition to the payroll tax exemption, HIRE Act Sec. 102 provides employers with an up-to-\$1,000 tax credit for retaining "qualified individuals" as defined for Code Sec. 3111(d) purposes.

The workers must be employed by the employer for a period of not less than 52 consecutive weeks, and their wages for such employment during the last 26 weeks of the period must equal at least 80% of the wages for the first 26 weeks of the period. The amount of the credit per eligible employee is the lesser of \$1,000 or 6.2% of wages (as defined for income tax withholding purposes) paid by the employer to the qualified employee during the 52-week consecutive period. The portion of the general business credit attributable to the new hire retention credit cannot be carried back to a tax year that begins before March 18, 2010.

Earlier IRS guidance on the payroll tax exemption and retention credit has taken the form of FAQs.

### **New FAQs on the Payroll Tax Exemption**

***When does employee begin work for payroll tax exemption purposes?*** General principles relating to employment apply, including the establishment, maintenance, and termination of the employer-employee relationship, all of which depend on the facts and circumstances. Accordingly, an individual begins employment on the date when, based on the facts and circumstances of the particular situation, the employer-employee relationship is first established (FAQ QE 17).

***Payroll tax exemption for rehired employee.*** If a qualified employer previously terminated an individual, and subsequently rehired him or her, the individual is treated as having started employment on the date when, based on the facts and circumstances of the particular situation, the employer-employee relationship is reestablished (FAQ QE 17).

***Qualified employee status.*** Individuals who have been on furlough, standby status, or

temporary layoff are qualified employees when they resume active status only if the furlough, standby status, or temporary layoff, constituted a termination of employment and, upon reestablishment of the employment relationship, the requirements to be a qualified employee are satisfied. Whether an employment relationship has been terminated is based on the facts and circumstances (FAQ QE 18).

***New hire replaces prior employee.*** The payroll tax exemption may be claimed for a new hire, as long as he or she otherwise is a qualified employee, who replaces:

- a worker who terminated employment voluntarily;
- a worker who was terminated for gross misconduct;
- a worker who was terminated due to poor performance; and
- a worker whose employment was previously terminated as part of a reduction in force due to lack of work (FAQs 10-23).

The payroll tax exemption may also be claimed for an employee who was terminated as part of a reduction in force and then is subsequently rehired, as long as the rehired employee is otherwise a qualified employee (FAQ QE 23).

***New hire is a formerly self-employed individual.*** For purposes of “qualified employee” status, work performed as a self-employed individual does not count in determining whether an individual has been employed for 40 hours or less during the 60-day period ending on the date before the individual begins employment (FAQ QE 19).

***Minors.*** IRS says minors may sign the HIRE Act employee affidavit (Form W-11), which must be signed under penalties of perjury (FAQ QE 24).

Example: A qualified employer may claim the payroll tax exemption for someone who was self-employed for the entire 60-day lookback period

**Reporting agents.** IRS says an employer is not required to provide copies of qualified-employee-completed Forms W-11 to its reporting agent. There are no specific payroll tax exemption procedures for employers that use reporting agents (FAQ QE 25).

### **New FAQs on the New Hire Retention Credit**

**Employment during consecutive 52-week period requirement.** If the employment relationship is not terminated during the 52 consecutive week period, and the wages paid to the qualified employee for the last 26 weeks of the 52-week period equal at least 80% of the wages paid to the employee for the first 26 weeks, the employee is treated as a retained worker even if he or she is not performing services the entire time (FAQ Q3). Thus, for example, unpaid vacation time or sick leave during the 52-week period doesn't disqualify the employee.

**When 52 consecutive week period begins.** This period begins on the date the employee begins employment with the employer, as explained above for purposes of the payroll tax exemption (FAQ Q2).

**What counts as wages?** IRS says all remuneration that is considered wages for federal income tax withholding purposes (including bonuses and taxable fringe benefits) counts for purposes of the new hire retention credit (FAQ Q 2).

**Claiming the retention credit.** The credit may be claimed for a retained worker for the first tax year ending after March 18, 2010,

for which the retained worker satisfies the 52 consecutive week requirement. However, since retained workers must be qualified employees, the credit applies only for workers hired after February 3, 2010, and before January 1, 2011.

A fiscal year taxpayer may claim the new hire retention credit on its 2010 income tax return if the requirements for the credit have been met by the end of its 2010 taxable year. For example, if a business with a tax year beginning April 1, 2010, hired a qualified employee on March 15, 2010, and the employee met the requirements for being a retained worker by March 31, 2011, the business may claim the credit on the return for the tax year beginning April 1, 2010, and ending March 31, 2011 (FAQ 3).

The new hire retention credit cannot be used to offset a business's AMT (FAQ 5).

### **Earn 5% Or More On Liquid Assets**

Yes, that is too good to be true, but we got your attention. As you are painfully aware, it is extremely difficult to earn much, if any, interest on savings, money market funds, or CDs these days. So, what are we to do? Well, one way to improve your earnings on those idle funds is to pay down home debt. Paying down a home loan having an interest rate of 5% with your excess liquid assets is just like earning 5% on those funds. The same goes for car loans and other installment debt. But, the best return will more likely come from paying off credit card debt! Of course, we are not suggesting you reduce liquid assets to an unsafe level, but rather, examine the possibility of paying off some of your present debt load with your liquid funds. Paying down \$100,000 on a 5% home loan is like making more than \$400 per month on those funds.



## 2011 HSA Limitations



Health Savings Accounts (HSAs) were created as a tax-favored framework to provide health care benefits when coupled with high deductible health insurance plans. HSAs are targeted mainly at the self-employed, small business owners, and employees of small to medium-sized companies who do not have access to health insurance.

The tax benefits of HSAs are quite favorable and substantial. Eligible individuals can make tax deductible (as an adjustment to AGI) contributions into HSA accounts. The funds in the account may be invested (somewhat like an IRA), so there is an opportunity for growth. The earnings inside the HSA are free from federal income tax, and funds withdrawn to pay eligible health care costs are tax-free. The dual benefit of tax-deductible contributions into and tax-free withdrawals from HSAs (and existing Medical Savings Accounts) is truly unique. No other tax-deferred type of account currently exists that offers such a benefit.

The annual 2011 inflation-adjusted deduction for individual self-only coverage under a high-deductible plan is \$3,050, unchanged from 2010. The comparable amount for family coverage is \$6,150, also unchanged from 2010. For 2011, a *high-deductible health plan* is defined as a health plan with an annual deductible that is not less than \$1,200 for self-coverage and \$2,400 for family coverage, and the annual out-of-pocket expenses (including deductibles and copayments, but not premiums) must not exceed \$5,950 for self-only coverage, or \$11,900 for family coverage.

## Maximizing Business Transportation Expense Deductions



The costs of commuting from a personal residence to places of business or employment generally are nondeductible personal expenditures. The deduction for commuting costs is disallowed regardless of the distance involved.

However, taxpayers whose residences qualify as their *principal place of business* can deduct transportation expenses incurred in going between their residence and other work locations in the same trade or business (including regular or temporary work locations), regardless of the distance. In the landmark *Soliman* case, the Supreme Court identified two factors for determining whether a home office qualifies as the taxpayer's principal place of business: (1) the relative importance of the activities performed at each business location and (2) the time spent at each place.

A taxpayer can meet other tests to qualify his or her residence for the home office deduction. But, the principal place of business test must be met for transportation costs between the residence and other work locations to be deductible.

For an *employee* to deduct daily transportation costs between a residence and other work locations in the same trade or business, the home office must be for the convenience of the employer in addition to being used *exclusively* and *regularly* as the principal place of business.

Whether telecommuters (i.e., employees who work from their residence much or all of the time) can deduct their local transportation costs depends on the particular facts.

However, their home offices often will fail to qualify as their principal place of business for tax purposes because they do not satisfy the criteria mentioned above. Thus, if they also maintain an office at their employer's place of business, the cost of going between their residence and the employer's office is nondeductible.

**Example: Management consultant with home office.**

Jack is a self-employed management consultant for a variety of small businesses. He maintains a home office used regularly and exclusively to set up appointments, store client files, and develop management reports for his clients. Jack does most of his consulting work by telephone, email, or mail from his home office. He routinely uses his personal auto to travel from his home to meet with prospective and current business customers or their representatives. His home office qualifies as his principal place of business.

Because Jack meets the principal-place-of-business/home-office criteria, his mileage traveling from his residence to see clients, to work at other regular or temporary work locations, or to perform other business duties is a deductible business expense.

Taxpayers who do not have a home office that qualifies as their principal place of business can still deduct the cost of daily transportation expenses incurred in going from their residence to temporary work locations in the following circumstances: (a) when the location is a temporary work site outside the metropolitan area where he or she lives and normally works (because there is no fixed place of business, the entire metropolitan area is deemed the workplace) or (b) a taxpayer who has one or more

regular work locations away from home can deduct the cost of transportation from the home to a temporary work site in the same trade or business, regardless of the distance or whether the site is inside or outside the residential metropolitan area. Generally, a metropolitan area includes the area within the city limits and the suburbs that are considered part of that area.

**Note:** When a taxpayer has two or more regular work locations (whether in the same business or different businesses), the daily transportation costs of going between these work locations are also deductible.

**MRDs Required In 2010**

Legislation in 2008 waived the Minimum Required Distributions (MRDs) for 2009 from IRAs and defined contribution plans, including Section 401(k), 403(b), and state-sponsored Section 457 plans. It did not otherwise change MRD rules. Therefore, MRDs are once again required in 2010.

The 2009 waiver has no impact on the 2010 MRDs of taxpayers who reached 70½ before 2009. These taxpayers compute their 2010 MRDs as they normally would. For taxpayers subject to the five-year distribution rule, 2009 is not counted as one of the five years. This impacts any account using the five-year rule whose account owner died in 2004 through 2008—basically, the five-year period is extended by one year.

Under the normal MRD rules, taxpayers who reached 70½ in 2009 would have had until April 1, 2010, to take their first MRD. But, since that distribution pertained to 2009, it was waived. However, the waiver did not change the individual's required beginning date. Therefore, the 2010 MRD for a taxpayer who reached 70½ in 2009 must be made no later than December 31, 2010.

**Example: MRDs for a taxpayer who reached 70½ in 2009.**

Lori reached 70½ in 2009. Her first MRD (for 2009) normally would have been required no later than April 1, 2010. However, since 2009 MRDs were waived, Lori did not take the 2009 distribution. She must take a 2010 MRD by December 31, 2010.

As a reminder, failure to take required distributions will subject you to a 50% penalty. So, it is very important to compute the correct distribution amount and take the 2010 distribution in a timely manner.

**Observation:** There is no requirement that a taxpayer who mistakenly fails to receive an MRD in one year make a catch-up distribution in the following year. Instead, the amount that must be distributed in the following year is determined without regard to the fact that the taxpayer failed to receive the MRD in the previous tax year.

**Beneficiary Designations.** This is a good time to review your beneficiary designation forms and IRA documents. At your death, your beneficiary designations and the terms of your IRA will control not only who will receive those assets, but also the availability of various postmortem planning opportunities for your heirs. Given the right set of circumstances, it may be possible for your IRA assets to continue to grow in their tax-advantaged environment for many years.

Please contact us if you have any questions regarding retirement plan distribution requirements or any other personal or business tax planning issues.

**Tax Calendar**



**SEPTEMBER 2010**

**September 10**

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

**September 15**

Individuals - Make a payment of your 2010 estimated tax if you are not paying your income tax for the year through withholding (or will not pay in enough that way). Use Form 1040-ES. This is the third installment date for estimated tax in 2010.

Employers - For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in August if the monthly rule applies.

Corporations - File a 2009 calendar year income tax return (Form 1120 or 1120-A) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension.

Deposit the third installment of estimated income tax for 2010. Use the worksheet Form 1120W to help estimate tax for the year.

Partnerships - File a 2009 calendar year return (Form 1065). This due date applies only if you were given an automatic five month extension. Provide each partner with a copy of Schedule K-1 (Form 1065) or a substitute Schedule K-1.

Electing large partnerships - File a 2009 calendar year return (Form 1065-B). This due date applies only if you were given an automatic six month extension

S corporations - File a 2009 calendar year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S).

Estates and Trusts - File a 2009 calendar year return (Form 1041). This due date applies only if you were given an automatic five month extension. Provide each beneficiary with a copy of Schedule K-1 (Form 1041).

## **OCTOBER 2010**

### **October 11**

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

### **October 15**

Individuals - File a 2009 income tax return and pay any tax, interest, and penalties due if you were given an automatic six month extension.

## **NOVEMBER 2010**

### **November 1**

Social Security, Medicare, and withheld income tax - File Form 941 for the third quarter of 2010. Deposit any undeposited tax. (If your tax liability is less than \$2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until November 13 to file the return.

Federal unemployment tax. Deposit the tax owed through September if more than \$500.

### **Other helpful line services**



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