



Celebrating our 20th Anniversary

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Interested in knowing more about our firm? Then take a minute to browse our website at www.cohensmithcpas.com – read about us - our services - and the people behind the name.

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

August 2007

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New Kiddie Tax Rules

Special *kiddie tax* rules apply to children under age 18 who have *unearned income* of more than \$1,700 in 2007. Unearned income generally includes all income except wages, salaries, and self-employed earnings (i.e., dividends and interest). The kiddie tax counteracts a variety of family income-splitting and income-shifting techniques which take advantage of the lower tax rates of the taxpayers' children, in effect, taxing the family unit as a whole. Effectively, the tax imposes the parents' marginal (highest) tax rate on a minor child's 2007 unearned income in excess of \$1,700, unless the child's tax rate is higher than the parents' tax rate. Prior to 2006, only children under age 14 were subject to the kiddie tax, but Congress increased the age to children under age 18 in the 2006 Tax Increase Prevention and Reconciliation Act.

Just as we began adjusting to the 2006 law change, Congress has changed the law once again, affecting 2008 calendar-year taxpayers. In the Small Business and Work Opportunity Tax Act of 2007, Congress *expanded* the kiddie tax rules to apply to children whose earned income (e.g., wages) does not exceed one-half of their support and are either: (a) age 18 or (b) a full-time student age 19–23. Note that the kiddie tax will still apply to children under age 18 regardless of their earned income level. So, starting next year for most taxpayers, the kiddie tax can potentially come into play until the year during which a child turns age 24.

In situations where the kiddie tax applies, taxpayers can still minimize its effect by purchasing in the child's name tax-deferred U.S. savings bonds, life insurance contracts, tax-exempt bonds, growth stocks (that appreciate rather than pay dividends currently), and qualified savings bonds registered in the parent's name that allow the parent to exclude all or a portion of the interest if the bond proceeds are used to pay qualified higher education expenses at eligible educational institutions.

Please call us to discuss the expanded reach of the kiddie tax, its effect on your family, and how to minimize your family's overall tax bill.

Donating a Life Insurance Policy to Charity

A number of charities now ask their donors to consider donating life insurance policies rather than, or in addition to, cash, in order to make substantially larger gifts than would otherwise be possible. The advantage to donors is that they can make a sizable gift with relatively little up-front cash or even no cash if an existing policy is donated. The fact that a charity may have to wait many years before receiving a payoff from the gift is typically not a problem, because charities normally earmark such gifts for their endowment or long-term building funds.

If handled correctly, a life insurance policy donation can net the donor a charitable deduction. A charitable deduction is also available for any cash contributed in future years to continue paying the premiums on a policy that was not fully paid up when it was donated. However, if handled incorrectly, no deduction is allowed. For this reason, we encourage you to contact us if you are considering donating a life insurance policy. We can help ensure that you receive the expected income or transfer tax deduction and that the contribution works as planned.

Retirement Savings Contributions for 2007

There is still ample time to plan for your 2007 retirement savings contributions. You can contribute up to \$4,000 (\$5,000 if you are age 50 or older by year-end) to your IRA in 2007 if certain conditions are met. For married couples, the combined contribution limits are \$8,000 (\$4,000 each) and \$10,000 (\$5,000 each if both are age 50 by year-end) when a joint return is filed, provided one or both spouses had at least that much earned income. Keep in mind that contributions to traditional IRAs may be tax-deductible subject to specific limitations.

When you establish and contribute to a Roth IRA, withdrawals are tax-free if specific requirements are satisfied. In addition, there are no mandatory distribution rules at age 70½ with a Roth IRA, and you can continue to make contributions past age 70½ if you meet the earned income requirement.

The 2007 annual deferral limit for qualified retirement plans is \$15,500. If you are at least age 50 by year-end, you can contribute an additional \$5,000 to 401(k), 403(b), and 457 plans in 2007. These contributions will generally decrease your taxable income.

Deduction for Teachers' Classroom Expenses

As the 2007–2008 school year approaches, teachers should remember to keep their receipts for money spent in 2007 on eligible tax-deductible expenses. Educators qualifying for the deduction include kindergarten through 12th grade teachers, instructors, counselors, principals, or aides in any elementary or secondary school. They can deduct up to \$250 of eligible out-of-pocket classroom expenses each year. Eligible expenses include books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services), other equipment, and supplementary materials used in the classroom. You do not have to itemize to take advantage of this deduction.

New Tax Law Benefits Small Business Owners

Congress recently passed and the President has signed yet another new tax law. This latest effort is called the Small Business and Work Opportunity Tax Act of 2007 (the Act). The stated purpose of the legislation was to provide small business owners with tax relief to help offset the cost of the newly increased federal minimum wage. We are limited by space, but have listed below some major provisions of the new law. Please call us if you have questions on how these or other provisions of the law will impact your business.

Section 179 Rules. The Section 179 rules allow small business owners to immediately expense business equipment purchases versus depreciating them over several years. The Act extends the current taxpayer-friendly Section 179 deduction rules for one more year—through tax years beginning in 2010—and also makes them even more generous starting with tax years beginning in 2007. For 2007, the maximum Section 179 deduction is generally increased to \$125,000 (from \$112,000 before the Act). For 2008 through 2010, the \$125,000 amount will be indexed for inflation.

Prior to the Act, the Section 179 benefit began phasing out on a dollar-for-dollar basis when eligible equipment purchased reached \$450,000. For 2007, the Section 179 deduction phase-out threshold is generally increased to \$500,000 of qualifying property. For 2008 through 2010, the \$500,000 amount will be indexed for inflation.

In addition, the current rule allowing Section 179 deductions for the cost of off-the-shelf software is extended through tax years beginning in 2010. The current rule allowing Section 179 elections to be changed or revoked on amended returns is also extended through tax years beginning in 2010.

Spousal Joint Ventures Taxed as Partnerships. A husband-wife joint venture that is treated as a partnership for federal tax purposes generally must file an annual Form 1065 (U.S. Return of Partnership Income) and issue each spouse a separate Schedule K-1 (Partner's Share of Income, Deductions, Credits, etc.) each year. This requirement can present a tax reporting hardship.

For tax years beginning after December 31, 2006, the Act allows some husband-wife joint ventures to “elect out” of the partnership rules for federal tax purposes when in compliance with specific requirements. After electing out, each spouse will report his or her share of the federal income tax items from the venture on the appropriate IRS form. Similarly, each spouse will report his or her share of net self-employment income from the venture and will receive credit for that income for Social Security benefit eligibility purposes.

While electing out won’t change a married couple’s total federal income tax liability or total self-employment tax liability, it will eliminate the need to prepare and file Form 1065 and the related Schedules K-1.

Work Opportunity Tax Credit (WOTC). The WOTC is available to employers of persons who fall into one of the designated targeted groups (generally, economically or physically disadvantaged persons). Under exceedingly complicated rules, the WOTC provides employers with a federal income tax incentive to hire members of certain targeted groups. Before the Act, the WOTC was scheduled to expire for wages paid to employees who begin work after 2007. The Act extends the WOTC to cover wages paid to qualified employees who begin work before September 1, 2011. In addition, the Act expands the list of targeted groups and makes other favorable changes for wages paid to affected employees who begin work after May 25, 2007.

Converting a Sole Proprietorship to an LLC

As sole proprietors, business owners enjoy the advantage of simplified income tax reporting. However, sole proprietorship status can expose a business owner’s personal assets to the risks and liabilities of their business operation.

State statutes generally allow a sole proprietor to conduct business as a limited liability company (LLC). The intent is to provide a broader protection from liability. The concept of the LLC statute is that the owner (technically referred to as a “member”) does not have any liability for business debts solely by reason of being a member or owner. Of course, this does not relieve them of responsibility for their personal actions or for debts they have personally guaranteed. But personal assets would be protected from claims arising because of ordinary business transactions. This liability protection could be particularly advantageous if they have employees working in their business, as their actions presently may expose the business owner’s personal assets. A sole proprietor interested in limiting personal liability should consult an attorney to more fully explore the protections that are relevant to each particular business situation.

Another attractive aspect of LLC status is that IRS regulations allow the business owner to continue reporting for income tax purposes as a proprietor, despite forming an LLC entity under state law. Gaining the extra legal protection of an LLC entity will not entail any extra filing with the IRS.

Of course, there will be transaction costs to create the LLC. It will be necessary for an attorney to draft a limited liability company document to be filed with the state. The attorney can provide an estimate of this cost, as well as any initial or recurring fees that must be submitted to the state office. Also, when conducting business as an LLC, it will be necessary to consistently use the LLC designation on business letterhead, business checking accounts, business licenses, and the like. The business owner would need to go through the process of adding the LLC designation to the various contracts and documents under which business is conducted.

In summary, a sole proprietor should weigh the advantages of the liability protection from LLC status against the initial legal and administrative costs of accomplishing the conversion. For most proprietors, the added liability protection will merit the costs of converting to LLC status.

AUGUST 2007

August 10

Social Security, Medicare, and withheld income tax. File Form 941 for the second quarter of 2007. This due date applies only if you deposited the tax for the quarter in full and on time.

August 15

Social Security, Medicare, withheld income tax. If the monthly deposit rule applies, deposit the tax for payments in July.

Nonpayroll withholding. If the monthly deposit rule applies, deposit the tax for payments in July.

SEPTEMBER 2007

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 17

Individuals. Make a payment of your 2007 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 2007.

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 2006 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 2007. Use the worksheet Form 1120W to help estimate tax for the year.

S corporations. File a 2006 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).