

Cohen Smith & Company, P.A.

NEWSLETTER



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January 2012

Correction - December Newsletter -2012 Unemployment Compensation Tax

In the December 2011 article entitled: 2012 Unemployment Compensation Tax, we inadvertently included the wrong 2012 annual salary maximum. The correct figures are as follows:

- **2012 Tax Rates (effective January 1, 2012):**

Minimum rate: .0202 or \$171.70 per employee

Maximum rate: .0540 or \$459.00 per employee

(The 2012 rate is based on annual salary up to **\$8,500** per employee)

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New Estate And Gift Tax Regime Takes Effect



Legislation enacted in 2010 established a favorable new federal estate and gift tax regime that took effect in 2011 and continues through 2012.

- ❖ For estates of individuals who died in 2011 or made gifts in 2011, there's a \$5 million unified federal estate and gift tax exemption.
- ❖ For estates of individuals who die in 2012 or make gifts in 2012, there will be a \$5.12 million unified exemption.
- ❖ The estate and gift tax rates are now a maximum of 35%.
- ❖ Married individuals who die in 2011 or 2012 can pass along their unused federal estate and gift tax exemptions to their surviving spouses. In other words, unused exemptions are "portable." The ability to effortlessly pass along unused exemptions to surviving spouses allows both spouses' exemptions to be utilized without having to set up trusts or engage in other tax planning maneuvers that were previously necessary.
- ❖ For heirs of decedents who die in 2011 and beyond, the familiar rule that allows the federal income tax basis of inherited capital-gain assets (such as real estate and stock) to be stepped up to reflect fair market value on the date of death was reinstated. With the restoration of the unlimited basis step-up rule, heirs won't owe any federal

capital gains taxes on appreciation that occurs through the date of death – as long as that date is 2011 or later.

- ❖ All but one of these beneficial changes will expire at the end of 2012 unless Congress takes further action. The unified gift and estate tax exemption will fall back to a paltry \$1 million, the maximum estate and tax rate will go up to a punitive 55%, and the portable exemption deal will die. The only taxpayer-friendly provision that will survive is the basis step-up rule for inherited capital gain assets (it's permanent, until Congress changes its mind).

Health Savings Account (HSA) Benefits



A Health Savings Account (HSA) represents an opportunity for eligible individuals to lower their out-of-pocket health care costs and federal tax bill. Since most of us would like to take advantage of every available tax break, now might be a good time to consider an HSA, if eligible. An HSA operates somewhat like a flexible spending account (FSA) that employers offer to their eligible employees. An FSA permits eligible employees to defer a portion of their pay, on a pretax basis, which is used later to reimburse out-of-pocket medical expenses. However, unlike an FSA, whatever remains in the HSA at year-end can be carried over by the employee to the next year and beyond. In addition, there are no income phase-out rules.

Naturally, there are a few requirements for obtaining the benefits of an HSA. The most significant requirement is that an HSA is only available to an individual who carries health insurance coverage with a relatively high annual deductible. By that we mean the individual's health insurance coverage must come with at least a \$1,200 deductible for single coverage or \$2,400 for family coverage. However, for many self-employed individuals, small business owners, and employees of smaller companies, these thresholds won't be a problem. In addition, it's okay if the insurance plan doesn't impose any deductible for preventive care (such as annual checkups).

Other requirements for setting up an HSA are that an individual can't be eligible for Medicare benefits or claimed as a dependent on another person's tax return. Individuals who meet these requirements can make tax-deductible HSA contributions of up to \$3,100 in 2012 for single coverage or \$6,250 for family coverage. When an employer contributes to an employee's HSA, such as in the case of a closely held business, the contributions are exempt from federal income, Social Security, Medicare, and unemployment taxes.

An account beneficiary who is age 55 or older by the end of the tax year for which the HSA contribution is made may make a larger deductible contribution. Specifically, the annual contribution limit is increased by \$1,000.

An HSA can generally be set up at a bank, insurance company, or other institution the IRS deems suitable. The HSA must be established exclusively for the purpose of paying the account beneficiary's qualified medical expenses. These include uninsured medical costs incurred for the account beneficiary, spouse, and dependents. However, for HSA purposes, health insurance premiums don't qualify.



2012 Retirement Contribution And Other Limitations

The IRS recently announced cost-of-living adjustments affecting the dollar limitations for retirement plans, deductions, and other items. Some of the limitations will increase for 2012 because the increase in the cost-of-living index met the statutory threshold. However, many limitations did not meet that threshold and remain unchanged from 2011.

The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan increased from \$16,500 in 2011 to \$17,000 in 2012. The catch-up contribution limit for those aged 50 and over remains unchanged at \$5,500.

You can contribute up to \$5,000 (\$6,000 if you are age 50 or older by year-end) to your IRA in 2012 if certain conditions are met (i.e., sufficient earned income). The IRA contribution limit is unchanged from 2011. For married couples, the combined contribution limits are \$10,000 (\$5,000 each) and \$12,000 (\$6,000 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 that increase for 2012.

When you establish and contribute to a Roth IRA, contributions are not deductible, but withdrawals are tax-free when 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 2012 limitation for SIMPLE retirement accounts remains unchanged at \$11,500. Likewise, the SIMPLE catch-up contribution for those age 50 by year-end is unchanged from 2011 at \$2,500.

The 2012 contribution limit for profit-sharing, SEP, and money purchase plans is the lesser of (1) 25% of the employee's compensation—limited to \$250,000, an increase of \$5,000 from 2011 or (2) \$50,000, an increase of \$1,000 from 2011.

The social security wage base for computing the social security tax (OASDI) increases to \$110,100 in 2012, up from the \$106,800 wage base for 2011. The additional \$3,300 for 2012 represents an increase of about 3% in the wage base.

Finally, the annual exclusion for gifts remains unchanged at \$13,000 in 2012.



Receiving Social Security Benefits Before Full Retirement Age

Social security retirement benefits are reduced when drawn before an individual reaches full benefit retirement age. As background, most social security retirement benefits are based on a worker's primary insurance amount (PIA). The PIA is based on an individual's taxable earnings averaged over the worker's lifetime to yield a monthly benefit that is designed to partially replace the earnings benefit lost because of retirement, disability, or death.

A fully insured individual can start receiving social security retirement benefits as early as age 62. However, the full benefit will be permanently reduced for each month before the individual reaches his or her full benefit retirement age (66 in 2012). Thus, the monthly benefits at age 62 will be significantly less than the benefits would have been at the full benefit retirement age.

Example: Drawing benefits before reaching the full benefit retirement age.

John reached age 62 in January and wants to retire. His PIA, based on his earnings history, is \$1,100 per month, and his full benefit retirement age is 66. If he retires at age 62, his monthly benefit will be reduced by 25% to \$825 per month ($.75 \times \$1,100$). If he waits until his full benefit retirement age, he will receive \$1,100 per month (adjusted for inflation).

The full retirement benefit for a spouse (or divorced spouse) is generally 50% of the retired worker's PIA. However, a retiree spouse who qualifies for social security benefits based on his or her own earnings record is entitled to receive his or her own retirement benefits, if greater. If the spouse receives benefits before reaching the full benefit retirement age, the spouse's benefit is reduced based on his or her birth date. The reduction in benefits is permanent. However, if only one spouse is retired and drawing benefits based on his or her earnings, the benefits may be increased when the other spouse retires.



Standard Mileage Rate For 2012

As you are probably aware, an employer's reimbursements to employees for properly documented business expenses are not subject to payroll taxes, nor must such reimbursements be reported on the employee's tax return. This tax-free treatment applies in the case of a mileage allowance, but only if the reimbursement rate is no more than the IRS-approved standard mileage rate, and mileage records are properly maintained.

To the extent a mileage allowance exceeds the standard mileage rate, it's considered made under what the IRS refers to as a nonaccountable plan. This means that such excess is not only taxable to the employee, but also subject to income and payroll tax withholding.

Beginning on January 1, 2012, the rate for business miles driven during 2012 remains unchanged from the mid-year adjustment that became effective on July 1, 2011 of 55.5¢ per mile. Thus, for reimbursements after December 31, 2011 (regardless of whether the mileage was incurred before or after this date), 55.5¢ per mile is the maximum rate at which you may reimburse employees for the use of their vehicles in your business activities without incurring a payroll tax or withholding liability related to the reimbursement.

If you choose to reimburse employees at a higher rate in 2012, the excess over 55.5¢ per mile is treated as additional compensation to the employee and is subject to income and payroll tax withholding.

Also, beginning January 1, 2012, the rate for medical or moving purposes will be 23¢ per mile, down from 23.5¢ per mile in 2011. The rate for miles driven in service of charitable organizations will remain at 14¢ per mile.

If you have any questions about the change in the IRS-approved reimbursement rate for mileage, please feel free to contact us.



Update On Employer-provided Cell Phones

A Provision of the Small Business Jobs Act of 2010 (2010 Jobs Act) relaxed the onerous record-keeping requirements for business-provided cell phones. However, the 2010 Jobs Act did not alter the requirement that, in certain situations, personal use of an employer-

provided phone would be treated as a taxable fringe benefit to the employee.

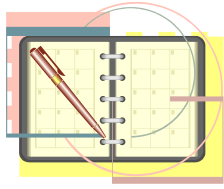
In response to numerous questions concerning the tax treatment for the cost of employer-provided cell phones used personally, the IRS recently issued guidance on this topic. This guidance indicated that when an employer provides an employee with a cell phone primarily for business reasons, the IRS will treat the employee's use of the cell phone for reasons related to the employer's trade or business as a working condition fringe benefit. The value of this benefit is excludable from the employee's income, and the substantiation requirements that the employee would have to meet in order to deduct the cost are deemed to be satisfied. In addition, the IRS will treat the value of any personal use of a cell phone provided by the employer primarily for business purposes as a *de minimis* fringe benefit excludable from the employee's income.

Nanny Tax Threshold Rises to \$1,800 for 2012

The Social Security Administration has announced that for 2012, cash remuneration paid by an employer for domestic service in the employer's private home isn't FICA wages if the amount paid during the year is less than \$1,800 (up from \$1,700 for 2011). What this means is that if you pay someone for household services less than \$1,800 during the year, you are exempt from the somewhat complex payroll reporting requirements.

However, if you paid household wages of \$1,000 or more in any calendar quarter during 2011, you are likely required to file and pay federal and state unemployment taxes for 2012.

TAX CALENDAR



JANUARY 2012

January 10

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

January 17

Individual taxpayers' final 2011 estimated tax payment is due unless the Form 1040 is filed by January 31, 2012, and any tax due is paid with the return.

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

January 31

Employers must file Form UCT-6 with the Florida Department of Revenue.

Most employers must file Form 941 (Employer's Quarterly Federal Tax Return) to report Medicare, Social Security, and income taxes withheld in the fourth quarter of 2011. (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 February 10 to file the return. Small employers who have been notified by the IRS should file Form 944 (Employer's Annual Federal Tax Return).

—Give your employees their copies of Form W-2 for 2011. If an employee agreed to receive Form W-2 electronically, have it posted on the website and notify the employee.

—Generally, give annual information statements to recipients of certain payments you made during 2011. You can use the appropriate version of Form 1099 or other information return. Form 1099 can be filed electronically with the consent of the recipient.

—File Form 940 [Employer's Annual Federal Unemployment (FUTA) Tax Return] for 2011 and deposit any unpaid tax using the EFTPS (electronic) system.

—File Form 945 (Annual Return of Withheld Federal Income Tax) for 2011 to report income tax withheld on all nonpayroll items, including backup withholding and withholding on pensions, annuities, IRAs, etc. 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 year in full and on time, you have until February 10 to file the return.

FEBRUARY 2012

February 10

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

February 15

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

February 29

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.

File Form W-3 (Transmittal of Wage and Tax Statements) along with Copy A of all the Forms W-2 you issued for 2011. If you file Forms W-2 electronically, your due date will be extended to March 31.

Other helpful on-line services



www.IRS.gov **www.MyFlorida.com**

&

www.Volusia.org