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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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www.IRS.gov

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Keeping Good Tax Records

In a tax emergency, would you be ready? Well-organized records not only help you prepare your tax return. They also help you answer questions if your return is selected for examination or prepare a response if you are billed for additional tax.

Fortunately, you don't have to keep all tax records around forever. There are laws known as statutes of limitations that impact how long you must keep receipts, canceled checks, and other documents that support an item of income or a deduction on your return.

Generally, for questioning the amount of tax you reported or making an assessment of additional tax, the IRS has three years from the date you filed the return. For filing a claim for credit or refund, you generally have three years from the date the original return was filed, or two years from the date the tax was paid, whichever is later. For either purpose, returns filed before the due date are treated as filed on the due date. There is no statute of limitations when a return is fraudulent or when no return is filed.

You should keep some records indefinitely, such as property records. You may need them to prove the amount of gain or loss if the property is sold.

Generally, income tax returns should be kept for three years from the date the return was filed. They could help you prepare future tax returns or amend a return.

For more information on recordkeeping requirements of individuals, order Publication 552, Recordkeeping for Individuals.

If you are an employer, you must keep all your employment tax records for at least four years after the tax becomes due or is paid, whichever is later.

If you are in business, there is no particular method of bookkeeping you must use. However, you must clearly and accurately show your gross income and expenses. The records should substantiate both your income and expenses.

Publication 583, Starting a Business and Keeping Records, and Publication 463, Travel, Entertainment, Gift, and Car Expenses, provide additional information on required documentation for taxpayers with business expenses. The publications are available at www.irs.gov or by calling 800-TAX-FORM (800-829-3676).

Taxing Social Security Benefits

On October 15, 2007, Kathleen Casey-Kirschling became the first Baby Boomer to officially apply (online at www.socialsecurity.gov) for Social Security retirement benefits. Ms. Casey-Kirschling was born one second after midnight on January 1, 1946, and is eligible for benefits in January 2008. Over the next two decades, nearly 80 million Americans will become eligible for benefits, more than 10,000 per day. With this in mind, we thought it would be helpful to discuss some of the federal tax aspects related to receiving benefits.

Individuals may have to pay federal income taxes on up to 85% of their benefits. Inclusion within taxable income can occur if you have substantial income from wages, self-employment, interest, dividends, and other taxable income, in addition to your benefits. However, no one pays federal income tax on more than 85% of his or her benefits.

The amount of your benefits included in federal taxable income depends on your provisional income. Provisional income (PI) is generally your adjusted gross income (AGI) plus nontaxable interest, one-half of your Social Security benefits, and some other AGI add-backs. If you file as an individual, head of household, or a qualifying widow or widower, and your PI is between \$25,000 and \$34,000, you may pay federal income tax on up to 50% of your benefits. If your PI is more than \$34,000, then up to 85% of your benefits may be taxable.

If you are married and file a joint return and you and your spouse have combined PI of between \$32,000 and \$44,000, you may pay federal income tax on up to 50% of your benefits. If your PI is more than \$44,000, then up to 85% of your benefits may be taxable. If you are married and file a separate return, you will generally pay taxes on your benefits.

Social Security recipients can have federal income tax withheld from their benefit payments. Withholding is voluntary and can be initiated at 7%, 10%, 15%, or 25% of your monthly benefits.

Employer-provided Cell Phones

While most taxpayers and businesses likely do not meet the rather strict cell phone record-keeping rules, it is important to at least understand what is required in order to successfully claim a deduction.

In a recent information letter addressed to U.S. Representative Dennis Moore, an IRS Branch Chief discussed the proper tax treatment of employer-provided cell phones. The letter states that an employer can exclude the value of an employee's use of an employer-provided cell phone from the employee's gross income, if the employer has some method of requiring the employee to keep records that distinguish business from personal phone charges. The Internal Revenue Code requires that the employee keep a record of each call and its business purpose. If the employee receives a monthly itemized cell phone statement, he or she should use the statement to identify each call as personal or business.

If the employee uses the cell phone exclusively for business, the value of all use is excluded from his or her income as a working condition fringe benefit. However, the employer must include the value of any personal usage in the employee's wages. Personal usage includes individual personal calls and a prorata share of monthly service charges.

Independent Contractor versus Employee – Bad Facts Yield Poor Result

One of the most common areas of contention between the IRS and businesses is the issue of worker classification. Businesses, if given a choice, typically prefer to classify workers as contractors so that the worker is responsible for all taxes and fringe benefits. The IRS, of course, has a responsibility to make sure appropriate payroll taxes are paid and that employees' out-of-pocket business expenses are only claimed as miscellaneous itemized deductions rather than on Schedule C. Thus, it will confront a company if it believes workers have been misclassified.

In a recent Tax Court Memorandum decision (*Peno Trucking, Incorporated*), the taxpayer challenged the IRS's determination that its drivers were employees. Although the taxpayer had some facts in its favor, unfortunately there were plenty of others that didn't look so good and ultimately these cost it the decision.

The Common Law Test

Determining whether a worker is an employee or contractor is normally a question of fact. Knowing this, the Court in *Peno Trucking* (relying on the much earlier Tax Court decision in *Ellison*), used the following factors to determine whether the company's drivers were common law employees:

1. *Control*: The degree of control exercised over the worker.
2. *Capital*: Who invests in facilities/tools for the worker.
3. *Opportunity*: Whether the worker has the chance to realize a profit or loss.
4. *Right to Discharge*: Whether the worker can be let go by the company, regardless of performance.
5. *Integral*: Whether the tasks performed by the worker are an essential part of the service recipient's regular business.

6. *Permanence*: The permanency of the work relationship.
7. *Intent*: The relationship the parties believed they were creating.

Using these well-known factors, here's how Peno Trucking stacked up.

1. *Control*: Based on an agreement with a customer to which it leased all of its trucks, Peno Trucking was responsible for hiring drivers; overseeing their work and confirming that it was in accordance with the customer's standards; and directing, supervising, paying, disciplining, and discharging the drivers. The fact that the company didn't directly exercise its ability to control the manner in which the drivers completed their work wasn't determinative since their work required little supervision. Instead, the fact it had the right to control was key. (Point goes to the government).
2. *Capital*: Workers who provide their own tools and work facilities are normally not employees (Ewens & Miller, Inc.). Thus, it was a good fact that Peno's drivers bought some of their own tools and supplies. However, these costs were insignificant in comparison to the company's substantial investment in providing and maintaining the trucks that the drivers used. (Point goes to the government).
3. *Opportunity*: The opportunity to earn a profit or the possibility that a loss can be incurred tends to indicate nonemployee status (Simpson), while earning an hourly wage or salary indicates an employer-employee relationship. The Peno drivers received a percentage of the amount Peno received for each load. Thus, they had no risk of loss. (Point goes to the government).
4. *Right to Discharge*: Employees generally can be discharged at the whim of the employer (subject to labor law rights in various states). Independent contractors, in contrast, normally have contractual rights and obligations, including the right to complete the work in accordance with the terms of the contract or to be compensated if the contract is ended prematurely. Peno had the right to terminate its drivers. (Point goes to the government).
5. *Integral*: The court gave this point to the government, even though it might have given at least a half of a point to the taxpayer if it had been in a little more generous mood. There was no disputing that the drivers contributed to Peno Trucking's business success – most of its business came from trips hauled in its own trucks. However, also included within the facts of the case was the point that Peno used some drivers that furnished their own rigs (the IRS didn't argue that these drivers were independent contractors). Thus, in theory, at least, Peno could have operated its business using a different model – indicating that perhaps the drivers in question weren't an integral part of the business.
6. *Permanence*: Independent contractors are, of course, just that – independent. Thus, they tend to be more transitory than employees. Peno's drivers were not obligated to accept a load, to work on any particular day, or to work any particular schedule. In addition, if they chose not to haul a load or work for a period of time, they weren't disciplined or sanctioned. Although these all sound like facts in support of independent contractor status, the Court nonetheless found in favor of the government on this issue – perhaps attaching more significance to the fact that of the 20 to 30 drivers in question during the years at issue, 13 had been with Peno for more than two years and four had been there more than three years.
7. *Intent*: Peno and its drivers had written agreements that specifically stated the drivers were independent contractors. However, the Court concluded that all of the other factors overrode this potentially good (and admittedly, self-serving) "fact". Thus, the court gave the IRS a clean sweep – seven to zip.

What about Section 530 Relief

As anyone who works in the employee-independent contractor area much will tell you, even if you suffer through a shut-out such as Peno Trucking did, there may still be hope. Section 530 relief, a nonstatutory provision enacted by Congress almost 30 years ago as a supposedly temporary solution, can shield a taxpayer who has mistakenly failed to properly classify workers as employees from employment tax liability. The key is there must be a reasonable basis for such failure and all of the required Federal tax forms must have been filed in a manner consistent with the taxpayer's classification.

In Peno's case, it was a good fact that it had consistently treated the drivers as contractors and had always issued Forms 1099-MISC to them. However, it still had to prove it had a reasonable basis for treating the drivers as nonemployees. It could do this by showing that it relied on the following:

- Judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer.
- A past IRS audit in which there was no assessment against it for the treatment (for employment tax purposes) of individuals holding positions substantially similar to those of the individuals now in questions; or
- A long standing recognized practice of a significant segment of the industry in which the worker is engaged.

In addition to these safe harbors, a taxpayer can also receive Section 530 relief if it can demonstrate, in some other manner, that it has a reasonable basis for not treating the individual as an employee.

Peno Trucking made one attempt to secure Section 530 relief by claiming it relied on the judicial precedent of the Ohio Industrial Commission, Bureau of Worker's Compensation, and the Court of Common Pleas. All three ruled that drivers who were hurt while working for Peno were independent contractors rather than employees. However, for the judicial precedent safe harbor to apply, the decision must have evaluated the employment relationship using a Federal common law analysis. In addition, the taxpayer must have relied on this authority during the periods at issue (*Peno*). The Court found that Peno didn't meet either requirement and denied its claim for Section 530 relief.

Caution: Section 530 relief only applies for federal employment tax purposes. This means the employer may be able to treat the worker as an independent contractor for payroll tax purposes, but will have to treat the worker as an employee (under the common law control rules) for employee benefit plan coverage and nondiscrimination purposes. Further, Section 530 relief only applies to the employer. The worker may be treated as either an employee or independent contractor under the rules that normally apply (i.e., the statutory worker occupations or the common law control rules). Thus, Section 530 is only a stopgap measure for payroll tax purposes and not a complete answer to the employer's worker classification problem for federal tax purposes.

Conclusion: Although not a subject that companies generally like to talk about, classifying workers incorrectly can have significant consequences – from past due payroll taxes to qualified plans and other fringe benefit plans that are no longer qualified. Thus, it is important to get it right.

Hunting, Fishing in Florida Bigger Than Disney and the NFL

Florida's hunters and anglers pump \$13 million a day into the state's economy. That's according to the Congressional Sportsmen's Foundation, which just released a report: "Hunting and Fishing: Bright Stars of the American Economy." According to the report, sportsmen support more jobs in Florida than Disney World, and their spending is triple the cash receipts of the state's orange crops and twice the revenues of Miami-based Burger King. The two million Florida residents who hunt and fish each year are more than the number who attend all of the NFL games in the state (1.6 million).

TAX CALENDAR

JANUARY 2008

January 15 - Individual taxpayers' final 2007 estimated tax payment is due unless the Form 1040 is filed by January 31, 2008, and any tax due is paid with the return.

January 31 - Most employers must file Form 941 (Employer's Quarterly Federal Tax Return) to report medicare, social security, and income taxes withheld in 2007. 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 12 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 2007. If an employee agreed to receive Form W-2 electronically, have it posted on the website and notify the employee.
- ❖ Give annual information statement to recipients of certain payments you made during 2007. You can use the appropriate version of Form 1099 or other information return.
- ❖ File Form 940 for 2007. If your undeposited tax is \$500 or less, you can either pay it with your return or deposit it. If it is more than \$500, you must deposit it. However, if you deposited the tax for the year in full and on time, you have until February 12 to file the return.

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.