

**COHEN, SMITH & COMPANY, P.A.
CERTIFIED PUBLIC ACCOUNTANTS
133 EAST INDIANA AVENUE
DELAND, FLORIDA 32724-4329
(386) 738-3300**

August 2005

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 months.

In This Issue

County Tangible Property Tax TRIM Notices
Alert! A "Loan" May Not Be a Loan
Sales and Use Tax - Power farm equipment

County Tangible Property Tax TRIM Notices

Within the next several weeks business and rental property owners will be receiving a Tangible Property Tax Notice (TRIM notice) from your County (assuming you owned tangible property used in business as of January 1, 2005 and filed a tangible personal property tax return). While this notice will likely indicate that it is not a bill, it will certainly become one in November, along with real property ad valorem taxes.

Please pay close attention to the values indicated on your tangible property tax notice. Even though we take great care in making sure you report only those tangible personal property assets that are in use by your business, and each year forward to you a detailed property asset listing in order to remove disposed property, your County utilizes their own internal techniques for valuation and reporting purposes.

What this means is that even though an asset may be shown as fully depreciated on your business property depreciation schedule, the County will likely show, and tax, at least a residual value. In addition, service lives used by the County for valuation purposes often exceed the depreciation lives used on your depreciation schedule, causing values to exceed the net book value shown on your financial statements.

If, after reviewing your tangible personal property notice, you believe the assessed values shown by the County exceed, by a significant amount, the actual fair market value of your personal property as of January 1, 2005, your next step would be to contact your County Property Assessor's office and request a detailed listing of your personal property record. This report will include useful lives and fair market values assigned by the County.

If, after reviewing your detailed asset listing, you believe significant differences exist between the value assigned by the County and fair market value, you should again contact the County Assessor's office and request a conference to review these differences.

In order to successfully challenge the value assigned by the County, you will need evidence substantiating the fair market value you believe is correct. For example, for the value of a copier, you might contact your copier vendor and request a letter indicating their estimate of fair market value.

In light of the above, you should be mindful of the fact that the tangible tax rate is approximately \$25 per \$1,000 of assessed value. Therefore, you should carefully consider the potential benefit of appealing your tangible property values against the time and effort required to potentially obtain a lower valuation and tax.

Of course, we remain available to assist you with any of the above. Should you have any questions regarding your tangible property notice or tangible personal property return, please do not hesitate to call.

Alert! A "Loan" May Not Be a Loan

In today's cash-strapped business climate, smaller corporations often borrow or lend money in transactions involving directors, shareholders, or their relatives. Without proper, contemporaneous loan documentation, serious negative tax consequences may result.

While you might think you know the definition of a loan, remember: To the IRS, a loan is not always a loan, especially when it comes to loans between corporations and the individuals who own them.

Although you can lend \$10,000 to your neighbor without either of you incurring tax on the transaction, the IRS may see "loans" between a corporation and a shareholder as something quite different. For example, a loan from a shareholder to a corporation may be considered an equity investment; when the corporation loans money to a shareholder, it may be treated as a distribution. These distinctions are critically important for income tax purposes.

Loan or equity

The Internal Revenue Code provides guidelines for determining whether a loan to a corporation results in debt or equity. These guidelines should be followed particularly closely whenever a corporation receives operating capital through shareholder loans rather than through equity. You need to understand the ground rules at the time the loans are made, and should follow up periodically during the life of the loan.

Loan or distribution

The Internal Revenue Code is very clear that a distribution made by a corporation with respect to its stock is a dividend. The determination of whether a shareholder's withdrawals from a corporation are "loans" or distributions of dividends depends on whether, at the time of the withdrawals, (1) the shareholder intended to repay the amounts received; and (2) the corporation intended to require repayment.

Although a court will listen to evidence that the parties orally agreed that the distribution was intended to be a loan, it is important to properly document the existence of a bona fide loan, especially when the distribution is from a small or closely-held company.

"Arms-length" transaction

Regardless of whether the loan is from or to a corporation, the transaction should be made at "arms length," meaning it should conform to a transaction that would be undertaken by two unrelated strangers, such as between a bank and an individual.

To determine whether an advance of funds was, in fact, a loan, a tax auditor will look for evidence that at the time the funds changed hands there was a genuine belief and agreement that the funds would be repaid. The IRS will look for shareholders borrowing money from the corporation rather than drawing a salary to avoid taxation on that advance of funds.

Other factors that would support the existence of a loan rather than a taxable distribution or equity are:

- * Whether collateral or other security was provided for the loan.
- * Whether the shareholder had the ability to repay the loan.
- * Written documentation of a loan agreement.
- * A set maturity date.
- * A written loan repayment schedule and whether payments were actually made.
- * A reasonable rate of interest.
- * The extent to which the shareholder controls the corporation.
- * The corporation's earnings and dividends history.
- * The size of the loan.
- * A written limit on the amount to be advanced.
- * Whether the lender took steps to enforce repayment.

Each transaction turns on the specific facts and circumstances surrounding it. The better your documentation, the better the chances the IRS will not recharacterize the loan.

Our office can help you avoid recharacterization and detail the tax consequences of having a loan recharacterized.

Distributions from C or S corporations

The better the documentation of the aforementioned items, the better the chances the IRS will not recharacterize the loan as a distribution. And if the loans are later reclassified as shareholder distributions, the tax consequences to the shareholder vary depending on whether the transaction was conducted with a C or an S corporation.

Put simply, if the loan to a shareholder has been recharacterized as a distribution from an S corporation, the excess of the amount distributed over the shareholder's basis in the corporation will be taxed as capital gain.

If the loan is recharacterized as a distribution from a C corporation, generally the distribution will be treated as dividends to the extent it is from the company's earnings and profits. Under current law, many dividends are taxed at a maximum federal rate of 15%.

SALES AND USE TAX - Power farm equipment

Effective July 1, 2005, the sale, purchase or rental of qualifying "power farm equipment" is fully exempt from sales tax. The 2005 session of the Florida Legislature passed a law that changed the partial exemption previously allowed for certain self-propelled, power-drawn, or power-driven farm equipment to a full sales tax and discretionary sales surtax exemption. The legislature also amended the exemption to now include certain new or used power farm equipment. "Power farm equipment" includes; moving or stationary equipment that contains within itself the means for its own propulsion or power; and moving or stationary equipment that is dependent upon an external power source to perform its functions. The "power farm equipment" must be for exclusive use: on a farm or in a forest in plowing, planting, cultivating or harvesting crops or products produced by agricultural industries or for fire prevention and suppression work for such crops or products. Repairs of power farm equipment and purchases of parts to repair power farm equipment remain subject to sales tax and discretionary sales surtax. (Florida Tax Information Publication 05(A)01-03, 06/15/2005.)

TAX CALENDAR

AUGUST 2005

August 1

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2005. 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 August 10 to file the return.

For federal unemployment tax, deposit the tax owed through July if more than \$500.

If you maintain an employee benefit plan with a calendar year end, file Form 5500 or 5500EZ for calendar year 2004.

August 10

Employees who work for tips. If you received \$20 or more in tips during July, report them to your

employer. You can use Form 4070.

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2005 only if you deposited the tax for the quarter in full and on time. Otherwise, Form 941 was due on August 1.

August 15

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

Individuals. If you have an automatic four-month extension to file your income tax return for 2004, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, and penalties due. If you need an additional two-month extension, file Form 2688.

SEPTEMBER 2005

September 12

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 2005 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 2005.

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 2004 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 2005. Use the worksheet Form 1120-W to help estimate tax for the year.

S corporations. File a 2004 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).