



Celebrating our 20th Anniversary

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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.

February 2007

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Corporate Annual Meetings Are Important

Generally, one of the requirements for maintaining a corporation's existence (and the liability protection it affords) is that the shareholders and Board of Directors must meet at least annually. Although most people view this requirement as a necessary evil, it doesn't have to be a waste of time. For example, in addition to being a first step in making sure the corporation is respected as a separate legal entity, an annual meeting can be used as an important tool to support your company's tax positions.

Besides the election of officers and directors, other actions that should be considered at the annual meeting include the directors approving the accrual of any bonuses and retirement plan contributions, and ratifying key actions taken by corporate officers during the year. It is not uncommon for the IRS to attack the compensation level of closely held C-Corporation shareholder/officers as unreasonably high and, thereby, avoiding taxation at the corporate level. A well-drafted set of minutes outlining the officers' responsibilities, skills, and experience levels can significantly reduce the risk of an IRS challenge. If the shareholder/employees are underpaid in the start-up years because of a lack of funds, it is also important to document this situation in the minutes for future reference when higher payments are made.

The directors should also specifically approve all loans to shareholders. Any time a corporation loans funds to a shareholder, there is a risk that the IRS will attempt to characterize all or part of the distribution as a taxable dividend. The primary documentation that a distribution is intended to be a loan rather than a dividend should be in the written loan documents, and both parties should follow through in observing the terms of the loan. However, it is also helpful if the corporate minutes document the need for the borrowing (how the funds will be used), the corporate officers' authorization of the loan, and a summary of the loan terms (interest rate, repayment schedule, loan rollover provisions, etc.).

If the corporation has accumulated a significant amount of earnings in the form of cash or other liquid assets, the minutes of the meeting should also spell out reasons for the accumulation in order to help prevent an IRS attempt to assess the accumulated earnings tax on accumulated earnings in excess of \$250,000 (\$150,000 for personal service corporations).

These are just a few examples of why well-documented annual meetings can be an important part of a corporation's records.

New Formula for the Telephone Tax Refund

Businesses and tax-exempt organizations can request a refund of the federal long-distance telephone excise taxes they paid during the 41-month period from March 2003 through July 2006. The IRS recently announced the availability of a formula that will allow businesses and tax-exempt organizations to estimate their federal long-distance telephone excise tax refund. Using the formula eliminates the need to examine 41-months of telephone bills in detail to calculate the refund. The IRS received input from business organizations, the Small Business Administration, and representatives from the tax-exempt community to develop the refund formula.

Alternative Minimum Biggest IRS Problem

A law meant to crack down on wealthy tax dodgers has instead become the most serious problem facing millions of taxpayers.

This year, the list of the most serious problems encountered by taxpayers was topped by the alternative minimum tax, which was enacted in 1969 to close loopholes that enable the wealthy to avoid paying taxes. But because the law was not indexed for inflation, a provision that originally affected about 20,000 taxpayers now hits tens of millions.

New Tax Break for S Corporation Shareholders

Congress has created a new tax break for charitably inclined S Corporation shareholders. The Pension Protection Act of 2006 (the Pension Act) allows these shareholders to recognize a generous contribution and, theoretically, a smaller gain and correspondingly lower tax bill when they sell their S-corporation stock.

When an S-corporation donates property, the IRS requires that the fair market value (FMV) of the property be used to determine the contribution amount. In this regard, it is not unusual for an S-corporation to donate appreciated property, like a building, where the property's FMV exceeds its tax basis (original cost plus improvements). The tax deduction for the charitable contribution is passed through to the shareholders. Prior to the Pension Act, the shareholders were required to reduce the basis of their S-corporation stock by the same amount—the FMV of the donated property. This often resulted in a higher taxable gain when their S-corporation stock was sold.

During tax years beginning after December 31, 2005, and before January 1, 2008, S-corporation shareholders still will be allowed a charitable deduction for their share of the property's FMV contributed by the corporation, but their stock basis will only be reduced by the contributed property's tax basis. A smaller reduction in the S-corporation stock basis can result in a smaller taxable gain when the S-corporation stock is sold.

New Option for Your Retirement Plan Distribution

For many individuals, their employer-sponsored retirement plan (e.g., stock bonus, pension, or profit-sharing plan) represents an integral component of their retirement and estate plans. Therefore, the decisions made when choosing how retirement plan assets will be distributed and taxed during the participant's lifetime, as well as at his or her death, are extremely significant.

It is important to note that following the death of a participant in an employer-sponsored retirement plan, the plan's guidelines often require that the participant's entire benefit be distributed in a lump sum to the designated beneficiary. If that beneficiary is the participant's spouse, the spouse is not required to receive the lump sum, but, instead, can choose to roll over the distribution into an IRA and, thereby, defer taxation on the distribution. Prior to the Pension Protection Act of 2006 (2006 Pension Act), a nonspouse beneficiary was not permitted to roll over distributions from employer-sponsored retirement plans. Thus, nonspouse beneficiaries were required to receive the lump sum distribution and incur an immediate tax liability.

The 2006 Pension Act gave taxpayers an additional option when determining how employer-sponsored retirement plan distributions are made and taxed. Beginning in 2007, the new law permits tax-free rollovers by direct transfers from a deceased person's employer-sponsored retirement plan account into a new IRA established by the nonspouse beneficiary for this purpose. [The same rollover privilege will be available for amounts paid to nonspouse beneficiaries under Section 403(a) and (b) annuities and Section 457 plans.] This change is a big deal because it allows nonspouse beneficiaries to benefit from the tax-deferral advantages offered by the IRA rollover strategy previously available only to spousal beneficiaries.

Tax Calendar

February 28 - The government's copy of Form W-2 and 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 April 2.

March 15 - 2006 income tax returns must be filed or extended for calendar-year corporations. If the return is not extended, this is also the last day for calendar-year corporations to make 2006 contributions to pension and profit-sharing plans.