



T. Dennis Connally Consultant, P.C.

Certified Public Accountant



DECEMBER 2008

IRS UPDATES

W-A-R-N-I-N-G CHARITABLE DONATIONS

The IRS has reminded taxpayers that several law changes affecting charitable donations have significant tax ramifications. Specifically, the IRS addressed the ability to continue to make donations from individual retirement accounts (IRAs), the requirement that household goods and clothing need to be in good used condition and that such requirement is waived in cases where a qualified appraisal is attached, and the requirements to be able to deduct cash contributions. The IRS also provided several information sources to assist taxpayers in determining the deductibility of their contributions.

The IRS also reminds people that household goods and clothing must be in good used condition in order for their fair market value to be deductible. The IRS has yet to define the term "good used condition." Taxpayers who make several donations of clothing and household foods would be well advised to take a digital photograph and keep the memory card with their tax records as insurance in the event of an audit.

All taxpayers are reminded that any charitable donation of money, no matter how small,

must be substantiated with a written communication showing the name of the charitable organization, the date of the donation and the amount of the contribution. The following additional tips were included to help individuals with their holiday season and year-end giving:

—Contributions are only deductible in the year they are made.

—Donors should make sure that a charitable organization is qualified by checking IRS publication 78.

—Individuals may only claim charitable contributions if they file Schedule A, Itemized Deduction.

—Motor vehicle donations are limited to the amount of the gross proceed from their sale.

—All non-cash donations in excess of \$500 must have a properly completed Form 8283 attached to the return to be deductible.

IRS HIGHLIGHTS COMPENSATION/WITH- HOLDING RULES FOR S-CORP OFFICER/SHAREHOLDERS

A new fact sheet from the IRS reminds S-Corp officers/shareholders that compensation must be reason-

able, warning that attempted "work

arounds" in the form of loans, payment of personal expenses or outright cash distributions are prohibited. Additionally, it emphasizes that S-Corp officers are specifically included in the definition of employee for federal employment tax purposes.

Compensation

The IRS reminded taxpayers that compensation to S-Corp officers must be reasonable. The mere fact that an S-Corp does not pay a salary to shareholder/employee is not the issue. The issue relates to making profit distributions in lieu of paying reasonable compensation. Neither statute nor regs specify what is reasonable. However, various courts have articulated some guidelines, the IRS noted. Some factors considered by courts in gauging reasonable compensation include training and experience; duties and responsibilities; time and effort devoted to the business; what comparable businesses pay for similar services; compensation agreements; and the use of a formula to determine compensation.

Wages

The IRS also reminded taxpayers that merely because an S-Corp officer is also a shareholder, this does not change the requirement that payments to the officer be treated as wages. S-Corp officer/

shareholders who provide more than minor services to their corporation and receive or are entitled to receive payment are employees whose compensation is subject to federal employment taxes. There is an exception for officers who provide only minor services or who perform no services.

Insurance

An S-Corp that pays accident and health insurance premiums for its shareholders, including its two percent-plus shareholders, may deduct the costs of the premiums, the IRS observed. The agency reminded S-Corps that the premiums must be included in a two percent-plus shareholder-employee's wages for income tax purposes. Two percent-plus taxpayers may currently deduct 100 percent of their health insurance premiums. The IRS also reminded S-Corps of Notice 2008-1, in which it determined that, if the medical coverage plan is in the name of the two percent shareholder, it can be considered to be established by the S-Corp if the S-Corp either paid or reimbursed the shareholder for the premiums and reported them as wages on the shareholder's Form W-2.

IRS RELEASES 2009 STANDARD MILEAGE RATES

The IRS has released the 2009 optional standard mileage rates to be used by employees, self-employed individuals and other taxpayers to compute deductible costs of operating an automobile (including vans, pickups and panel trucks) for business, medical, moving and charitable purposes. The 2009 rates for business, medical and moving purposes are higher than the rates for the first half of 2008 but lower than the rates for the second half of 2008, which were raised by a mid-year adjustment in response to a spike in gasoline prices.

Business Mileage Rate

The standard mileage rate for business mileage will be 55 cents per

mile. When the standard business mileage rate of 55 cents is used for automobiles owned by the taxpayer, depreciation will be considered to have been allowed at a rate of 21 cents per mile. Such depreciation reduces the taxpayer's basis in the automobile.

The standard business mileage rate may not be used for automobiles used for hire (e.g. taxicabs), or when five or more automobiles are owned or leased and used simultaneously by the taxpayer (e.g. fleet operations). Rules providing for substantiation of an employee's ordinary and necessary expenses for local travel or transportation away from home are also provided. Such expenses will be deemed substantiated when the employer, its agent or a third-party provider provides a mileage allowance under a reimbursement or other expense allowance arrangement.

Medical, Moving Mileage Rate

The standard mileage rate for medical and moving expenses will be 24 cents per mile.

Charitable Mileage Rate

The standard mileage rate for charitable purposes will remain at 14 cents per mile.

REDUCE YOUR ESTATE TAXES THRU GIFTING DURING YOUR LIFE

Presently, the first \$2,000,000 worth of assets will pass estate tax free on death, although the threshold is reduced by any "lifetime taxable gifts." This will increase to \$3,500,000 in 2009 unless Congress acts to the contrary. Each person has the ability to gift up to \$12,000 per year to any other person, or to special trusts that are established for other people who have special withdrawal rights over these trusts. This goes up to \$13,000 per year per person beginning January 1, 2009. For example, a married couple with three children could gift \$72,000

worth of assets to their children or in trust for their benefit without this counting as a "taxable gift." When a "taxable gift" is made by a donor a gift tax return is filed, but no gift tax is due until \$1,000,000 in taxable gifts have been given by a donor. For example, if a husband and wife have two children, then their annual gifting allowance is \$48,000. If they gift \$248,000 in one year, then each of them would have used \$100,000 of his or her \$1,000,000 lifetime gift tax exemption. Assuming they make no other taxable gifts, when each spouse dies, the first \$1,900,000 would pass free of estate tax instead of \$2,000,000. While there was obviously an intent to eliminate the estate tax, the \$1,000,000 lifetime gift tax exemption has never been scheduled for expansion. This assures Washington, DC, that if the estate tax was repealed and then brought back, there would still be plenty of assets held by the older generation which would be subject to estate tax upon passage.

As stated above, the \$2,000,000 exemption is scheduled to go to \$3,500,000 in 2009m and under present law, there will be no estate tax for people who die in 2010. The estate tax exemption is scheduled to come down to \$1,000,000 in 2011 and to stay at \$1,000,000 thereafter.

We have been predicting a \$3,000,000 to \$4,000,000 per person estate tax exemption and lower estate tax rates, but this may not come to fruition based upon the political changes we are seeing.

*Happy
New*