



Are you overlooking this credit?

Small businesses and tax-exempt organizations that pay health insurance premiums for their employees may qualify for a new tax credit.

The IRS conducted outreach and educational efforts to inform businesses about the credit, but says the volume of claims for the credit has been low. Of the 4.4 million taxpayers who could potentially qualify for the credit, only 309,000 taxpayers claimed the credit through mid-October 2011.

If you have a small business, perhaps you should review the requirements for this tax credit.

Current rules. A small employer is eligible for the credit if it makes contributions to purchase health insurance for its employees. A "small employer" is generally defined as an employer with fewer than 25 full-time employees with annual wages averaging less than \$50,000. The employer must cover at least half of the cost of health care coverage for workers based on its single rate.

The maximum credit is equal to 35% of the employer's contributions (25% for tax-exempt organizations). The full credit may be claimed only if the employer has ten or fewer full-time employees with average annual wages of no more than \$25,000. Otherwise, the credit amount is gradually phased out.

Doing the calculations necessary for this credit can be enough to discourage taxpayers, but ignoring the credit could mean you're paying higher taxes than necessary. For help in determining your eligibility for the health benefit credit, contact us. ♦

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Two laws and adjusted tax numbers for 2012, plus more changes ahead

Congress ended 2011 without agreeing on much of anything, but did manage to pass two bills with tax changes that will affect individuals and businesses in 2012.

■ **Hiring vets credit.** The first bill, the *Three Percent Withholding Repeal and Job Creation Act*, was signed into law by President Obama on November 21, 2011. The law repeals the three percent withholding requirement on certain payments to government contractors, and it provides tax credits to employers who hire unemployed veterans.

A credit of up to \$5,600 is available for hiring veterans who have been unemployed for more than six months, and a credit of up to \$2,400 is available for hiring vets who have been unemployed for more than four weeks but less than six months. A credit of up to \$9,600 is available for hiring

unemployed veterans who have service-related disabilities. The credits apply to vets hired after November 21, 2011, through December 31, 2012.

■ **Payroll tax cut.** The second law, the *Temporary Payroll Tax Cut Continuation Act*, was signed in late

December after weeks of Congressional wrangling over how to pay for an extension of the payroll tax cut for workers. Congress finally agreed to keep

the 4.2% social security tax rate on wages through February 29, 2012, and the expectation is that the cut will be extended through the end of 2012.

■ **Annual adjustments.** Each year the IRS adjusts certain tax numbers as required by previous laws or for inflation. Here are some of the changes that you'll need to be aware of as you do your 2012 tax planning.

• **Business numbers.** The standard

What's
New for
2012?



(continued on page 2)

More changes ahead *(continued from page 1)*

mileage rate for business driving remains at 55.5¢ a mile. First-year expensing under Section 179 decreases to \$139,000, with a phase-out threshold of \$560,000. First-year bonus depreciation for qualified property placed in service in 2012 is cut from the 2011 rate of 100% to 50%. The transportation fringe benefit limit decreases to \$125 for vehicle/transit passes and increases to \$240 for qualified parking.

• **Retirement plans.** Contribution limits to retirement accounts changed only slightly. The maximum salary deferral for 401(k) plans increases to \$17,000 for 2012. Those who are 50 or older may contribute up to \$22,500. Maximum salary deferral for SIMPLEs remains at \$11,500 (\$14,000 for 50 and older). The contribution limit for IRAs remains at \$5,000 (\$6,000 for 50 and older).

• **Social security.** The wage base for the social security tax increases in 2012 to \$110,100. Retirees under full retirement age can earn up to \$14,640 without losing benefits.

• **HSAs.** The contribution limit for health savings accounts (HSAs) increases to \$3,100 for individuals and to \$6,250 for families. An additional \$1,000 may be contributed by those 55 or older.

• **Estate and gifts.** The top estate tax remains at 35% for 2012, while the exemption amount, as adjusted this year for inflation, increases to \$5,120,000. The annual gift tax exclusion remains at \$13,000.

■ Miscellaneous changes.

• **Individuals.** The kiddie tax threshold remains at \$1,900. The nanny tax threshold

increases to \$1,800. The standard mileage rate for medical and moving mileage decreases to 23¢ a mile, and the rate for charitable driving remains at 14¢ a mile. The alternative minimum tax exemption is cut to \$33,750 for singles and to \$45,000 for married couples filing a joint return.

• **Basis.** The requirement that brokers must report your basis in stocks acquired and sold after 2010 expands this year to include shares in mutual funds and stocks acquired in a dividend reinvestment plan.

• **Foreign assets.** Beginning this year, taxpayers who have an interest in certain foreign assets valued at more than \$50,000 must report those assets on their income tax return using IRS Form 8938.

For details and planning guidance this year, please contact us. ♦

Tax pros and cons of investing in munis

Municipal bonds – often called “munis” for short – can be an attractive investment option.

What exactly are munis? They are debt obligations issued by government entities. In effect, investors are lending money to the issuer in exchange for interest payments over a predetermined length of time. When that time period expires, the bond matures and the investor recovers the full amount of the original investment.

What’s the tax appeal? There are three main attractions.

1. The interest income from munis is exempt from federal income tax. Thus, the higher your tax bracket, the more you can benefit from munis. For someone in the 35% tax bracket, a 4% return on a muni is equivalent to a 6% return from a comparable taxable investment.
2. The interest income from munis is usually exempt from state income tax if the bonds are issued by your state of residency. This could enhance the after-tax comparison to taxable investments.
3. The interest income from munis generally doesn’t increase your adjusted gross income (AGI). As a result, you might



investment alert

realize other tax benefits that are linked to AGI.

The tax aspects are essentially the same if you invest in munis through a municipal bond fund. Some funds hold only in-state munis for resident investors.

Are there any potential tax drawbacks to munis? Yes. Keep the following points in mind:

- If you sell a muni at a profit before it matures, you must report a capital gain on your tax return. Currently, the maximum tax rate is 15% for a bond held longer than one year, but this tax rate for long-term gains is scheduled to increase to 20% after 2012.
- The interest income from munis may increase the tax on social security benefits paid by retirees. You’re taxed on the benefits if your “provisional income,” which includes tax-exempt interest, exceeds a threshold of \$25,000 (\$32,000 for joint filers).
- Investments in “private activity bonds” – bonds used to finance non-government functions like stadiums – could trigger alternative minimum tax (AMT) complications.
- Other special tax rules may come into play for munis sold at a discount or purchased at a premium.

Finally, you should consider economic factors besides taxes. Be aware that munis carry a risk of default and may be “called” by the issuer (i.e., redeemed prior to the maturity date). Obtain all the information you’ll need for a sound investment decision. ♦

IRS puts the squeeze on independent contractors

A thriving business often relies on a high-performance mix of employees and independent contractors to get the company's work done. But while the team may act as a cohesive unit, the IRS treats these two kinds of workers very differently from a tax standpoint.

Citing an epidemic of misclassification, the IRS is cracking down on businesses who incorrectly categorize workers as independent contractors. The IRS's motivation is two-fold: lost payroll taxes to the government and lost employee benefits for the workers. When someone is classified as an employee, the business owner must pay social security, Medicare, and unemployment taxes associated with that employee. Other costs such as group health insurance and retirement coverage can also apply.

But when a worker instead is classified as an independent contractor, none of those extra costs come into play. What's more, a contractor can be let go at any time and for any reason within contractual restraints. It's no wonder that contractor status is preferred by businesses.

What is a contractor?

But desirable or not, business owners must classify its workers correctly or face stiff penalties. So who can rightly qualify as an independent contractor? There are many factors to consider, but generally a contractor is someone who controls how they do the work, is paid as the work is done (as opposed to just hourly), and is not permitted to leave the project prematurely without adverse financial



20 factors the IRS looks at

Formerly, the IRS used a "20 Factor" test to determine whether a worker was an employee or an independent contractor. Though these have been consolidated into three general categories (behavioral control, financial control, and relationship of the parties), the old 20-factor test remains useful in properly classifying workers. Keeping in mind that the IRS assumes employee status for workers, here's a quick review of the 20 factors.

1. How many instructions are given about how, when, and where the work is to be done?
2. How much training is provided by the company?
3. How closely integrated is the work with the company business?
4. Does the worker have to do the work personally?
5. Does the worker hire, supervise, and pay assistants?
6. How long-term is the arrangement?
7. Who sets the working hours?
8. Does the individual work full-time for the company?
9. Is the work done on the employer's premises?
10. Who dictates the order or sequence of the work?
11. Are written or oral reports required?
12. Is payment by hour, week, or month – or by the job?
13. Are business or traveling expenses reimbursed?
14. Who provides tools, material, and equipment?
15. Does the worker have a significant investment?
16. Is there a potential for profit or loss?
17. Is work done for different companies at the same time?
18. Are services available to the general public on a regular basis?
19. Can the worker be fired?
20. Can the worker terminate relationship without liability?

implications. These are just some general guidelines; each situation can be impacted by special circumstances.

In the face of increased IRS scrutiny, employers should take steps now to determine if they are making the right call regarding their workers. This might involve a thorough self-review of each assignment to see if the factors supporting independent contractor status are valid. To help prevent future problems, employers should insist on signed agreements with contractors that thoroughly specify the scope of the work and how compensation is structured. And if it is necessary for contractors to use your equipment or insurance coverage, be sure to keep such transactions at arm's length, meaning that they pay the market rate for any such benefits.

Settle up with the IRS

What do you do if you discover a misclassification, perhaps one that goes back many years? Fortunately, the IRS has established the Voluntary Classification Settlement Program (VCSP) whereby businesses can settle up with the IRS for past mistakes. Those who opt in pay just 10% of the past year's payroll taxes that would have been due had the workers been properly categorized. To qualify, the business must have consistently classified the workers in question as contractors, filed Forms 1099 for the past three years, and not currently be under federal or state classification audit.

Running an efficient workplace is hard enough, but when you add in complex tax rules to boot, the task becomes that much harder. That is where we come in. To help you navigate through the regulatory maze, give our office a call. ♦





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What the IRS is up to

Small corporation audits

The IRS is planning to conduct 2,500 random line-by-line audits of small corporations in order to update its audit selection formulas. The audits will involve 2010 tax returns of corporations with assets of less than \$250,000.

No FICA for under-18 kids

Sole proprietors and husband-wife partnerships don't have to pay FICA tax on the wages they pay to their children who are under the age of 18. The IRS says this exemption also applies to wages paid to under-18 children who work for a parent's one-person LLC that elects to have LLC status disregarded for tax purposes.

How to track your refund

The IRS reminds taxpayers that they can track the status of their tax refunds for

2011 using the "Where's My Refund?" tool available on the IRS website or using the IRS2Go phone app. By providing social security number, filing status, and exact dollar amount of the expected refund, individuals can get information about their refunds 72 hours after IRS acknowledgment of e-filed returns or three to four weeks after mailing a paper return.

IRS reopens program

To encourage taxpayers with offshore accounts to get current with their tax obligations, the IRS has reopened its "offshore voluntary disclosure program (OVDP)." Similar programs in 2009 and 2011 resulted in the collection of more than \$4.4 billion of taxes owed.

The 2012 program will be similar to the 2011 program; however, one difference is that there is currently no deadline by which taxpayers must apply. ♦

Spring 2012 tax deadlines

- **March 15** – 2011 income tax returns are due for calendar-year corporations.
- **March 15** – Deadline for calendar-year corporations to elect S corporation status for 2012.
- **April 2** – Deadline for payers who file electronically to file 2011 information returns (such as 1099s) with the IRS.
- **April 2** – Deadline for employers who file electronically to send copies of 2011 W-2s to the Social Security Administration.
- **April 17** – 2011 individual income tax returns are due.
- **April 17** – 2011 partnership returns are due.
- **April 17** – 2011 annual gift tax returns are due.
- **April 17** – Deadline for making 2011 IRA contributions.
- **April 17** – Due date for first installment of 2012 individual estimated tax.
- **May 15** – Deadline for calendar-year tax-exempt organizations to file information returns. ♦

This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.