

New Way to Settle Worker Classifications

Continued from Page 2

relief if they agree to prospectively treat workers as employees. The VCSP is generally available to businesses, tax-exempt organizations and government entities that are mistakenly treating their workers or a class or group of workers as independent contractors.

To be eligible, the employer

- must have consistently have treated the workers in the past as nonemployees
- must have filed all required Forms 1099 for the workers for the previous three years
- cannot currently be under audit by the IRS or the Department of Labor or a state agency concerning the classification of these workers

Interested employers should apply for the program at least 60 days before they want to begin treating the workers as employees.

An employer accepted into the program will pay an amount effectively equaling just over one percent of the wages paid to the reclassified workers for the past year. No interest or penalties will be due, and the employers cannot be audited on payroll taxes related to these workers for prior years. For the first three years under the program, participating employers will be subject to a special six-year statute of limitations, rather than the usual three-year period. ■

Hold the (Cell) Phone: The IRS Calls In

The IRS has issued new guidance on the tax treatment of employer-provided cell phones used by employees. The guidance is in accordance with the removal of strict reporting requirements under the Small Business Jobs Act of 2010.

The value of a cell phone provided to an employee where use might be both business and personal is excluded from the employee's taxable income if there are substantial business reasons.

The IRS explains that the value of a cell phone provided to an employee where use might be both business and personal is excluded from the employee's taxable income if there are substantial business reasons for providing the cell phone. **Some examples are:**

- The employer needs to contact the employee for work-related emergencies.
- The employer requires that the employee be available to speak with clients outside the office.
- The employee must speak with clients in other time zones outside the usual work day.

Also, in a new memo to its field force, the IRS has provided instructions concerning deductions of cell phones provided to employees and reimbursements to

employees for business use of their personal cell phones. For instance, IRS agents have been cautioned to look for reimbursements for personal cell phone use by employees that exceed the actual cost of the cell phone. Both the new guidance and memo relating to cell phone use are effective retroactively for tax years beginning after 2009.

Finally, note that a cell phone provided as a benefit to an employee without any business connection is not considered a tax-free fringe benefit. ■

IF YOU'RE "GOING GLOBAL," WE CAN HELP!

We are members of AGN International, Ltd., (AGN), a prestigious association of 199 accounting and consulting firms with 481 offices around the world. Our affiliation with AGN International assures collaboration with foremost authorities in taxation, auditing and business management across the globe. AGN enables us to provide you with accounting and consulting expertise in an array of industries in over 300 major cities in the U.S., Canada and Mexico and throughout Europe, West Asia and Africa, Asia-Pacific and Central and South America.

Call us if you'd like to learn more about our worldwide expertise.

This publication is intended to provide accurate authoritative information on the subject matter covered. This publication does not have any official authority and the information contained therein should not be acted upon without professional advice that should be related to specific situations. © 2012

FRONT RANGE

Footnotes

How to Tax-proof a Business Venture



2

Straight Talk on Above-the-line Deductions



3

IRS Explains Rules for Estate-tax Portability



3

Locking Down the Home Sale Tax Exclusion

Even with real estate prices depressed in many parts of the country, long-time homeowners might be liable for tax on a sizeable gain when they finally sell the family abode. Fortunately, a special tax law provision may enable taxpayers to reduce or completely avoid the capital gains tax. This provision includes both a "use" and "ownership" test.

BACKGROUND: By making a tax return election, a taxpayer can exclude from taxable income up to \$250,000 of gain — or \$500,000 for joint filers — from the sale of a home. To qualify for this tax exclusion, the home must have been owned and used by the taxpayer as a principal residence for at least two of the five years prior to the sale.

Theoretically, someone could qualify for the home sale exclusion every two years.

This home sale exclusion generally does not apply, however, if the taxpayer sold another qualified principal residence within the last two years. Theoretically, someone could qualify for the home sale exclusion every two years.

Keeping those basic rules in mind, here are some of the key points about the home sale exclusion:

- The home must be used as a principal residence for any two of the last five years. The years do not have to be consecutive. Furthermore, a taxpayer can meet the use and ownership requirements in different tax years.
- Joint filers can claim the maximum exclusion if (1) either spouse meets the two-year ownership test, (2) each spouse meets the two-year use test and (3) neither spouse has elected the exclusion within the last two years. This is particularly



important for taxpayers who have recently divorced or remarried.

This is particularly important for taxpayers who have recently divorced or remarried.

- In order to meet the use requirement, the taxpayer must physically occupy the home, but short absences are allowed. Conversely, a longer absence, such as a one-year sabbatical by a college professor, does not count as time that the home is being used as the principal residence.

Continued on Page 2

Volume 26, Issue 1
First Quarter, 2012

MEMBER OF



Return Service Requested

1930 17th Street, Suite 200
Boulder, CO 80302

BROCK AND COMPANY A PROFESSIONAL CORPORATION

BROCK AND COMPANY
Certified Public Accountants
Business Advisors

PRSR STD
U S POSTAGE
PAID
BOULDER, CO USA
PERMIT NO. 909

BROCK AND COMPANY
A PROFESSIONAL CORPORATION

Certified Public Accountants
Business Advisors



1930 17th Street
Suite 200
Boulder, CO 80302
(303) 444-2971

900 S. Main Street
Suite 200
Longmont, CO 80501
(303) 776-2160

3711 JFK Parkway
Suite 315
Fort Collins, CO 80525
(970) 223-7855
Metro: (303) 530-9343

26 West Dry Creek Circle
Suite 710
Littleton, CO 80120
(303) 794-5661

11990 Grant Street
Suite 220
Northglenn, CO 80233
(303) 450-0400

Visit our web site at www.brockcpas.com

Locking Down the Home Sale Tax Exclusion

Continued from Page 1

• If someone owns two homes and lives in both places during the year, the home where that person stays for most of the year is generally treated as the principal residence. For instance, if a taxpayer spends seven months at a winter home and five months at a summer home, the winter home is considered to be the principal residence.

• To the extent that the home has been used for business or rental use — including using a portion of the residence as a home office — the taxpayer must recapture allowable depreciation deductions attributable to the period after May 6, 1997. Any unrecaptured income is taxed at the 25 percent rate, as opposed to the current maximum 15 percent capital gains rate.

Finally, a partial exclusion may be available due to a change in employment, a health reason or other unforeseen circumstances from an event that could not have reasonably been anticipated.

Reminder: This is just a general overview of the key rules. It is recommended that homeowners obtain professional assistance concerning the tax ramifications of a sale. ■

New Way to Settle Worker Classifications

The IRS is offering a unique opportunity to employers who have misclassified workers as independent contractors rather than as employees. Under a special IRS program, an employer may volunteer to settle the tax debt for a minimal amount.

Generally, employers are predisposed to treat certain types of workers as independent contractors to save on payroll taxes and employee benefits. But the issue is often contested by the IRS. It can result in hefty tax obligations and penalties.

Under the Voluntary Classification Settlement Program (VCSP), eligible employers can obtain relief if they agree to prospectively treat workers as employees.

NEW DIRECTION: Under the Voluntary Classification Settlement Program (VCSP), eligible employers can obtain

Continued on Page 4

How to Tax-proof a Business Venture

Virtually any new business undertaking in 2012 is likely to be a risky proposition. At least entrepreneurs and investors can secure some tax protection under Section 1244 of the Internal Revenue Code. If certain requirements are met, a Section 1244 shareholder can claim a tax loss of up to \$100,000 if the business goes under, without any dollar limit on profits.

Section 1244 shareholder can claim a tax loss of up to \$100,000 if the business goes under, without any dollar limit on profits.

BACKGROUND: In the normal course of events, a shareholder treats a loss from a failed business venture as a capital loss for tax purposes. The loss may be used to offset any capital gains realized during the year plus up to \$3,000 of highly taxed ordinary income. Any excess loss is carried over to future years.

Therefore, it may take a long time to write off large investment losses. For example, say that a taxpayer incurs a \$50,000 loss from a business venture and expects to have an offset of \$10,000 a year for the foreseeable future. It could take five years to recover the full tax benefit of the loss.

Conversely, Section 1244 allows the taxpayer to claim a bigger deduction on a loss from a small-business investment. The loss is completely deductible against ordinary income, after offsetting capital gains, within an annual limit. A single filer can deduct up to \$50,000 of losses from Section 1244 stock in one year. The annual limit for joint filers is \$100,000.

To qualify for this special tax treatment, these four key requirements must be met:

1. The corporation must issue the stock directly to the shareholders. In other words, a shareholder cannot acquire the stock from another taxpayer and deduct a loss against ordinary income.

In other words, a shareholder cannot acquire the stock from another taxpayer and deduct a loss against ordinary income.

2. The stock must be acquired in exchange for cash or property contributed to the corporation. For instance, a shareholder cannot receive the shares as compensation for services performed.

3. The stock must be issued by a “small-business corporation.” For this purpose, a small-business corporation is defined as a corporation with capital of \$1 million or less.

4. The corporation must be an actual operating company. During the past five years, the corporation must have received less than 50 percent of its gross receipts from rents, royalties, dividends and other investment income. If the corporation is less than five years old, this test applies to those years it has been in existence.

Note that Section 1244 may be applied to both common and preferred shares of stock. Furthermore, this tax protection is not limited to investments in C corporations. An S corporation may issue Section 1244 stock if it qualifies under the tax rules.

Final words: Do not confuse this form of tax protection with other tax breaks for “qualified small business stock” (QSBS). For QSBS acquired during certain time periods, an investor who sells the stock may exclude a portion of the gain, or all of the gain in some cases, from tax. Obtain more details regarding sale of QSBS. ■



Loose Change



NEW HIRING CREDIT — On November 21, 2011, the president signed new legislation providing an expanded tax credit to employers who hire unemployed veterans. The maximum credit is \$2,400 for hiring veterans unemployed for at least 4 weeks; \$5,600 for hiring veterans unemployed at least six months; and \$9,600 for hiring unemployed veterans with disabilities. The new law also repeals a

future 3 percent withholding requirement on government payments to certain contractors.

PAPERLESS SOCIETY — Retirees who still receive Social Security retirement payments by check have until March 1, 2013, to switch to electronic means. Payments can be deposited either directly into a bank or credit union or loaded onto a prepaid debit card. To use direct deposit, you must provide the bank routing number and account number for the institution. Those who do not choose an electronic payment option by the due date will receive payments via a debit card.

Straight Talk on Above-the-line Deductions

Tax professionals often speak about deductions that are “above” or “below” the line. In this case, the “line” is the point for determining adjusted gross income (AGI). The types of expenses generally associated with tax deductions — such as charitable donations and mortgage interest — are deducted below the line after being transferred from Schedule A. But “above-the-line deductions” are more valuable than Schedule A deductions because they reduce AGI for other tax purposes. Also, these deductions may be claimed by non-itemizers.

“Above-the-line deductions” are more valuable than Schedule A deductions because they reduce AGI for other tax purposes.

Which expenses are deductible above the line? Here are a few common examples:

Tuition deduction: If a taxpayer falls below certain income limits, he or she may deduct up to \$4,000 of the tuition and fees paid for postsecondary school education. The \$4,000 write-off is available for single filers with a modified AGI (MAGI) up to \$65,000; \$130,000 for joint filers. Single filers can claim a \$2,000 deduction if they have a MAGI up to

\$80,000; \$160,000 for joint filers. **Caveat:** This deduction cannot be claimed in conjunction with a higher education tax credit.

IRA contributions: The rules limiting IRA deductions based on the amount of income apply only to active participants in employer-sponsored retirement plans. In that case, deductions for 2011 returns are phased out for single filers with a MAGI between \$56,000 and \$66,000; \$90,000 and \$110,000 for joint filers if both spouses are active participants. If only one spouse is an active participant, the deduction for joint filers is phased out between \$169,000 and \$179,000 of MAGI.

Student loan interest: A taxpayer who is legally obligated to pay off a student loan for higher education can deduct up to \$2,500 of interest on his or her tax return. This deduction is phased out for a single filer with a MAGI between \$60,000 and \$75,000; \$120,000 and \$150,000 for joint filers. **Note:** A child taking this deduction cannot be claimed as someone else’s dependent.

Moving expenses: Job-related moving expenses are deductible if a two-part test is passed: (1) The commute from the old home to the new workplace must be 50 miles farther than the commute from the

old home to the old workplace. (2) The taxpayer is generally required to stay at the new job for at least 39 weeks of the next 12 months. If an individual qualifies, he or she can deduct the cost of transporting household goods and personal effects plus travel and lodging costs (but not meals) en route to the new home.

Self-employment tax breaks: If a taxpayer is self-employed, he or she may be able to claim several tax deductions above the line. This includes 50 percent of the self-employment tax the taxpayer is required to pay and 100 percent of health insurance costs and qualified retirement plan contributions. For example, a self-employed individual may deduct annual

This includes 50 percent of the self-employment tax the taxpayer is required to pay and 100 percent of health insurance costs and qualified retirement plan contributions.

contributions to one of the “simplified” retirement plans allowed by law within generous limits.

Caution: This list is certainly not all-inclusive. Obtain professional assistance to maximize deductions on 2011 returns. ■

IRS Explains Rules for Estate-tax Portability

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “2010 Tax Relief Act”) features the most generous federal estate-tax exemption ever. Furthermore, for the first time, exemptions are deemed to be “portable” between spouses. Now the IRS has issued new guidance for those people who elect to use this provision.

BACKGROUND: Prior to the 2010 Tax Relief Act, the estate-tax exemption gradually increased from its previous high of \$1 million in 2001 to \$3.5 million in 2009, before the estate tax was effectively repealed for 2010 only. These changes were coordinated with other provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), such as reductions in the estate-tax rates and modified “carryover basis” rules.

The new law reinstates the estate tax repealed by EGTRRA, but also allows a \$5 million exemption for decedents dying in 2011 and 2012. (The IRS recently announced that the inflation-adjusted exemption for 2012 is \$5.12 million.) In

The IRS recently announced that the inflation-adjusted exemption for 2012 is \$5.12 million.

addition, exemptions are portable between spouses, so the estate of a surviving spouse may be able to use a portion of the unused exemption from the first spouse to die.

A new notice from the IRS clarifies the portability rules. Significantly, an estate that wants to transfer the unused estate-tax exclusion of a deceased spouse to a surviving spouse must file an estate-tax return, but will not need to make an affirmative election. The estate of the spouse will be considered to have made the portability election as long as it files a timely estate-tax return. In the new notice, the IRS also emphasized that the estates of decedents dying before 2011 cannot transfer an unused exclusion amount.

Note that an estate of a decedent dying in 2011 with assets under \$5 million would not owe any estate tax and would

not normally file an estate-tax return. However, under the new notice, these estates must file the return to benefit from the portability provision, even if no estate tax is owed. Normally, the return is due nine months after the date of death. An executor can request a six-month extension.

The 2010 Tax Relief Act also requires the estate making a portability election to compute the deceased spouse’s unused exclusion amount. Until the estate-tax return is revised, the IRS says that simply completing the estate-tax return will satisfy this requirement. If the executor of a small estate does not want to make a portability election, he or she does not have to file an estate-tax return. If a return is otherwise required, the executor should follow the IRS instructions. Finally, the IRS indicated that it will be issuing regulations on implementing the portability provisions.

Caution: The rules in this area are subject to change after 2012. Contact an experienced estate-tax professional for further guidance. ■