

Arkansas Public Accountant

A Publication of the Arkansas Society of Public Accountants



July 2004

• **FROM YOUR**
PRESIDENT'S PEN •



Dear Members:

I was glad to see those that attended the Estates and Trust Seminar we had in Little Rock in June. This seminar was very educational and enlightening and Gear Up speakers did a great job. ASPA will be having an Accounting Seminar on August 5th and 6th. You should be receiving an enrollment application soon so make plans to attend.

Many of you that are also members of NSA (National Society of Accountants) have been receiving your brochures for NSA's 59th Annual Convention.

This year's convention is August 28-30 in San Antonio, TX. ASPA is helping sponsor a reception at the convention since it is held in our district. I hope you make plans to attend this premier event for tax and accounting professionals. For more information, the link to NSA's website is <http://nsacct.org>.

Summer is officially here, which usually means vacations and heat. There is something else in Arkansas that has had people heated up. That is sales taxes. Effective July 1st, there are several business activities that will now be collecting sales tax. For most of these businesses its pretty clear when to charge customers sales tax. However, the construction sector has had its battles over who will and when to charge sales tax. Several revisions were made to Reg. 2004-1 and there are still a few areas that are unclear. With the impending deadline we have been busily trying to educate our business clients that are affected by these new regulations as to when and how to charge sales tax.

After trying to teach several clients how to properly collect and track sales tax, it is probably a very good thing that Arkansas will have an Amnesty program from July 1, 2004 until December 31, 2004. Just for your information, all the tax collected during this time is earmarked for Arkansas

Topics Covered in this Newsletter

**ABUSIVE EMPLOYEE PLAN (EP)
TAX SCHEMES**

**ABUSIVE "DONOR ADVISED FUND"
ARRANGEMENTS**

**HOW THE IRS CATCHES TAX
CHEATS**

**GOOD GIFT FOR A CHILD
ROTH IRA**

education. Arkansas has a web site that has information on it about the Amnesty program with a FAQ section, as well as a printable application. Starting July, you can enter your application online. The link to the website is <http://www.arkansas.gov/dfa/amnesty.html>.

I hope each of you are enjoying the summer days of Arkansas, or wherever you find yourself. Rest up because the extension deadline is just around the corner.

Sincerely,
Brian L. Thompson, CPA
ASPA President

The best things in life are free; but sooner or later the government will find a way to tax them.

Unknown

Tax Information from the IRS

July 2004

**Provided by SB/SE Taxpayer Education and
Communication
Little Rock, AR**

Abusive Employee Plan (EP) Tax Schemes

The IRS is cautioning the public about abusive tax avoidance transactions that involve various types of employee benefit plans. Typically promoters of these schemes will approach employers and ask for their participation in arrangements that promise questionable tax benefits. The promoter will then – for a fee – help the employer set up these arrangements. Business owners should be wary of these programs.

Consider the following examples:

Example 1: A sole proprietor has operated a business for several years. In 2003, he opens a Roth IRA contributing \$3,000 to the account – the maximum allowable by law. The Roth IRA acquires 100% of the stock of a newly formed corporation for \$1,000. The corporation has few assets at the time of the acquisition. Shortly after the corporation was acquired by the Roth IRA, the sole proprietor sold his accounts receivable to the newly formed corporation for \$2,000 although the fair market value of the accounts at the time was \$10,000. Later, the proceeds from the accounts receivable were received by the newly formed corporation and distributed to the Roth IRA as the sole shareholder of the corporation. The proceeds from the accounts receivable were taxable to the newly-formed corporation at the applicable corporate tax rate, but no tax was paid on the distribution of the proceeds to the Roth IRA on the grounds that the income of a Roth IRA is not subject to tax. The sole proprietor anticipates receiving a tax-free distribution of the proceeds from the Roth IRA (plus any earnings on the proceeds) in a later year.

Example 2: The owner of a personal corporation opened a Roth IRA in 2002 and contributed \$1,000 to the account. Shortly afterward, the Roth IRA acquired 100% of the stock of a newly formed corporation. In 2003, the owner entered into an agreement with the new corporation to provide the same services to the new corporation that she had provided to the solely owned corporation, with the new corporation receiving payment for such services. The agreement provided payment of \$50,000 per year although the owner had earned \$200,000 per year in each of the prior two years for these services. In accordance with the agreement, the owner performed the same services she had performed in prior years and received \$50,000 in 2003 from the newly formed corporation, while the new corporation retained \$150,000 of the \$200,000 received in connection with such services. The amount retained

by the new corporation was distributed to the Roth IRA as the sole shareholder. If the owner had received the \$200,000 as earnings, he could not have made a contribution to the Roth IRA. The amounts received by the new corporation would have been taxable to the corporation at its corporate tax rate, but no tax was paid on the distribution to the Roth IRA and the owner paid taxes only on the \$50,000 received for his services. The owner anticipates receiving a tax-free distribution of the proceeds (plus any earnings on the proceeds) from the Roth IRA in a later year.

Example 3: The owner of a personal corporation participates in a section 412(i) pension plan maintained by her corporation. The pension plan provides a \$1,400,000 death benefit, payable upon the death of the owner, to her beneficiaries. Although the death benefit is equal to \$1,400,000, the plan purchased a life insurance policy with a face value of \$5,000,000. The plan provides that if the owner dies while employed by the corporation, \$1,400,000 is payable to her beneficiaries but the remaining \$3,600,000 is to be applied to pay premiums under the plan for other participants. The employer corporation deducted the contributions paid to the plan that were used to pay the premiums on the full amount of the insurance policy.

A number of programs like these have been identified by the IRS as “listed transactions”. Listed transactions are those that the IRS has determined to be structured for the significant purpose of tax avoidance or evasion. (See IRS Announcement 2000-12 for a complete explanation of “listed transactions”.) Parties who participate in listed transactions may be required to disclose the transaction, register it with the IRS, or maintain a list of investors for providing to the IRS.

Examples 1 and 2 above are listed transactions

according to Notice 2004-8. Example 3 is a listed transaction according to Revenue Ruling 2004-20.

For more information, visit the “EP Abusive Tax Transactions” section on the IRS Retirement Plans web page at www.irs.gov/ep. The section provides additional information about retirement plan abuse and details IRS efforts to shut down those transactions deemed abusive. It also warns promoters and plan professionals about the consequences of participating in such schemes and provides a hotline for reporting suspected abusive transactions to the IRS.



Abusive “Donor Advised Fund” Arrangements

The Internal Revenue Service is cautioning the public that payment to certain organizations that offer purported “donor advised fund” arrangements are not deductible under section 170 of the Internal Revenue Code.

A public charity exempt from tax under section 501(c)(3) may operate, as its primary or secondary activity, so-called “donor advised funds” to further its charitable purposes. A donor advised fund typically is a separate fund or account established and maintained by a public charity to receive contributions from a single donor or a group of donors. For the payment to qualify as a completed gift to the charity, the charity must have ultimate authority over how the assets in each account are invested and distributed in furtherance of its exempt purposes. While the donor may recommend charitable distributions from the account, the charity must be free to accept or reject the donor’s recommendations. Payments to a charity are deductible as “charitable contributions” only if they meet all the requirements of section 170 of the Code. A pay-

ment to a charitable organization that is intended to benefit the taxpayer is not a “charitable contribution” within the meaning of section 170(c). Thus, payments to a charitable organization to establish a separate fund are not deductible charitable contributions if the taxpayer expects that the taxpayer, the taxpayer’s family, or related parties will receive personal benefits (such as the payment of tuition or other personal expenses) from the fund.

Certain promoters, or organizations that claim section 501(c)(3) status, may encourage individuals to establish purported “donor advised fund” arrangements that can be used for the taxpayer’s personal benefit. The promoter may even refer to the separate fund or account as the “taxpayer’s foundation” or the “taxpayer’s family public charity.” The Internal Revenue Service is actively examining these types of arrangements and may in appropriate cases disallow deductions under section 170 for payments in connection with these arrangements. In addition, taxpayers may be taxed on investment income earned on, or benefits received from, the separate funds or accounts. Moreover, an organization that participates in these arrangements may fail to qualify for, or jeopardize, its tax-exempt status under section 501(c)(3).

If you have specific questions on a tax scheme, or wish to report a possible scheme, call 1-866-775-7474, or send an e-mail to: irs.tax.shelter.hotline@irs.gov.

The American compliance record stems from a combination of civic obligation, fear of audit, and confidence that everyone else on the block is chipping in.

The Washington Post

Omnibus

A recent conversation with a senior IRS executive confirmed that the IRS will continue to pursue high-publicity projects, such as sham trusts, offshore use of credit/debit cards to launder untaxed income, and sophisticated multilevel tax shelters used by large corporations. The limited resources available to the IRS have necessitated that its energy be focused on busting large-dollar tax-avoidance schemes. Taxpayers who operate in the underground economy (small businesses keeping no records and dealing exclusively in cash) will not be on the radar screen. So, expect voluntary compliance among the public at large to get worse.

Where is the IRS when it comes to criminal investigations? During 2003, the IRS criminal division recommended criminal tax charges against 1,036 taxpayers. Considering that millions of individual income tax returns are filed each year, this is a drop in the bucket. Part of the reason for the modest enforcement effort is that IRS special agents support the activities of other government agencies, which need expert forensic accountants to examine complex financial transactions. Implication: Taxpayers who take aggressive positions or even evade tax entirely have little chance of being criminally prosecuted.

How the IRS catches tax cheats. Although routine audits that exposed unreported income have been considerably scaled back, the IRS still has powerful weapons...jilted lovers, scorned spouses, and disgruntled partners or employees. Incriminating information furnished by someone who may be trying to get even is generally regarded as very serious by the IRS. How to go about claiming innocent spouse relief: Provide the IRS specific information about specific transactions on Form 211, Application for Reward for Original

Information. Merely stating, "I don't think my ex-husband is reporting all his income" will probably not be taken very seriously.

Notes from the Executive Secretary

I have had requests recently to move the Gear Up 1040 Seminar from the current location.

I offer this in way of explanation --- I have checked into numerous locations, including the Alltel Arena, with no success.

I am sorry to say that I have been unable to find a suitable location for this seminar. I just wanted those of you who made this request to know that I did look into other locations and was not able to find anything that would serve our purposes. As other things open up, I will continue to look at them.

IRS to increase audits of executive compensation. Recent examinations of returns of 24 diverse large businesses found problems and abuses ranging from improper reporting of benefits to nonfiling. The new audits will target deferred compensation, executive fringe benefits, golden parachutes, and other compensation elements.

Meal & entertainment (M&E) deductions now can be supported by "statistical sampling." These expenses long have been difficult to for businesses to deduct because the IRS has required documentation for each individual meal. But new IRS rules permit a sample of expenses to be used to support M&E deductions that are not subject to the 50% limit. This will relieve taxpayers of the need to scrutinize each and every item relating to an M&E account. IRS Revenue Procedure 2004-29; IRB 2004-20,1.

Good Gift for a Child Roth IRA

The best gift you can make to a child or grandchild may be the funds to finance annual contributions to a Roth IRA.

Many minors earn income from summer jobs, after school work, work done for a family business, etc. Such children are eligible to make Roth IRA contributions up to 100% of their earned income, subject to the limits outlined below. If they don't have the money to do so, you can give it to them.

Big payoff: Distributions from Roth IRAs can be totally tax free, unlike those from traditional IRAs and other kinds of retirement plans. And due to the power of compound earnings over the many future years of a young child's life, the final tax-free payout may be huge.

Example: Roth IRA contribution limits are \$3,000 IN 2004, \$4,000 FOR 2005 – 2007, and \$5,000 for later years. Starting this year, a child age 15 makes these maximum contributions for seven years, through age 21. If the average return in the IRA is 7% - the long-term average after inflation for stocks- then at age 21, the child will have about \$40,000 in the IRA.

Without investing another dollar, the IRA will grow to more than \$700,000 by the time the child reaches 65—all tax free, making it worth much more than the same amount of money in any other kind of retirement account.

At age 21, the child can have attained some

future retirement security without having to save any more for retirement during his/her working life.

TAX INSURANCE ???

Tax insurance has received a green light from the IRS for legitimate transactions. Tax insurance protects the tax benefits of a legitimate transaction – such as a corporate reorganization or estate-planning strategy—when an IRS private letter ruling is not available. If a later audit results in a tax increase, the insurer compensates the taxpayer. New IRS regulations approve tax insurance, recognizing that insurers are motivated to examine transactions conservatively to minimize their own risk.

Typical premiums cost from 5% to 11% of the tax at issue—but if a major business deal or a family’s wealth is at stake, the coverage can help all sleep at night.

OPEN SEASON FOR MEMBERSHIP IRSAC AND IRPAC

IRS is requesting nominations for membership in the Internal Revenue Service Advisory Committee (IRSAC) and the Information Reporting Program Advisory Committee (IRPAC). Nominations will be accepted for current vacancies. All applicants should submit a resume, complete an application form and Federal tax check waiver form. In addition, FBI and practitioner (if applicable) checks are required of all applicants. Please refer to the IRSAC/IRPAC fact sheet for specific details about the nominations and selection process.

THE DEADLINE FOR SUBMITTING APPLICATIONS IS FRIDAY, JULY 30, 2004.

The IRSAC provides an organized public forum for IRS officials and representatives of the public to discuss relevant tax administration issues. The Council advises the IRS on issues that have a substantive effect on federal tax administration. As a body designed to focus on broad policy matters, the IRSAC reviews existing tax policy and/or recommends policies with respect to emerging tax administration issues. The IRSAC suggests operational improvements, offers constructive observations about IRS’ current or proposed policies, programs, and procedures and advises the IRS on particular issues having substantive effect on federal tax administration.

The IRPAC advises the IRS on information reporting issues of mutual concern to the private sector and federal government. The Committee works with the Operating Division Commissioners and other IRS executives to provide recommendations on a wide range of information reporting administration issues. Membership is balanced to include representation from the taxpaying public, the tax professional community, and small and large businesses, state tax administration, and the payroll community.

If you are interested in becoming a member of IRSAC or IRPAC, please contact Gregory Metcalf at 501-324-5328 ext 264, or E-mail at Gregory.O.Metcalf@irs.gov.

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**APPLICATION FOR MEMBERSHIP IN
THE ARKANSAS SOCIETY OF
PUBLIC ACCOUNTANTS**

P.O. Box 725
Newport, Arkansas 72112
longaspa@cox-internet.com
www.arspa.org

Last Name First Name Middle Initial Business Phone Home Phone

Business Address _____

How many years of accounting have you had? _____ Date of Birth _____

Sole Practitioner [] Partner [] Employee [] Corporate Officer []

Name of Firm _____ Number of Employees _____

Name of Partner(s) _____

Are you a Licensed, Registered or Certified Public Accountant? _____ If yes, give License# _____

Are you an Accredited Public Accountant? _____ If yes, give Accreditation # _____

Are you an Enrolled Agent _____ If yes, give EA # _____

Do you hold an Associate or Baccalaureate degree with a minimum of 24 semester hours in Accounting? Yes _____ No _____

Are you engaged in any other trade or profession? _____ If yes, please describe _____

Please list other accounting organizations in which you hold membership: _____

I hereby state that the accompanying statements are correct to the best of my knowledge and belief. I further state that I will abide by the Constitution and By-Laws of the Society and will practice in strict conformity with the Code of Ethics and Rules of Professional conduct adopted by the Society.

Date _____ Signature of applicant _____

Annual dues are payable IN FULL in advance and are prorated for credit by ASPA on a monthly basis to August 31 - the end of ASPA's fiscal year.

[] Membership Annual Dues \$85.00 [] Firm Annual Membership \$50.00 [] Diamond State Annual Dues \$15.00
(Non-Residents only)

Do Not Write Below This Line

State Member Approving Membership

Signature _____ Title _____ Date _____

Sponsor, If Any

FOR ASPA OFFICE USE ONLY

Control Number

Amount

Date Received

"State Society dues payments may be deductible as an ordinary and necessary business expense. However, they are not deductible as charitable contributions for Federal income tax purposes.

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FOR YOUR INFORMATION

The ARKANSAS PUBLIC ACCOUNTANT is the monthly publication of the ARKANSAS SOCIETY OF PUBLIC ACCOUNTANTS. We are a professional organization dedicated to the promotion of accountants and tax preparers in the State of Arkansas. We accept newsworthy articles and advertising. If you have either of these for publication, please contact the editor.

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