

Arkansas Public Accountant

A Publication of the Arkansas Society of Accountants



November 2004

• FROM YOUR

PRESIDENT'S PEN •

Dear Members:



It's finally over for another year. With seventy-five days until the next one begins, tax Season mercifully came to an end on October 15th. It seems to me that the last extension season is much more difficult than April for our practice. I guess it is because we have a deadline which we strictly adhere to in April but don't have any for the last filing period.

We will be taking a look at the numbers and try to see what we did right and where we can improve as we prepare for next year. If your practice is like ours, you gained some in numbers and you had a few clients that didn't choose to let you prepare their 2003 return. Those folks that you prepared their returns for a number of years and didn't come back always seem to bother me the most. Those are the ones that you would like to really know where you messed up.

With the holiday season fast approaching and the tax institute to attend, there is much to do to get ready for January. Those of us who changed tax software or who plan to make a change have the chore to convert last year's data over to the new software. It will be interesting to see impact the changes in the law will have on the arrival of the software in January. It would be interesting to note how many of you send out tax organizers to your clients and what kind of response you get from sending them. Also, it would be interesting to note how many of you schedule appointments for your clients at the beginning of the season. It would be nice to have some medium to exchange this type of information.

Topics Covered in this Newsletter

- **IRS BREAK FOR ANNUITY OWNERS UNDER 59 1/2**
- **EMPLOYERS OF "TIPPED" EMPLOYEES CAN LOWER AUDIT RISK**
- **IRS CAN'T TAKE MONEY IN PENSION DURING BANKRUPTCY.**
- **TAX PROFESSIONAL SEMINAR Q & A.**

We have engagement letters to update for both our tax clients and also our write-up clients. In the past we have included the privacy act information with our engagement letters. This has simplified that process somewhat.

The most important thing that we need to do between now and January 1 is to find some time to exhale and relax just a little. This will give us what we need to reload. This time of year helps us to reflect, plan and hopefully find ways to improve. It is also a time for giving thanks and spending precious time with family and friends. I wish all of you a peaceful two months before we start all over again.

One final note, please mark you calendars for our Gear-Up Tax Seminar to be held at the Robinson Center/Double Tree on December 15&16.

Sincerely,

Tom Simmons, President
Arkansas Society of Accountants

**ANNUITY OWNERS, UNDER AGE
59 1/2**

You've just received a break from the IRS. New IRS rules give persons who are receiving payments under annuities issued by insurance companies a one time option to change their payments schedules without incurring a 10% early distribution penalty.

This means an annuity's payout can be changed to reflect market results—with payments reduced if the stock market's fall since 2000 has lowered the annuity's value, or increased if this year's market rise has increased its value. The new rules are meant to match those instituted for pension plan annuities in 2002.

IRS notice 2004-15

EMPLOYERS OF "TIPPED" EMPLOYEES CAN LOWER AUDIT RISK..... through a newly extended IRS program.

Danger: Businesses owe employment taxes on tips received by employees, so if employees don't report their tips, a business can face an audit, a big back tax bill, and penalties.

Saver: Voluntary participation in the Tip Rate Determination and Education program that the IRS has just made permanent after a successful test. One option: A business agrees to educate employees about their tip-reporting duty and give them monthly statements of credit card and other known tips, and the IRS agrees not to audit it on tips. A business can design details of its own program. The test program was scheduled to expire soon but has been made permanent due to its success. Details: IRS Publication 1875, Tips on Tips.

Estate avoids undervaluation penalty when both sides' experts were wrong. When a woman died, her shares in a private company were valued by the IRS at \$32.4 million and by her estate at \$1.75 million. Finding the difference “startling,” the court valued the shares at \$13.5 million. The IRS then sought to impose undervaluation penalties on the estate. Court: When assets are undervalued by more than 25% a penalty of 40% normally applies, and here the under-valuation was 87%. But this valuation was difficult, both sides made errors—and the estate’s valuation was much closer to the court’s than was the IRS’s. This gives sufficient cause to lift the penalty.

Estate of Josephine T. Thompson, TC Memo 2004-174.

IRS CAN'T TAKE MONEY IN PENSION DURING BANKRUPTCY

An individual who was declaring bankruptcy owed \$140,000 to the IRS but had more than \$200,000 in a qualified retirement plan account. The IRS previously has placed a lien on the retirement account and said that this allowed it to use the account assets to collect the tax debt.

Conflict: The federal pension law, ERISA says funds in qualified retirement plan accounts are not subject to creditor claims. Taxpayers say this keeps such funds from being included in a “bankruptcy estate” and beyond the reach of IRS as a creditor at least until they are paid upon retirement.

But the IRS says ERISA also states its provisions do not override any other federal law—and that other federal laws give IRS the power to take “any” assets a taxpayer owns to settle a tax debt notwithstanding ERISA and a bankruptcy filing.

Lower courts had ruled both ways on this issue when this case reached one of the 11 US circuit Courts of Appeal.

Decision: For the individual. The IRS cannot take the pension money.

Reasons: If the IRS position was correct, then declaring bankruptcy would expose an individual to accelerated claims. This is because it is well settled that, absent bankruptcy, an IRS lien on a qualified retirement account gives the IRS no right to collect anything until the account goes into “pay” status, such as at retirement. If the IRS could collect the assets during the term of the bankruptcy reorganization, then it would collect sooner,



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or the reorganization, then it would collect sooner, or the reorganization plan might have to be rejected by the court because there would be too few assets to fund it.

The IRS itself has argued the opposite way in court, saying that funds in a pension account cannot secure a tax debt, when its object was to increase the amount of an unsecured debt above applicable limits in bankruptcy filings.

**Tax Information from the IRS
November 2004
Provided by SB/SE Taxpayer Education
and Communication
Little Rock, AR**

**Check Carefully Before Applying for
Offers in Compromise**

The Internal Revenue Service has issued a consumer alert advising taxpayers to beware of promoters' claims that tax debts can be settled for "pennies on the dollar" through the Offer in Compromise Program.

Such promoters make money by inappropriately advising indebted taxpayers to file an application for an offer in compromise with the IRS, promising unrealistic results, even when the taxpayers do not meet the requirements of the program. This bad advice costs taxpayers money and time.

Taxpayers may refer promoters who are using the program inappropriately to the IRS's Office of Professional Responsibility for civil sanctions by sending their complaint

to: Office of Professional Responsibility (SE:OPR), Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, DC 20224.

An offer in compromise is an agreement between a taxpayer and the IRS that resolves the taxpayer's tax debt. The IRS has the authority to settle, or "compromise," federal tax liabilities by accepting less than full payment under certain circumstances.

"This program serves an important purpose. But we do warn taxpayers to watch out for unscrupulous promoters charging excessive fees to taxpayers who have no chance of meeting the program's requirements," said IRS Commissioner Mark W. Everson. "Taxpayers should not be duped by high-priced promises."

Although there are some tax practitioners who promote dubious schemes, most practitioners give quality service to their clients. Taxpayers who need a qualified tax professional to prepare and submit their offer in compromise application form may contact state or local tax professional associations to find enrolled agents, CPAs or attorneys in their geographic area with the education and experience to assist them.

The application package, IRS Form 656, Offer in Compromise, was recently redesigned with new instructions, worksheet and checklist to make it easier for taxpayers to determine if they are eligible for the program and to accurately prepare the necessary forms. The recent revision of the application form also contains a new paid preparer signature block. Taxpayers may wish to reconsider using preparers who hesitate to identify themselves on the form.

An offer in compromise may be considered only after other payment options have been exhausted. If taxpayers are unable to pay their taxes in full, there are other payment options, such as monthly installment agreements, that must be explored before an offer in compromise can be submitted.

Additional information is available in IRS Publication 594, The IRS Collection Process, and Form 9465, Installment Agreement Request. These documents provide complete information on all options available and help taxpayers determine if they qualify for a payment program.

Taxpayers who are unable to pay their taxes in full and who have explored the various options should use the checklist in the Form 656 package to determine if they are eligible for an offer in compromise.

Some taxpayers may be exempt from the \$150 application fee depending on income or whether the offer in compromise is based solely on doubt as to tax liability. Taxpayers who claim the income exception must certify their eligibility by completing Form 656-A, Income Certification for Offer in Compromise Application Fee. This certification should be attached to Form 656 in lieu of the \$150 fee at the time of submission. The Form 656 package contains a worksheet designed to assist taxpayers in determining whether they qualify for the income exception. The income exception applies only to individuals.

The publications and forms are available at on this Web site or by calling 1-800-829-3676 to order copies. All publications and forms are free.

Tax Professional Seminar Q & A

Q. How many years are available through the *Transcript Delivery System*?

A. Return transcripts are available for the current year and the three prior years. Account transcripts are available for six years. Wage and Income Return documents (W-2's, 1099's, ect.) are available for six years.

Q. Can a Form 1120 be e-filed that an extension has been applied for and accepted?

A. Yes.

Q. What is the appropriate box to report Sec. 125 Cafeteria Plan amounts?

A. A cafeteria plan is a written plan under which participants (all employees) may choose their own "menu" of benefits consisting of cash and "qualified benefits". They are also referred to as flexible benefit plans. In general, a cafeteria plan can't include any plan which provides for deferred compensation, except for certain 401(k) plans, post-retirement insurance maintained by educational institutions (IRC 125(d)), and matching contribution plans under 401(m). The cafeteria plan can also include one or more flexible spending accounts which are funded by employee contributions on a pre-tax salary reduction basis to provide coverage for specified expenses, for example, qualified medical or dependent care assistance.

Box 12-Codes

You will report deferrals to the plans listed below in Box 12. The amount reported is only the part of the employee's salary that he/she did not receive because of the deferral. Only elective deferrals will be reported in Box 12. The following are not elective deferrals and may be reported in Box 14:

- Nonelective employer contributions made on behalf of an employee
- After-tax contributions, such as voluntary contributions to a pension plan that are deducted from an employee's pay.
- Required employee contributions.
- Employer matching contributions.

Plans that qualify to be shown in Box 12:

- **Elective deferrals to a 401(k) cash or deferred arrangement.** (Includes SIMPLE retirement account that is part of a 401(k) arrangement. The amount deferred will be shown in Box 12 with a Code of "D". If the deferred amount exceeds the limit for elective deferrals, then the excess is reported on a Form 1099-R.
- **Elective deferrals under a 403(b) salary reduction agreement.** Use code "E".
- **Elective deferrals under a 408(k)(6) salary reduction SEP.** Use code "F".
- **Elective deferrals under a 457(b) deferred compensation plan.** Use code "G". Reporting for this plan includes elective deferrals by employee and employer contributions (including nonelective deferrals) to any governmental or nongovernmental

section 457(b) deferred compensation plan.

- **Elective deferrals under a 501(c)(18)(D) tax-exempt organization plan.** Use code "H". In this instance, you will include this amount in Box 1 wages. The employee will deduct the amount on his/her Form 1040.
- **Employee salary reduction contributions under a 408(p) SIMPLE.** Use code "S". However, if the 408(p) is part of a section 401(k) arrangement, then you must use the code "D".

Box 14-Other

The only item that is required to be entered in this box is the lease value of a vehicle provided by your employee that is reported in Box 1. If you elect not to enter this value in Box 14, then you will have to provide a separate statement to your employee.

Box 14 is not required for these items, but they may be reported in this box:

- Four nonelective deferrals listed above under Box 12.
- Union due
- Uniform payments
- Health insurance premiums deducted
- Nontaxable income
- Educational assistance payments
- Parsonage allowance and utilities
- State disability insurance taxes withheld



APPLICATION FOR MEMBERSHIP IN
THE ARKANSAS SOCIETY OF
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P.O. Box 725
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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
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*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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