

Arkansas Public Accountant

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• **FROM YOUR
PRESIDENT'S PEN** •



Dear Members:

The big flap over social security finds our clients and us on both sides of the issue. It is apparent that the fund is in trouble over the long haul and maybe over the short haul. There are a number of things about retirement that are very troublesome. As financial advisors to our clients, we can make some suggestions that will help hedge against some of the problems.

One of the newest of the problems facing our retiring clients is the development of the American Airlines retirement fund. Just imagine if you were a retiree of a large company and are counting on your company's retirement to supplement social security or the other way around. Then to find out that you don't have your company retirement and social security doesn't look too healthy either. The sad part of this situation is that it looks really real now. If large companies can just deny responsibility to their retirees, where are we?

There are more than 76 million Baby Boomers moving toward retirement. We make up nearly 30 percent of the U.S. population. With a longer live expectancy, many of the Boomers could live up to three decades into retirement.

On average a person reaching retirement has only saved \$70,000 for retirement. Looking at increased medical costs and higher medicine costs the problems look almost insurmountable. There have been several additions to our opportunities to save in recent years. We should be encouraging our clients to take advantage of both their private and company retirement plans. Another bit of advice that we should share with our clients is for them not to put all of their company retirement in their company stocks. Diversification is the key to a healthy plan.

Topics Covered in this Newsletter

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Not only should we be encouraging our clients to max out their retirement savings, but we should be doing the same thing. The older we get, the smaller growth we get in our money, and so it is very important to begin this program early in our work career.

Our advice and help to our clients is very important in saving them tax dollars and also helping them plan for their futures. We can be very beneficial to them in helping to make the quality of their lives much better.

Sincerely,

Tom Simmons, President ASA

REPEAL AMT?

Could this really be possible? Let's hope so.

I have just read an article stating that the Senate Finance Committee, chaired by Charles E. Grassley a republican from Iowa and endorsed by others have introduced a bill that would repeal AMT for individual taxpayers for years beginning after December 31, 2005.

This bill would cost \$600 million under current tax law and would increase to between \$800 million and \$1 trillion if the 2003 tax relief is extended as proposed by President Bush. This is according to a number of estimates cited by Finance Committee aides.

I am sure that most of you would agree that this would be wonderful for a great number of our clients and that list is growing all the time.

Also in that same publication was some

surprising facts about check fraud. It seems that all a person needs to draft our bank accounts is a routing number and our account number. They say that this information is very easy to access.

We need to all be aware of this and keep a close watch on the information that we share with others.

As they say, "forewarned is forearmed."

Editor

DOUBLE-CHECK MERCHANT ACCOUNT TRANSACTIONS.

A firm that makes retail sales on-line will first have to obtain a "merchant account: in order to process purchases paid by credit card.

The merchant account, typically arranged with your bank or through a service such as PayPal, allows merchants to accept and process credit card transactions. Collected funds are periodically deposited into your business checking account. The credit card company assembles charges to be billed to the cardholder at the end of the billing cycle.

Important: Monitor the merchant account. Verify that it actually forwards the amount of funds that matches the amount of recorded sales.

Trap: There have been some instances where the merchant companies neglected to bill the cardholder. Therefore it is prudent for the selling company to reconcile its records with the merchant company's on a timely basis.

Otherwise, not only might real income be less than recorded sales, but when the reported sales are included in income, you might pay tax on amounts you never received.

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MARVELOUS TAX BREAKS FOR WEEKEND FARMERS

Taxpayers who qualify as farmers enjoy many special tax breaks. Traditional farmers qualify, of course, but so can weekend and “lifestyle” farmers – gentlemen farmers.

Here is a rundown of the main tax breaks and what it takes to claim each one.

who is a farmer?

For tax purposes, just about any person who grows or raises something can take advantage of tax breaks for farmers. This means that a penthouse greenhouse in which orchids are grown or a horse farm in the suburbs can qualify.

The tax law does not set a uniform definition of “farmer.” For instance, what defines a farmer for deciding whether estimated taxes have to be paid is different from the definition used for determining whether cash accounting can be used. We’ll explore the definitions below.

deducting losses

Sometimes it may take a number of years to develop a certain type of farm – for example, it takes three to five years for a

standard-sized apple tree to begin bearing fruit.

Naturally, farmers want to deduct losses in early years or when weather conditions result in poor crops. And so called gentlemen farmers want to be able to use their losses to shelter their income from other sources.

There are two hurdles to clear before you can deduct the expenses of a farm...

- You must be in a trade or business. Simply maintaining a horse on a property doesn’t amount to a business, but breeding horses can qualify.
- You must engage in the activity with the intention of showing a profit. If you do, then your losses are deductible – even if they exceed income from the activity.

If you can’t show a profit motive, then losses (expenses from farming) are limited to farm income. Excess losses are lost forever.

Establishing a profit motive: You can rely on a presumption in the law that you are engaged in the activity for profit if you show a profit in three out of five years (losses in the two down years are fully deductible), or two out of seven years if the activity is breeding, training, showing or racing horses.

But even if you have losses year after year, and fail the three-out-of-five or two-out-of-seven-year tests, you can still show your profit motive by the way in which you run your farm. **How to do this....**

- Have a written business plan to show how you intend to become profitable.
- Keep good records, including a separate business bank account for the farming activity.
- Talk with experts about how to improve operations and follow through on these suggestions.

cash basis

One of the main tax advantages of being a farmer is the right to use the cash method of accounting. This allows you to deduct expenses when you pay them and defer the reporting of income until you receive payment. In operation, this means that if you've had a good year, you can reduce your taxes by loading up on prepaid farming supplies, such as feed and seed, at year end, as long as there is a business purpose for the purchases.

Other costs that might otherwise be viewed as capital expenditures – because they produce a benefit extending more than one year – can also be deducted currently if you make the election to use the cash method. This election applies, for example, to expenditures for fertilizer, lime, and other materials used for enriching or conditioning the land.



Debt Forgiveness is Not Always Taxable

When a debt is forgiven by the party to whom it is owed, taxable income generally – but not always – results to the debtor, says the IRS.

IRS legal opinion: When loan proceeds are received, they are not taxable income because of the obligation to repay them. But if that obligation is lifted, the proceeds that are kept rather than repaid comprise an economic gain that is taxable.

However, a debt may result from a cause other than receiving something that is to be repaid. In such a case, debt forgiveness does not produce taxable income because the debtor does not gain by keeping anything.

Example: An individual guarantees a loan received by another and becomes liable on the guarantee. Later, the obligation to pay on the guarantee is forgiven. Because the guarantor does not keep the loan proceeds, no taxable income results.

New case: A company that had made illegal overcharges was ordered by the United States Department of Energy to pay restitution. The company's sole owner was held personally liable for the restitution payment, jointly with the company. But later, the agency released its judgment (for unspecified reasons) and issued Form 1099-C, reporting to the IRS that the owner of the company had received "discharge of indebtedness income."

IRS decision: The owner is similar to a loan guarantor. He is a separate taxpayer from the company and did not benefit personally from the overcharges. Thus, being released from the obligation to repay them did not produce taxable income to him.

**TAX INFORMATION FROM
THE IRS
PROVIDED BY SB/SE
TAXPAYER INFORMATION &
COMMUNICATION
LITTLE ROCK, AR**

IRS Nationwide Tax Forums

The IRS Nationwide Tax Forums offer the latest word from the IRS on tax law, compliance and tax practice and procedure. The tax professional community is offered a one-stop shop with opportunities to attend seminar presentations and workshops, as well as focus groups with subjects from ethics and professional conduct to how to enroll and participant in e-file and the new e-services. Participants consult with software vendors and tax service providers and have the opportunity to learn about benefits of professional organizations such as the (ABA) American Bar Association, American Institute of Certified Public Accountants (AICPA), National Association for Enrolled Agents (NAEA), National Association of Tax Professionals (NATP), National Society of Tax Professionals (NSTP), and National Society of Accountants (NSA).

The IRS Nationwide Tax Forums will be held at the following locations and dates:

San Francisco, CA			
June 28	–	June 30	
Houston, TX			
July 12	–	July 14	
Atlanta, GA			
July 26	–	July 28	

New York, NY
August 9 – August 11
Las Vegas, NV
August 23 – August 25
Chicago, IL
August 30 – September 1

Want to learn more about Appeals?

The IRS Appeals organization has a new streaming video called, “Appeals—Today and Tomorrow”. It’s designed for practitioners and taxpayers who need to know more about the Appeals organization and the appeals process.

The goal of Appeals is to offer a premier dispute resolution process for businesses and individuals with a tax dispute. This comprehensive video is a five-part course that a viewer can take from beginning to end or they can choose to access specific topics. The five lessons include:

1. The Role of Appeals – Explore Appeals’ role in the administrative process.
2. An Overview of the Appeals process – Learn how to request an appeal, Appeals commitments and expectations, and conferencing options.
3. Introduction to Examination Cases – Walk through an Appeals employee’s consideration of a case, through managerial approval of the

proposed resolution, to the sharing of payment options, if applicable.

4. Introduction to Collection Cases – Explore the (4) processes for appealing the collection actions.
5. Introduction to Alternative Dispute Resolution- Compare the traditional appeals process to the Alternative Dispute Resolution processes that shorten the overall process, reduce taxpayer burden and avoid costly litigation.

Access “Appeals – Today and Tomorrow” at www.irs.gov, keyword = Appeals. Viewer feedback is important to us. Please help Appeals make this product better by completing the online evaluation.

If you need additional information related to the above topics, please contact the local Taxpayer Education and Communication office at 501-324-5328 ext.276.

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New Bankruptcy Law

The new bankruptcy act, signed into law by President Bush on April 20, changes the treatment of tax obligations in personal bankruptcy.

Old law: Bankrupt individuals filing under Chapter 13, the old “wage earner” repayment plan- could obtain a discharge of tax obligations in certain situations.

Example: Under the old law, if you did not file a return, you might qualify for discharge.

New law: Taxes are not dischargeable in bankruptcy. The new bankruptcy act does, however, contain some protections for funds in Section 529 college savings plans and

Coverdell education savings accounts, something completely missing under prior law.

The Supreme Court has ruled that IRAs are exempt from creditor claims in bankruptcy. The Court has held that IRAs are not included in an individual’s bankruptcy estate, the assets of which are used to pay creditor claims. **Ruling:** IRAs “are payable on account of age.” So under federal law, they are protected from creditors in the same manner as pensions. This overrules lower-court decisions saying that since IRA owners can take early distributions from their IRAs, creditors can reach such funds, too. **Key:** The court said that the 10% early distribution penalty deters early distributions sufficiently to maintain the status of IRA distributions as “age related.” Richard Gerald Rousey et us. V. Jill R. Jacoway; S.Ct., No. 03-1407.

A Phone Call is Not a Hearing

A business owner who faced a tax levy requested a hearing with the IRS Appeals Division. Subsequently, an IRS Appeals officer called and talked to him and his tax adviser for 45 minutes. The officer then held that the levy was proper as a result of this “hearing.”

Taxpayer’s objection: He had never received any “notice of hearing” and did not know that the phone call constituted one.

IRS reply: The taxpayer didn’t object to the call during it, and when asked if he had any more information to add to his side of the case, said no.

Court: Appeals hearings can be informal, but a taxpayer who asks for one is entitled to at least some minimal notice of it. So a new hearing is ordered.

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FOR YOUR INFORMATION

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LaVerne Long, ED
P O Box 725
Newport, AR 72112 - 0725
Email: longaspa@cox-internet.com
Phone: 870-523-5329
Fax: 870-217-0154



Arkansas Society of Accountants
P.O. Box 725
Newport, AR 72112