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ARKANSAS SOCIETY OF · ACCOUNTANTS

RESPECTED ACCOUNTING PROFESSIONALS SERVING OUR COMMUNITIES

Monthly Newsletter

April 2007

• FROM YOUR PRESIDENT'S PEN •

Dear Members,

A beautiful young lady was riding a black and white pinto horse. As she was galloping along she began to lean to the left and was in danger of sliding off the horse when she grabbed the horse by the mane and up-righted herself. However, she overcompensated and began falling to the right. All the while this was taking place the young lady was screaming, "Help me! Help me!" Just as she was about to fall, Billy, a Wal-Mart associate, came out and unplugged the horse. As the young lady dismounted she was heard to mutter to herself, "That was a fun ride, but I'm glad it's over."

The young lady's ride was indicative of what happens to most of us during the tax filing season. We sometimes began to slip to one side, pull ourselves up by the bootstraps, overcompensate, and then began to slip to the other side. All the while we are begging staff to, "Help me! Help me! Now that tax filing season is almost over I hope you've had a great ride. But aren't you glad it's over?

An issue which may affect future tax filing seasons is one of tax return preparer regulation. On February 16th, Representative Denny Sumpter from West Memphis filed House Bill 1533 entitled " An act concerning the regulation of tax consultants and tax preparers; and for other purposes." In order to obtain a license, an applicant would be required to pass an exam. A separate exam would be required for a tax consultant license and a tax preparer license. The bill in its present form would exempt licensees of the Arkansas State Board of Public Accountancy (Pas and CPAs) and their employees.

Although the regulation of tax consultants and tax preparers may be a valid issue, the ASA legislative committee along with ASCPA and the State Board opposed the bill. A list of Discussion Points was formed by members of the three bodies and forwarded to Rep Sumpter on March 13th. After reviewing the Discussion Points, Rep Sumpter stated that he would not push the bill forward this legislative session. However, he did state that he would put the bill in interim study and hopefully be able to sit down with all interested parties at a later date and have a bill ready for the next session.

On the national level, Taxpayer Advocate, Nina Olsen, has advocated a national registration of tax preparers. Ms. Olsen's proposed legislation would also require that tax preparers pass an exam before being licensed. EAs, CPAs, and Attorneys would be exempt from taking the exam. As you can see, the regulation of tax preparers and consultants is an issue that probably is not going away. It looks like it could be another "horse ride".

Ronny Woods P.A.
President

WASHINGTON STRUGGLES OVER DEALING WITH ALTERNATIVE MINIMUM TAX

On March 5, the staff of the Joint Committee on Taxation published an overview of the alternative minimum tax (AMT). The document, prepared in advance of a March 7 House Ways and Means Committee meeting on the AMY, highlights the basics of this tax, how it will affect more and more taxpayers in the coming years and what it will cost them, and the options for reform.

RIA observation: The study vividly demonstrates why the AMT is such a thorny problem for Congress and the Administration and will be a key driver in the debate over the 2001 EFTRRA (Economic Growth and Tax Relief Reconciliation Act) tax provisions scheduled to expire after 2010. It also shows why it will be politically unpalatable for Congress not to enact at least a short-term AMT "fix" for at least 2007 and perhaps 2008 as well.

Rising AMT tide. Absent Congressional action, the percentage pf taxpayers affected by the AMT is projected to jump from 2.5% in 2006 to 13.8% in 2007. It will increase to 15.1% in 2008, 16.5% in 2009, and 17.98% in 2010. AMT liability and lost credits expressed as a percentage of total individual income tax liability also will jump. For example, it is projected to rise from 2.5% in 2006 to 6.7% in 2007.

The principal reason for the sharp increase in the AMT's impact from 2006 to 2007 is that, under current law, beginning this year: (1) the AMT exemption levels drop to where before 2001, and (2) nonrefundable personal credits (except for the adoption, child, and saver's credits) are no longer allowed against the amt. The number of taxpayers affected by the AMT continues to rise through 2010 because the AMT exemption levels are not indexed for inflation while the regular income tax is. By 2010, almost 31 million individual income tax returns will have AMT liability and/or restricted use of credits totaling approximately $119 billion.

The Joint Committee study also shows how the AMT's reach will extend further down the income distribution chain. For example, in tax year 2006, 170,000 taxpayers, or 1.6% of those with adjusted gross income between $75,000 and $100,000 are estimated to be affected by the AMT and will likely have an AMT liability or lost credits totaling $290 million. However, for 2007, almost half of the taxpayers in this income group, nearly 5.7 million, would be affected by the AMT and experience AMT liabilities or lost credits totaling 6.3 billion.

Beyond 2010. Absent Congressional action, the tax reductions enacted by the 2001 EGTRRA will expire after 2010. For example, the reduced regular income tax rates would expire (e.g., the top tax rate would rise from 35% to 39.6%), the relief from phase-out's of personal exemptions and itemized deductions would be eliminated, and the marriage penalty relief for the standard deduction and the 15% bracket would disappear. Paradoxically, if the EGTRRA reductions are allowed to expire, the number of taxpayers affected by the AMT after 2010 will decline. That's because regular income tax liability would rise for many taxpayers and thus cause fewer of them to be exposed to the AMT (which applies only if tentative minimum tax exceeds regular tax liability).

Selected reform options. The joint Committee study presents legislators with the following options for long-term AMT reform, and shows what each would cost over 2007-2017:

- Permit the deduction for state and local taxes for purposes of computing AMTI (alternative minimum taxable income): $576.5 billion.

- Permit a deduction for personal exemptions for purposes of computing AMTI: $509.8 billion.

- Permit the deduction for miscellaneous itemized deductions for purposes of computing AMTI: $114 billion.

- Permit a deduction for the standard deduction for purposes of computing AMT: $95.2 billion.

- Permit deductions for state and local taxes, miscellaneous itemized deductions, personal exemptions, and the standard deduction for purposes of computing AMTI: $783.7 billion.

- Repeal the AMT: $872.3 billion. *

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IRS UNVEILS 2007 LIST OF NOTORIOUS TAX SCAMS "THE DIRTY DOZEN"

IRS has unveiled its latest list of notorious tax scams, which it calls the "Dirty Dozen", highlighting five new scams that IRS auditors and criminal investigators have uncovered. IRS publishes the list each year to remind taxpayers to be wary of schemes that promise to eliminate taxes.

RIA recommendation:

Practitioners should counsel clients to steer clear of these schemes and take steps to remedy the situation for any client that may have gotten involved in one of them.

"Dirty Dozen" for 2007. The IRS has identified the following tax scams as this year's "Dirty Dozen." This list includes five new scams involving: fraudulent telephone excise tax refunds, abusive use of Roth IRAs, the American Indian employment credit, domestic shell corporations, and structured entities.

1) Telephone excise tax refund abuse.

Early filings show that some individuals have requested large and apparently improper amount for the special telephone tax refund. For example, some taxpayers seem to be seeking a refund of their entire phone bills, rather than just the 3% long-distance excise tax. In some cases, tax preparers are filing improper requests for their clients. The IRS is investigating potential abuses in this area and will take prompt action.

2) Abusive Roth IRAs

The IRS says that taxpayers should be wary of advisers who encourage them to shift under-valued property to Roth Individual Arrangements (IRAs). For instance, some promoters have the taxpayer move under-valued common stock into a Roth IRA, circumventing the annual maximum contribution limit and allowing otherwise taxable income to go untaxed.

3) Identity theft.

The IRS says it's aware of several email identity theft scams (so called "phishing") involving taxes. Fraudsters send bank customers fictitious correspondence and IRS forms in an attempt to trick them into disclosing personal financial data. A typical email notifies a taxpayer of an outstanding refund, urging him to click on a hyperlink and visit an official-looking website where his is asked to give his Social Security and credit card number. The IRS emphasizes that it does not use email to initiate contact with taxpayers. A taxpayer who has any doubt whether a contact from IRS is authentic can call 800.829.1040 to confirm it.

4) Disguised corporate ownership.

The IRS says that domestic shell corporations and other entities have been formed and operated in certain states to disguise the ownership of a business or financial activity. They are being used to facilitate income underreporting, non-filing of tax returns, listed transactions, money laundering, financial crimes and possibly terrorist financing.

5) Zero wages.

In this scam, a Form 4852, Substitute Form W-2, or a "corrected" Form 1099 showing zero or little income is filed with a return. The taxpayer may include a statement rebutting wages and taxes reported to IRS by the payer or may refer to the paying company's refusal to issue a corrected Form W-2.

6) Return preparer fraud.

Dishonest return preparers can cause many headaches for taxpayers who fall victim to their ploys. Such preparers derive financial gain by skimming a portion of their clients' refunds and charging inflated fees for return preparation services. They attract new clients by promising large refunds. The IRS says that taxpayers should choose carefully when hiring a tax preparer.

7) American Indian employment credit.

In this scam, Native American employees reduce the income on their returns, citing an American Indian employment or treaty credit. Although businesses employing Native Americans or their spouses can claim such a credit, it isn't available to employees. Unscrupulous promoters have also informed Native Americans that they're not subject to federal income tax and had them eliminate withholding by filing Form W-8 BEN, Certificate of Foreign Statue of Beneficial Owner for U.S. Tax Withholding. Promoters have also sent email with false IRS letterheads to solicit personal financial information in order to process their "non-tax" status.

8) Trust misuse.

Unscrupulous promoters for years have urged taxpayers to transfer assets into trusts. They promise reduction of income tax subject to tax, deductions for personal expenses and reduced estate or gift taxes. However, some trusts do not deliver the promised tax benefits, and the IRS is actively examining these arrangements. The IRS says that taxpayers should seek the advice of a trusted professional before entering into a trust.

9) Structured entity credits.

The IRS says that promoters of this newly identified scheme set up partnerships to own and sell state conservation easement credits, and rehabilitation and other credits.

The credits are the only assets of the entities and once they're fully used, investors receive a K-1 indicating the initial investment is a total loss, deductible on their return. The IRS states that forming such an entity isn't a viable business purpose; the investments aren't valid; and the losses aren't deductible.

10) Abuse of charitable organizations and deductions.

The IRS says it has observed an increase in the use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur, for example, when a taxpayer moves assets or income to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets or income, thereby obtaining a tax deduction without transferring a commensurate benefit to charity. Contributions of non-cash assets also continue to be an area of abuse, especially the overvaluation of contributed property. The IRS also notes an upswing in private tuition payments being disguised as charitable contributions to religious organizations.

11) Form 843 tax abatement.

This scam involves a return filer requesting abatement of previously assessed tax using Form 843, Claim for Refund and Request for Abatement. Often the requesters have failed to file returns in the past and the tax they want abated has been assessed by IRS through the Substitute for Return Program.

12) Frivolous arguments.

The IRS warns taxpayers to be aware of frivolous arguments such as those claiming that wages are not income and paying taxes is entirely voluntary.

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Transportation Reimbursements Increase in 2007

In 2007, employers can provide employees with any or all of......

- Up to $215 per month (a $10.00 increase of 2006) in reimbursements for parking costs incurred by employees when computing to work.
- Transit passes worth up to $110 per month (a $5.00 increase) when employees use public transit to commute to work.
- Reimbursement of up to 48.5 cents per mile for the use of their cars for business driving.

Saver: These reimbursements are exempt from payroll taxes, income tax free to employees and deductible by employers, so they save taxes for both the company and its employees. Employers should make full use of them to minimize after-tax compensation costs.

Example: An employee is in the 25% income tax bracket, and 15.3 % payroll tax (combined employer/employee) is due on his wages. Thus, a salary raise of $3,000 results in total tax due to the IRS of more than $1,200, with the employee receiving only $2,020.50 after tax (subtracting 25% income tax and 7.65% payroll tax) and the employer paying $229.50 of payroll tax.

Better: If the employer instead provides $2,580 in parking ($215 X 12 months), its compensation cost is zero, while the employee keeps more, the full $2,580 in value after tax.

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BUSINESS WINNERS HOTLINE

IRS loses, mostly. Pays for disclosures. An IRS agent investigating a business's owners told several of their associates and customers that they were being investigated, accused the owners of committing various tax crimes, and told customers that they might be liable for the owners' unpaid taxes. The owners sued the IRS, and a trial court awarded them $77,000 in damages ($1000 for each disclosure) plus legal fees of more than $460,000, plus more than $170,000 in punitive damages. The IRS objected to the awards on appeal. Court: The IRS clearly violated confidentiality rules. The awards are upheld, except for the punitive damages, which are not allowed by the law. Leonard Snider et al, CA-8m Nos. 05-3636, 05-3835, 05-3639, 05-3836, 05-4203.

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IRS loses. Sideline expenses are deductible when they produce income. Julie Toth was an executive and skilled equestrian who began a horse boarding and training activity initially as a sideline. But, by the end of the first year, it was a for-profit business. IRS argument: The activity initially did not qualify as a business, so expenses incurred during that period could not be deducted as business expenses but had to be capitalized as "start-up costs" incurred before the business began. Court: The activity produced income from the start, and the expenses incurred to generate income are deductible whether it's a business or not. So the expenses are deductible. Julie A. Toth, 128 TC No. 1

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IRS loses. Ignored court hearing. A company that owed taxes to the IRS declared Chapter 11 bankruptcy. To keep its business running, it sought to use cash that it had. The bankruptcy court scheduled a hearing on the issue and sent notices of it to four IRS offices. The IRS didn't respond, and the court approved the use of the funds, again sending notices to the IRS. Six weeks later, the IRS objected, saying the hearing notices hadn't been properly sent to the US Attorney's office. The court said it was too late—its decision became final after 10 days. The IRS appealed. Court of Appeals: The IRS had ample actual notice but failed to act. The 10 day deadline to appeal is upheld and the decision stands. Patriot Contracting Corp., DC NJ, No, 06-2133.

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IRS loses. Bound by its stipulations. Doyle Mathia went to Tax Court to dispute a tax bill on income from his 8.5% interest in a partnership. Both sides agreed to stipulated facts before the trial. Among them was that Mathia was not a "notice partner" who dealt with the IRS so he was bound by an agreement that the partnership's managers reached earlier with the IRS. Later, the IRS tried to change this stipulation, saying that Mathia was a notice partner and , therefore, wasn't bound by the agreement. Court: The IRS had no excuse for stipulating wrong facts. Throwing out the stipulation would require a costly trial to find facts, to the taxpayer's detriment. The IRS remains bound by what it agreed was true. Jean Mathia, TC Memo 1007-4.

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RETIREMENT PLAN LIMITS RISE FOR 2007

Cost-of-living adjustments to various contribution limits mean greater savings opportunities in 2007.

Top employee contribution to a 401(k) plan will rise to $15,500 (up from $15,000 in 2006) ...for SIMPLE IRAs, the top employee contribution will rise to $10,500 (up from $10,000 in 2006). However, the catch up contribution amounts for those who are 50 or older by the end of the year are unchanged at $5,000 fir 401(k)s and $2,500 for SIMPLE IRAs.

APPLICATION FOR MEMBERSHIP IN THE ARKANSAS SOCIETY OF ACCOUNTANTS

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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 __________

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

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FOR YOUR INFORMATION

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Return Service Requested