Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

SPRING 2011 Volume XVI, Number 1

Inside This Issue:

- Stay Off the IRS Radar: Don't Mix Business & Personal Bank Accounts!
- Dependents and Exemptions: What You Need to Know
- Stop Pinching Yourself. Your Paycheck is Larger.
- Updating Your W-4? Get Tax Help.
- Should You File Or Not? Do It Anyway.
- Tax Calendar
- Since You Asked...

Stay Off the IRS Radar:

Don't Mix Business & Personal Bank Accounts!

Whether you are working on your business part-time, operating as a sole proprietor, or starting a business with a more formal structure (such as a partnership or corporation) – it's vital that you keep your business banking separate from your personal finances.

Keeping the two separate not only provides your business with credibility, it reduces your personal liability (a must if you are incorporating your business as a distinct and separate legal entity under its own name) and helps you to manage your taxes, bills, and other payments.

Below are some reasons why you might want to consider a business bank account and information on how to go about finding the right one for you. If you aren't convinced that you need to separate your business and personal banking, consider the following reasons:

It Keeps Your Books in Order and the Tax Man from Your Door – From a recordkeeping and cash flow standpoint, co-mingling your finances can quickly become sticky, even for freelancers and part-time business owners. It is a risk most business owners or start-ups cannot afford to take!

For one thing, IRS recordkeeping requirements for income and tax deductions require that business and personal transactions be kept separate. While the IRS doesn't require that you maintain a separate bank account for your business, it does require accurate recordkeeping – and keeping things separate makes it a lot easier to provide a clear audit trail.

It is a Must that You Maintain a Separate Business Banking Account – If your business is incorporated or you have intentions of incorporating, there is no choice in the matter since you are operating a separate tax-paying entity.

- **Save on Accounting Costs –** Rifling through the line-by-line items in a year's worth of bank statements can also be a headache come tax time; if you use an accountant, it will cost you more in the long run if he or she has to rummage through your messy recordkeeping.

- **Streamline Your Tax Payments –** If you make or plan on making quarterly estimated tax payments to the IRS and your state treasury, it is always useful to have a set-aside business bank account where a percentage of each paycheck is deposited to ensure that your tax obligations are covered. This way, when it comes time for making payments, you are not scrambling with your personal finances to cover your taxes. This is particularly important for sole proprietors and independent contractors who operate under their own business names.

  Even if you don't set up a formal business account, at least maintain a separate online bank account where tax payments can easily be transferred from one bank account to another.

- **Give Your Business a Professional Image –** Another reason, albeit superficial, why you should have a business bank account, is that when it comes to writing checks and paying bills, it will give your business more credibility and also save you plenty of headaches.

  Even if your business is registered under a "doing business as" (DBA) name, such as "Creative Web Concepts," clients will still be using your personal name when making payments unless a bank account with your business name is set up for that purpose.

  This can often catch-out accounting departments which have invoices in hand from "Creative Web Concepts" but must make checks payable to a separate individual. This can affect your ability to be paid accurately and on time. It can even attach a part-time/lack of professionalism tag to your business.

Setting Up a Business Banking Account

Once you have decided that a business bank account is the way to go, how do you find the right bank and the right account? Choosing a bank for your business can be an overwhelming and frustrating process, but it can have a big impact on your success. Unlike personal checking accounts, a business banking account is fee-based. However, the benefits gained and the headaches avoided as your business grows will outweigh the costs. An additional benefit is that these fees are tax-deductible.

If you have questions or need more information on this topic, please give this office a call.

Dependents and Exemptions: What You Need to Know

Some tax rules affect every person who may have to file a federal income tax return; these rules include dependents and exemptions. Here are some important facts you need to know that are related to dependents and to claiming exemptions on your tax return.

Exemptions reduce your taxable income – There are two types of exemptions: personal exemptions (one for the filer or two if married taxpayers are filing jointly) and exemptions for dependents claimed on a tax return. For each exemption claimed on the tax return for 2010, a $3,650 deduction is allowed. For example, a married couple filing jointly with two dependent children would be allowed 4 exemptions for a total deduction equaling $14,600 (4 times $3,650).

A spouse is never considered a dependent – This is because, when filing a joint return, a couple is allowed to claim two exemptions, one for each of them. If filing a separate return, a taxpayer may claim the exemption for a spouse only if the spouse had no gross income, is not filing a joint return, and was not the dependent of another taxpayer. (This exception for separate returns usually does not apply if you live in a community property state such as California, Texas, Washington and others.)

Exemptions for dependents – Generally, an exemption can be claimed for each of a taxpayer's dependents. A dependent is a taxpayer's qualifying child or qualifying relative. It is possible for a non-relative to qualify as a dependent if the person lived with the taxpayer all year as a member of the taxpayer's household and other tests are met. The Social Security number (SSN) of any dependent claimed as an exemption must appear on the tax return. Without the SSN, the IRS will disallow the dependent exemption.

Child of divorced or separated parents – The exemption for a child can be claimed by only one of the parents. If more than one parent claims the child as a qualifying child and the parents don't file a joint return together, the child is treated as the qualifying child of: (a) the parent with whom the child resided for the longer period of time during the tax year, or (b) if the child resides with both parents for the same amount of time during the tax year, the parent with the higher adjusted gross income. However, a child is treated as the qualifying child of the noncustodial parent if the custodial parent releases a claim to the exemption using IRS Form 8332.

This is frequently a bone of contention between divorced and separated parents. It is important to understand that the law governing who has the right to claim a child's exemption is federal tax law, and the IRS will not accept a state court's allocation of exemptions. For example, a state divorce court cannot award physical custody to one parent and then specify that the other parent can claim the child for tax purposes.

Dependents may still be required to file their own tax returns – Even if an individual is claimed as a dependent on someone else's tax return, the individual claimed as the dependent may still be required to file their own tax return depending on a number of factors, including the amount of unearned, earned or gross income, marital status, any special taxes owed, and any advance Earned Income Tax Credit payments received.

The dependent of another may not claim an exemption – If someone else – such as a parent – claims an individual as a dependent, then the individual may not claim a personal exemption on his or her own tax return.

Some people cannot be claimed as dependents – Generally, you may not claim a married person as a dependent if he or she is filing a joint return with a spouse. Also, to claim someone as a dependent, that person must be a U.S. citizen, U.S. resident alien, U.S. national, or resident of Canada or Mexico for some part of the year. There is an exception to this rule for certain adopted children. Call this office for information related to the exceptions.

For more information on exemptions, dependents, and whether you or your dependent needs to file a tax return, please give this office a call.

Stop Pinching Yourself. Your Paycheck is Larger.

That is the result of a new stimulus provision included in tax legislation passed late in December last year that takes the place of the Making Work Pay Credit that expired at the end of 2010.

This new provision reduces employees' Social Security (OASDI) payroll tax withholding by a full 2 percentage points from 6.2 percent to 4.2 percent of wages paid. The reduction applies to all wage earners regardless of income. The employer's share of the payroll tax is unaffected. For wage earners with payrolls in excess of the $106,800 payroll tax cap, their savings for 2011 will be $2,136 (2% of $106,800). The OASDI portion of the self-employed (SE) tax for self-employed individuals would also be reduced by 2 percentage points, reducing the overall SE tax from 15.3% to 13.3%. This reduced Social Security withholding will have no effect on an individual's future Social Security benefits.

There is a potential tax trap for some individuals with multiple jobs if the income from these jobs exceeds the $106,800 payroll tax cap. These individuals will have too much withheld in the way of payroll tax, which is returned to them as a credit on their tax return for the year. Some may have become accustomed to utilizing the excess payroll tax to offset the tax on other income or to increase their refunds for the year. If this applies to you, keep in mind that you will have already received part of the expected overpayment in the form of reduced withholding during the year.

Without further Congressional action, the rates will return to normal in 2012, at which time the withholding tax will increase and take-home pay will be correspondingly reduced. If you have questions, please call this office.

Updating Your W-4? Get Tax Help.

Around the beginning of the year, employers typically ask their employees to provide new W-4s. You may have already done that. If you have updated your W-4 recently and did so without knowledge of the consequences, it may be appropriate to revisit the issue and have this office assist you in completing an appropriate W-4 that suits your unique circumstances.

Owing money at the end of the year or receiving excessively large refunds while struggling to make ends meet during the year may be an indicator that your W-4 has been incorrectly completed. There are many factors to consider when completing a W-4, such as those involving individuals and couples with multiple jobs and people who are having children, getting married, getting divorced or buying homes – and the list goes on!

That is why it is helpful to seek professional assistance and have a tax projection for the year.

The W-4 form that is provided to your employer establishes the amount of income tax that is to be withheld from your payroll. It allows you to specify your filing status and the number of dependent exemptions to be claimed on your tax return. This is where frequent errors occur.

Let's say that you are married and have two dependents. On your tax return, you claim four exemptions. The natural thing for you to do would be to claim "married" and four exemptions on the W-4. However, for W-4 purposes, the exemption for the taxpayer and spouse are automatically built into the married rates, and only two exemptions should be claimed. The result, of course, is that the taxpayer ends up claiming more exemptions than he or she actually has, which can result in under- withholding if the standard deduction is used, leading to the potential that tax may be due rather than the taxpayer being entitled to a refund.

It is also common practice and acceptable for taxpayers to claim additional exemptions when they have excessive withholding. The withholding tables do not account for large itemized deductions or other situations that might reduce taxable income.

Some taxpayers increase the number of exemptions to provide more take-home pay from their payroll checks. That might seem like a good idea at the time that they do it, but it could lead to an unexpected and difficult-to-deal-with tax liability when tax time rolls around.

If you wish to change your payroll withholding amount and are unsure about the results, this office can help you determine the correct number of exemptions to produce the desired result.

Should You File Or Not? Do It Anyway.

Not all individuals are required to file tax returns. If your income is less than the sum of your standard deduction and personal exemptions, you are generally not required to file a tax return. There are, however, circumstances where you may have to file anyway based on certain types of income or special circumstances.

Even if you are not required to file, it may be in your best interest to do so. The following are some of the instances in which you may want to file a tax return even though you are not required to do so.

Federal or State Income Tax Withheld – You should file to get money back if federal or state income tax was withheld from your pay, if you made estimated tax payments, or if a prior year overpayment was applied to this year's tax return.

Making Work Pay Credit – You may qualify for the Making Work Pay Credit if you had earned income from work. The maximum credit for a married couple filing a joint return is $800; it is $400 for other taxpayers.

Earned Income Tax Credit (EITC) – You may qualify for EITC if you worked but did not earn a lot of money. EITC is a refundable tax credit, which means you could qualify for a tax refund even if you had no withholding.

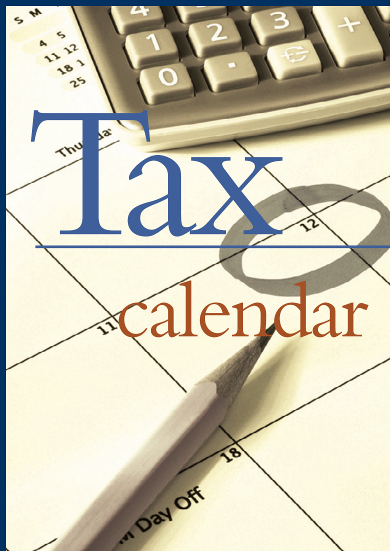
Additional Child Tax Credit – This refundable credit may be available to you if you have at least one qualifying child and the credit exceeded your tax liability for the year.

American Opportunity Credit – Up to 40% of this credit, which applies to the first four years of post-secondary education, is refundable, and the maximum credit per student is $2,500.

First-Time Homebuyer Credit – The credit is a maximum of $8,000, or $4,000 if your filing status is married filing separately. To qualify for the credit, taxpayers must have bought – or entered into a binding contract to buy – a principal residence located in the United States on or before April 30, 2010. If you entered into a binding contract by April 30, 2010, you must have closed on the home on or before September 30, 2010. If you bought a home as your principal residence in 2010, you may be able to qualify, and claim the credit even if you already owned a home. In this case, the maximum credit for long-time residents is $6,500, or $3,250 if your filing status is married filing separately.

Health Coverage Tax Credit – Certain individuals, who are receiving Trade Adjustment Assistance, Reemployment Trade Adjustment Assistance, or pension benefit payments from the Pension Benefit Guaranty Corporation, may be eligible for a Health Coverage Tax Credit worth 80 percent of monthly health insurance premiums when they file their 2010 tax returns.

If you have questions related to whether you must or should file, please give this office a call.



March – June 2011

March 15, 2011:
The 2010 calendar year Corporation and S Corporation returns are due, including any taxes owed. This is also the due date for providing Schedule K-1 to the S Corporation shareholders. If you cannot file the Corporation return by the March due date, file for the automatic six-month extension.

March 31, 2011:
This is the due date for electronically filing 1099 forms, W-2 forms, W-2G forms and tip reporting. File these forms electronically if you did not previously file paper versions of the forms on or before February 28.

April 1, 2011:
This is the last day to withdraw 2010's required minimum distribution from Traditional or SEP IRAs for taxpayers who turned 70 1/2 in 2010 and avoid a penalty. Taxpayers who became 70 1/2 before 2010 were required to make their 2010 IRA withdrawal by December 31, 2010.

April 18, 2011:
- The first quarter estimated tax installment payment for the 2011 tax year is due.
- This is the filing due date for your 2010 income tax return or an extension request, and to pay any tax due. If you expect to owe, but are unable to file your return timely, estimate how much you owe and include your payment with the extension. If you owe taxes when filing your extended tax return, you will be liable for both the late payment penalty and interest from the due date.
- This is the filing due date for the 2010 calendar-year Partnership return(s) and to provide Partnership Distribution forms (Schedule K-1) to the partners. If you cannot file a Partnership return by the April due date, file for the automatic five-month extension.
- This is the last day to make an IRA contribution for tax year 2010.
- This is the last day for calendar-year filers to make 2010 SEP or Keogh contributions unless an extension is filed.

June 15, 2011:
- The second installment of your 2011 individual estimated taxes is due. If your income or deductions have changed significantly, you should call to determine if any adjustment in estimates is appropriate.
- U.S. citizens living abroad on April 18, 2011 must file a 2010 income tax return (if not already filed) or file for an extension.

June – July 2011:
It's time to review your 2011 year-to-date income and expenses to ensure your estimated tax payments and withholding are adequate to avoid underpayment penalties.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

Since You Asked...

You Asked: Since I am helping support my parents, am I qualified to claim a tax benefit?

Answer: If you are helping support your parents, you may qualify to claim a tax benefit if you are providing over half of your parents' support. But you may be having difficulty showing over half of the support for both parents, thus failing to qualify for the dependency exemptions (and for the beneficial head of household filing status if you are a single taxpayer).

You may overcome this problem by designating the support to only one of your parents. This may allow you to claim at least one parent as your dependent and, if you are unmarried, permit you to file as head of household.

If you are supporting both parents and would like to discuss how the foregoing might apply to your specific situation, please give this office a call.

You Asked: I think I may have been a victim of a scam. What are the steps I should take?

Answer: The IRS does not initiate taxpayer contact via unsolicited e-mail or ask for personal identifying or financial information via e-mail. If you receive a suspicious e-mail claiming to come from the IRS, do not open any attachments or click on any links in case it contains malicious code. Be aware that the links often connect to a phony IRS web site that appears authentic and then prompts the victim for personal identifiers, bank or credit card account numbers or PINs. To make it appear legitimate, much of the content is directly copied from an actual page on the IRS web site and then modified by the scammers. Forward the suspicious e-mail or URL address to phishing@irs.gov and then delete the e-mail.