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Newsletter

APRIL 2009

April 15 is a major tax day

Wednesday, April 15, is a red-letter day in the world of taxes. It is the deadline for filing certain returns and taking certain tax-related actions. Here are the major deadlines.

- Filing 2008 income tax returns for individuals. If you cannot file your return by this deadline, be sure to file an extension request by April 15. The automatic extension (you don't need to explain to the IRS why you need more time) gives you until October 15, 2009, to file your return. An extension does not, however, give you more time to pay taxes you still owe. To avoid penalty and interest charges, taxes must be paid by April 15.
- Filing 2008 partnership returns for calendar-year partnerships.
- Filing 2008 income tax returns for calendar-year trusts and estates.
- Filing 2008 annual gift tax returns.
- Making 2008 IRA contributions.
- Paying the first quarterly estimate of 2009 individual estimated tax.
- Amending 2005 individual tax returns (unless the 2005 return had a filing extension).
- Original filing of 2005 individual income tax return to claim a refund of taxes. Each year taxpayers have tax refunds due them for prior years, and unless a return is filed to claim the refund by the three-year statute of limitations, the refund is lost forever.

How long should you keep tax records?

After filing your 2008 tax return, you may be wondering how long to keep your tax records. Unless fraud, evasion, or a substantial understatement of income is involved, the IRS generally has only three years in which to question your return. If the IRS asks, you must be able to prove the validity of your tax return, which includes providing the underlying supporting data. How long you keep your paperwork depends directly on the statute of limitations, but here are some guidelines.

Your copy of the tax return. Consider keeping it forever since you never know when this document will come in handy. Remember that in many cases, the IRS destroys original returns after four or five years. It's always best to have your copy to fall back on.

Cancelled checks, bank/investment statements, and receipts. Keep them for seven years. Because of various combinations of the statute of limitations and technical provisions in the law, keeping them for seven years, rather than just for three years, is recommended.

Stock or bond trade confirmation statements. Keep for seven years after the sale of the stock. For example, say that you bought 200 shares of stock in 1986 and sold them in 2008. You'll want to hold on to both the buy and sell confirmation statements until at least April 2015.

Escrow closing documents and improvements to property. Keep for seven years after the sale of the property. Keep these documents to prove your cost of the property when it is finally sold. This is true for rental property, investment property, and even your personal residence. You might think that keeping cost basis records on your personal residence is no longer required because of the gain exclusion rules on the sale of a principal residence. That's not entirely true, since these laws could change at any time, or your gain could exceed the gain exclusion limits.

This listing is not all-inclusive, and you might have special circumstances. If you need any help with your recordkeeping requirements, give us a call.

S corporations face close IRS scrutiny

The S corporation is a popular form of business ownership. One reason for this is that S corporations avoid the double taxation that applies to regular C corporations, while still offering protection from personal liability.

However, as the popularity of S corporations continues to rise, they are facing greater scrutiny from the IRS. In particular, the IRS has focused its attention on three issues.

- ***Shareholder-owner compensation.*** The basic tax rule is that compensation paid to shareholder-employees must be reasonable in amount. Historically, the IRS has questioned compensation amounts paid to C corporation owners that seemed unreasonably high. With an S corporation, a high-tax bracket owner may establish a compensation amount that is extremely low – or even zero – while increasing other pass-through income (i.e., dividends). By doing so, the owner avoids employment taxes on these payments.

  The IRS recognizes the tax benefits of this strategy. Therefore, it may object to compensation that appears to be low relative to corporate profits.

- ***Shareholder basis.*** Generally, a shareholder's "tax basis" for deducting corporate losses may be increased by contributing additional capital to the company, buying more stock, or lending funds to the company. The IRS may challenge basis adjustments resulting from loans by third parties to the company. Furthermore, it has consistently maintained that a shareholder's guarantee of an S corporation debt does not increase basis.

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- ***Fringe benefits.*** An S corporation may provide tax-free fringe benefits, like health insurance or employer-paid group-term life insurance coverage (up to $50,000), to its employees. However, if an employee owning 2% or more of the company receives fringe benefits, he or she is generally taxed on the value. To avoid abuses, the IRS may examine fringe benefit packages. Note that there are several exceptions to the general rule. For example, certain “working condition” fringe benefits are tax-free to 2%-or-more shareholders.

S corporation owners must be careful to observe all the technicalities in the tax law to avoid problems with the IRS. If you have questions or need assistance, contact our office.