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TAX AND BUSINESS Alert™

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Taxing Social Security Benefits

On October 15, 2007, Kathleen Casey-Kirschling became the first Baby Boomer to officially apply (online at *www.socialsecurity.gov*) for Social Security retirement benefits. Ms. Casey-Kirschling was born one second after midnight on January 1, 1946, and is eligible for benefits in January 2008. Over the next two decades, nearly 80 million Americans will become eligible for benefits, more than 10,000 per day. With this in mind, we thought it would be helpful to discuss some of the federal tax aspects related to receiving benefits.

Individuals may have to pay federal income taxes on up to 85% of their benefits. Inclusion within taxable income can occur if you have substantial income from wages, self-employment, interest, dividends, and other taxable income, in addition to your benefits. However, no one pays federal income tax on more than 85% of his or her benefits.

The amount of your benefits included in federal taxable income depends on your *provisional income*. Provisional income (PI) is generally your adjusted gross income (AGI) plus nontaxable interest, one-half of your Social Security benefits, and some other AGI add-backs. If you file as an individual, head of household, or a qualifying widow or widower, and your PI is between $25,000 and $34,000, you may pay federal income tax on up to 50% of your benefits. If your PI is more than $34,000, then up to 85% of your benefits may be taxable.


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If you are married and file a joint return and you and your spouse have combined PI of between $32,000 and $44,000, you may pay federal income tax on up to 50% of your benefits. If your PI is more than $44,000, then up to 85% of your benefits may be taxable. If you are married and file a separate return, you will generally pay taxes on your benefits.

Social Security recipients can have federal income tax withheld from their benefit payments. Withholding is voluntary and can be initiated at 7%, 10%, 15%, or 25% of your monthly benefits.

The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Tax Calendar

January 15—Individual taxpayers' final 2007 estimated tax payment is due unless Form 1040 is filed by January 31, 2008, and any tax due is paid with the return.

January 31—Most employers must file Form 941 (*Employer's Quarterly Federal Tax Return*) to report Medicare, Social Security, and income taxes withheld in the fourth quarter of 2007. (If your tax liability is less than $2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until February 11 to file the return. Small employers who have been notified by the IRS should file Form 944 (*Employer's Annual Federal Tax Return*).

—Give your employees their copies of Form W-2 for 2007. If an employee agreed to receive Form W-2 electronically, have it posted on the website and notify the employee.

—Give annual information statements to recipients of certain payments you made during 2007. You can use the appropriate version of Form 1099 or other information return. Form 1099 can be filed electronically with the consent of the recipient.

—File Form 940 [*Employer's Annual Federal Unemployment (FUTA) Tax Return*] for 2007. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you deposited the tax for the year in full and on time, you have until February 11 to file the return.

—File Form 945 (*Annual Return of Withheld Federal Income Tax*) for 2007 to report income tax withheld on all nonpayroll items, including backup withholding and withholding on pensions, annuities, IRAs, etc. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the year in full and on time, you have until February 11 to file the return.

February 28—The government's copy of Form 1099 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to March 31.

February 29—The government's copy of Form W-2 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to March 31.

March 17—2007 income tax returns must be filed or extended for calendar-year corporations. If the return is not extended, this is also the last day for calendar-year corporations to make 2007 contributions to pension and profit-sharing plans.

Employer-provided Cell Phones


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In a recent information letter addressed to U.S. Representative Dennis Moore, an IRS Branch Chief discussed the proper tax treatment of employer-provided cell phones. The letter states that an employer can exclude the value of an employee's use of an employer-provided cell phone from the employee's gross income, if the employer has some method of requiring the employee to keep records that distinguish business from personal phone charges. The Internal Revenue Code requires that the employee keep a record of each call and its business purpose. If the employee receives a monthly itemized cell phone statement, he or she should use the statement to identify each call as personal or business.

If the employee uses the cell phone exclusively for business, the value of all use is excluded from his or her income as a working condition fringe benefit. However, the employer must include the value of any personal usage in the employee's wages. Personal usage includes individual personal calls and a prorata share of monthly service charges.

Teaching Children about Money

How to tie their shoes and tell time are important skills parents teach their children. But don't forget the important skill of learning how to handle money. If you don't teach them, they'll be left to the experts on the schoolyard or (worse yet) Madison Avenue.

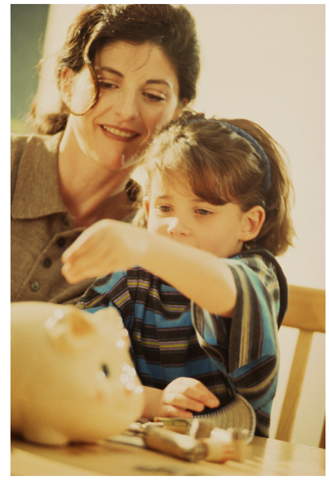
No matter what age your children are, you can teach them important money management techniques that will serve them well their entire lives.

You may want to begin by looking back at how you learned about finances and who taught you. What are some principles you had difficulty understanding, and what are the struggles you've had in handling your own finances? What are some things you wish your parents had taught you about money? Ultimately, your kids may be more grateful for the financial lessons you taught them than the inheritance you leave them.

Remember that financial lessons should be age appropriate. Different lessons can be taught at different ages, but the financial principles remain the same. Money is important, must be earned, should be conserved, and may be shared. Parents should make careful decisions about basics such as allowance, expenses, bank accounts, etc. These decisions should be made collectively, communicated clearly, and administered equitably.

Allowance. Even young children, four or five years old, can begin to learn the value of money. An allowance is money that is not earned, but bestowed simply as a privilege for being a part of the family. The amount varies with each family. A small weekly allowance deposited into a piggy bank can be an important tool. However, the money shouldn't just disappear into the piggy bank, never to be seen again. Occasionally, it should be counted and eventually spent on a special item or activity. This can instill the value of saving and the excitement of purchasing a desired treat.

Chores. Additional money can be obtained by doing extra tasks around the house (above and beyond what is normally expected, which varies by family). This can be used to develop a work ethic in the child and to supplement the allowance so the child can purchase (with his or her own money) items that the parents don't want to buy. Eventually, learning to do chores may lead to a part-time job so your child can continue to learn the value of hard work and how to earn extra money for special purchases.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Bank Accounts. At some point, it will be time to take the piggy bank to the local bank and open a savings account. Here's an opportunity to teach your kids that a bank is a great place to keep your money safe from impulse purchases. Perhaps, if your children are fortunate enough to have their savings grow rapidly, some of it can be siphoned off into a mutual fund, where new lessons can be learned. High school may be a good time to convert that savings account into a checking account (perhaps with a debit card). Balancing a checkbook is a skill they will need as they grow into adulthood.

Credit Cards. This is the scary one. But it may also be the most important one. Many adults have gotten in serious trouble with credit card debt. You owe it to your children to teach them how to use credit cards responsibly. They need to realize that it's not "free money." The bill will come in, and it better be paid in full and on time. They need to learn this lesson while they're still living at home, so the best time to obtain a credit card may be when they get their drivers license.

Money management is an important skill to pass on to your children. Call us if we can help you with this critical task.

Planning for C Corporation Distributions

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Historically, dividend treatment has been something to avoid because of the double taxation issue. Essentially, your C corporation pays income taxes on the earnings that generate the dividends, then you also pay income taxes when the earnings are paid out to you. This harsh effect has been softened somewhat by the lowering of the maximum dividend tax rate to 15%.

A traditional planning strategy for a closely held C corporation has been to calibrate shareholder-employee salary and bonus payments to reduce the corporation's annual taxable income to $50,000, thereby taking advantage of the entire 15% corporate tax bracket. Sometimes, however, paying the remaining $42,500 ($50,000 × 85%) as a dividend and intentionally arranging for you to be double-taxed can be beneficial. For example, a dividend paid by your corporation begins to become tax-efficient compared to a deductible payment when your income tax rate is 28% or higher, and your corporation's tax rate does not exceed 15%. As long as the corporation's top rate is 15%, dividends become relatively more tax-efficient as your personal tax rate increases to 33% and 35%.

Your corporation may have built up substantial earnings and profits over the years. A profitable corporation becomes exposed to the accumulated earnings penalty tax when it accumulates earnings in excess of reasonable business needs and does not pay dividends. Right now, the accumulated earnings tax rate is only 15%. However, after 2010, the accumulated earnings tax rate will return to the maximum individual federal rate on ordinary income, currently 35%. Therefore, now is a great time to pay out dividends and reduce your corporation's exposure to the accumulated earnings penalty tax.

Another way for you to tap the earnings that have built up in your corporation is to arrange for the corporation to distribute cash and/or property for your stock. This is called a stock redemption. A stock redemption may be treated as a sale in some cases, which qualifies for capital gain or loss treatment. Sale treatment would be preferred if you have a substantial basis in your stock. Sale treatment is a good thing because the maximum tax rate on long-term capital gains is currently only 15%.

With careful planning, we can determine whether dividend treatment or a stock redemption is best for you. Please give us a call if you have questions or require additional information.

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