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DECEMBER 2011

ODOMETER READING ON BUSINESS VEHICLE REQUIRED DECEMBER 31

To claim a business expense deduction for vehicle usage, the total miles driven during the year, as well as the number of business miles and personal miles, must be reported in the tax return in which the deduction is claimed. On December 31, you should record the odometer reading of any vehicle used for business for which a deduction will be claimed.

TIME TO COMPUTE PERSONAL-USE VALUE OF AN EMPLOYER-PROVIDED VEHICLE

Early January 2012 is the time to compute the 2011 personal-use value of employer-provided vehicles that must be reported on the employees' 2011 Forms W-2, and on which FICA and possibly federal income tax must be withheld and paid. Included with this newsletter is a form that you may use to compute the personal-use value of an employer-provided vehicle.

CHANGES IN DEATH TAXES

Each of the years 2008 through 2011 had a change in the amount that a person could transfer free of transfer tax as follows:

Year	Exemption Amount
2008	$2 Million
2009	$3.5 Million
2010	No Death Tax
2011	$5 Million

Three of the four changes have increased the exemption over the previous exemption amount, with the only decrease being the return of the death tax effective January 1, 2011. Under current law, the exemption amount for 2013 will decrease to $1,000,000 and top estate tax rates for 2013 will increase from the current 35 percent back to the 55 percent rate of 2001.

As with most taxes, the largest obstacle to its removal is probably the loss of revenue to the government. However, the death tax has appeal to some of our nation's wealthiest families. For example, Bill Gates, Sr., the father of Bill Gates (one of the world's wealthiest individuals), wrote in an editorial concerning death taxes, "it is a modest repayment for the government providing the conditions and the stimulations to economic life that has made wealth possible." We disagree as to what makes wealth possible, belonging more in the Ben Franklin school of economics, that is – getting up early, working smart and hard, and prudent savings create wealth. Regardless of the source of wealth, however, most of us feel that, having earned our income and paid the income tax on it, we should be able to leave our accumulation to our heirs without another tax. It might be helpful to think about diminishing our "modest payments" (death taxes) through lifetime giving and family investment entities within the current (and likely future) transfer tax system.

For 2011 and 2012, federal death taxes commence on estates with net assets (assets minus liabilities and expenses of administration) of more than $5 million. In other words, if, at the time of

(Continued on reverse)

death in 2011, an individual owns less than $5 million (for example, one-half of $10 million of community property owned by a married couple) in fair market value of net assets (after adding back lifetime gifts not qualifying for the annual gift tax exclusion), then there is no federal death tax due. The total fair market value of property that each person may transfer (in addition to the annual gift tax exclusion) without federal estate taxes is sometimes referred to as the "effective exemption" and is now $5 million.

Minimizing transfer (estate and gift) taxes usually involves the use of valuation discounts, the early use of the gift tax exemption, and the maximum use of a donor's annual gift tax exclusion per donee. The annual gift tax exclusion ($13,000 for both 2011 and 2012) is a tax-free transfer amount in addition to the lifetime exemption amount.

Many people are hesitant to make annual exclusion gifts because of concerns about their financial security and about the possibility that property that they view as family investment capital might be consumed or dissipated by the donee. For those who feel financially secure enough to make gifts, developments over the past few years have made the concerns over management and control (i.e., savings versus spending by the donee) somewhat easier to handle. Historically, trusts have been the favored method of controlling assets handed down to younger generations. They have become administratively costly for smaller taxable estates, and they have lost some significant income tax advantages in recent years. The limited liability company (LLC), a relatively new legal form, and the limited partnership are now generally favored over trusts and offer flexibility in making gifts, while retaining management control and reducing transfer taxes. The senior generation can transfer assets to an LLC and retain management control over investment decisions, cash distributions, etc., subject to a fiduciary duty to the other owners. This arrangement can be established without any current income tax cost.

The use of a family entity can significantly diminish federal transfer taxes in several ways. First, the use of a family entity encourages maximum utilization of the $13,000 annual gift tax exclusion, since the senior generations can make the gifts but still control the investment assets and prevent their consumption or dissipation.

Second, the recipient of the gift receives a nonmarketable interest in an entity (the LLC) and has very limited voting rights and no control over the entity. Accordingly, that interest is recognized by the courts as being worth less than its proportional share of the entity's net assets. The courts (and now, to a lesser degree, the IRS) have also similarly valued such interests for gift tax purposes. For example, a gift of a one-percent interest in an LLC that owns $1.3 million of assets represents $13,000 of underlying assets, but is, under current law, being valued by the courts and the IRS at significantly less than $13,000. Accordingly, the annual gift tax exclusion is "expanded" in the sense that the senior generation can remove more than $13,000 of assets from its death tax base and not exceed that $13,000 annual gift tax exclusion. For example, at a 35 percent valuation discount, each annual gift of $13,000 (one per recipient per donor) will allow the tax-free transfer of $20,000 ($13,000 ÷ .65 = $20,000) of underlying fair market value of net assets. Thus, for 2011, a married couple could transfer $40,000 ($26,000 ÷ .65 = $40,000) of underlying value to each child, grandchild, or any other individual by using only their two annual gift tax exclusions.

Louisiana no longer has a death or gift tax. Accordingly, in addition to annual exclusion gifts ($13,000 each), an individual can transfer $5 million using the federal exclusion without any federal or Louisiana gift tax.

Finally, in addition to the lifetime giving benefits of a family investment entity, the entity has, under current law, significant benefits at the death of the senior generation. If the interest owned by the decedent is less than a voting majority, then its value will, under present law, be subject to discounts for lack of marketability and lack of control.

In the late nineties, the Clinton Administration unsuccessfully proposed the elimination of lack of marketability and lack of control discounts for an interest in a family entity in which the underlying assets are cash and marketable securities. The Internal Revenue Service often disputes valuation discounts for closely held entities that are, at least to us, clearly discernible in the market place. In Kimbell (2004) and Strangi (2005), the 5th Circuit Court of Appeals issued opinions favorable to the government, but which are very informative for taxpayers on how to and not to form and operate such an entity. We continue to recommend family investment entities for consideration by all those with potentially taxable estates. There are also many non-tax reasons for using such entities, which may be more important for smaller estates than the tax savings. Please let us know if we may be of any help in your consideration.

COMPUTATION OF PERSONAL-USE VALUE OF EMPLOYER-PROVIDED VEHICLES—2011

Name of Employer ______________________________ Name of Employee ______________________________

Is employee a corporate officer or more than 1 percent shareholder? ☐ Yes ☐ No

VEHICLE INFORMATION

1. Description (make, model, and year)______________________________
2. Valuation Date (The initial valuation date is the date placed in service. Subsequent valuation dates are based on a hypothetical lease for four full calendar years. For example, if a vehicle is first placed in service January 12, 2009, the second valuation date is January 1, 2014. The third valuation date would be January 1, 2018.)______________________________
3. Fair market value on valuation date indicated at item 2 above______________________________

EMPLOYEE CERTIFICATION

4. Total number of miles driven during 2011 ____________ Miles
5. Total commuting miles during 2011 ____________ Miles
6. Total other personal (noncommuting) miles during 2011 ____________ Miles
7. Total personal miles (sum of line 5 and line 6) ____________ Miles
8. Is another vehicle (other than an employer vehicle) available for personal use? ☐ Yes ☐ No

The above information is supported by adequate evidence and is correct to my best knowledge and belief. I understand this information will be used to compute the value of the personal use of this employer-provided vehicle, which will be reported on my W-2 for 2011.

Signed______________________________ Date______________________________
(Employee)

COMPUTATION OF PERSONAL-USE VALUE

9. Personal-use percentage (divide line 7 by line 4) ____________%
10. Annual lease value (determine from table below based on fair market value at line 3 above) (prorate annual lease value based on number of days used if less than full year) $____________
11. Personal-use annual lease value (multiply line 9 and line 10) $____________
12. Gasoline provided by employer:
    a. Actual gasoline cost $____________
    b. Personal portion actual cost [multiply line 9 and line 12(a)] $____________
    c. 5.5¢ times personal miles (line 7) $____________
    d. Personal-use gasoline [lesser of line 12(b) or line 12(c)] $____________
13. Gross personal-use [sum of line 11 and line 12(d)] $____________
14. Reimbursements made by employee $____________
15. Net personal-use value to report on Form W-2 (line 13 minus line 14) $____________

ALTERNATIVE METHOD OF COMPUTATION (Use this section *only if* vehicle meets requirements described below.)

This method is available if the fair market value at line 3 is $15,300 or less for automobiles and $16,000 or less for trucks and vans. Also, the employee must have regularly used the vehicle in the Company's trade or business, or the employee must have driven at least 10,000 total miles during the year (10,000 miles is prorated if vehicle available less than full year). Once this alternative method is chosen for an employee and vehicle, it must be used in all subsequent years until it fails to meet the criteria above.

1. Gross Personal-Use Value:
   (1/1/-6/30 Personal Miles x .51¢ = __________) plus (7/1/-12/31 Personal Miles x 55.5¢= __________) $__________
2. Employee Reimbursement to Employer (__________)
3. Net Personal-Use Value to Report on Form W-2 (2 minus 3) $__________

ANNUAL LEASE VALUE TABLE

(1) Automobile FairMarket Value	(2) Annual Lease	(1) Automobile FairMarket Value	(2) Annual Lease Value	(1) Automobile FairMarket Value	(2) Annual Lease Value
$0- 999	$ 600	$12,000- 12,999	$ 3,600	$24,000- 24,999	$ 6,600
1,000- 1,999	850	13,000- 13,999	3,850	25,000- 25,999	6,850
2,000- 2,999	1,100	14,000- 14,999	4,100	26,000- 27,999	7,250
3,000- 3,999	1,350	15,000- 15,999	4,350	28,000- 29,999	7,750
4,000- 4,999	1,600	16,000- 16,999	4,600	30,000- 31,999	8,250
5,000- 5,999	1,850	17,000- 17,999	4,850	32,000- 33,999	8,750
6,000- 6,999	2,100	18,000- 18,999	5,100	34,000- 35,999	9,250
7,000- 7,999	2,350	19,000- 19,999	5,350	36,000- 37,999	9,750
8,000- 8,999	2,600	20,000- 20,999	5,600	38,000- 39,999	10,250
9,000- 9,999	2,850	21,000- 21,999	5,850	40,000- 41,999	10,750
10,000- 10,999	3,100	22,000- 22,999	6,100	42,000- 43,999	11,250
11,000- 11,999	3,350	23,000- 23,999	6,350	44,000- 45,999	11,750
				46,000- 47,999	12,250
				48,000- 49,999	12,750
				50,000- 51,999	13,250
				52,000- 53,999	13,750
				54,000- 55,999	14,250
				56,000- 57,999	14,750
				58,000- 59,999	15,250

For vehicles having a fair market value in excess of $59,999, the annual lease value is equal to: (.25 x the fair market value of the automobile) + $500.

Auto Usage Form Contains Required Information

Employers must obtain the auto use information and certification from each employee to whom an auto is furnished in time to complete the fourth quarter payroll tax returns and the 2011 Forms W-2. Completion of the auto usage form on the reverse of this page will enable an employer to compile the information required for the income tax returns, payroll tax returns, and Forms W-2. Much of the information on the auto use form must also be included in the employer's federal income tax return. Accordingly, employers should retain the completed vehicle use forms as written evidence supporting the information in the income tax return.

If you provide vehicles to employees, you must withhold federal income tax on the personal-use value of the vehicles unless you elected not to withhold income tax by giving employees timely notice. If income tax is to be withheld, you can withhold a flat 25 percent or withhold as if the personal-use value is part of regular wages. If you did not compute or estimate the personal-use value and withhold taxes during 2011, the income tax and FICA (Social Security and Medicare tax) may be withheld from 2012 wages at any time between January 1 and April 1, 2012.

Regardless of when the taxes are withheld, however, the 2011 personal-use value is considered 2011 compensation, and the withholdings must be reported on the fourth quarter 2011 Form 941 and paid or deposited accordingly. Both the compensation and the withholdings must be included on the 2011 Form W-2.

An employer may elect not to withhold income taxes for 2012 on the personal-use value of a vehicle by notifying the employees in writing by January 31, 2012, or within 30 days after the employee is provided a vehicle, if later.

We will be glad to assist you with the completion of the auto usage form or answer your questions about its preparation.

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TAX AND BUSINESS Alert™

December 2011

Health Savings Account (HSA) Benefits

A Health Savings Account (HSA) represents an opportunity for eligible individuals to lower their out-of-pocket health care costs and federal tax bill. Since most of us would like to take advantage of every available tax break, now might be a good time to consider an HSA, if eligible. An HSA operates somewhat like a flexible spending account (FSA) that employers offer to their eligible employees. An FSA permits eligible employees to defer a portion of their pay, on a pretax basis, which is used later to reimburse out-of-pocket medical expenses. However, unlike an FSA, whatever remains in the HSA at year-end can be carried over to the next year and beyond. In addition, there are no income phase-out rules.

Naturally, there are a few requirements for obtaining the benefits of an HSA. The most significant requirement is that an HSA is only available to an individual who carries health insurance coverage with a relatively high annual deductible. By that we mean the individual's health insurance coverage must come with at least a $1,200 (in 2011 and 2012) deductible for single coverage or $2,400 (in 2011 and 2012) for family coverage. However, for many self-employed individuals, small business owners, and employees of smaller companies, these thresholds won't be a problem. In addition, it's okay if the insurance plan doesn't impose any deductible for preventive care (such as annual checkups).

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Other requirements for setting up an HSA are that an individual can't be eligible for Medicare benefits or claimed as a dependent on another person's tax return. Individuals who meet these requirements can make tax-deductible HSA contributions of up to $3,050 in 2011 and $3,100 in 2012 for single coverage or $6,150 in 2011 and $6,250 in 2012 for family coverage. When an employer contributes to an employee's HSA, such as in the case of a closely held business, the contributions are exempt from federal income, social security, Medicare, and unemployment taxes.

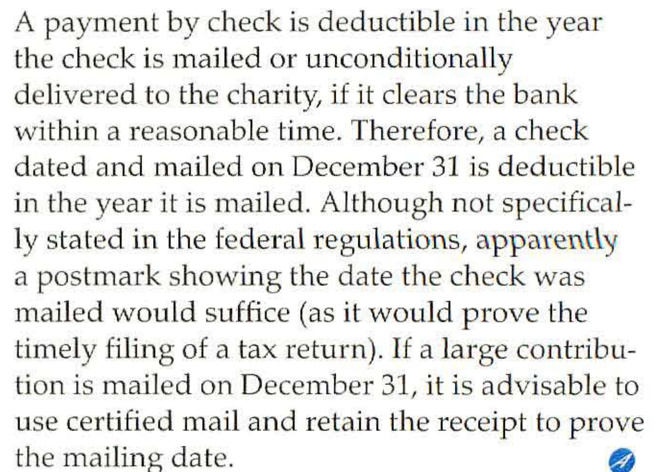
An account beneficiary who is age 55 or older by the end of the tax year for which the HSA contribution is made may make a larger

(Continued on Page 2.)

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.

Timing Year-end Charitable Contributions

Making a charitable donation is admirable, but the tax deduction is nice, too. A charitable contribution is generally deductible in the year the property is delivered to the charity, which is when the taxpayer parts with the ability to control it. However, a charitable payment can take many forms. Whatever the form, if the deduction is substantial, the taxpayer can avoid reporting issues by inquiring about the charity's policies and procedures for recording the date of the gift prior to making the donation. This is especially



important for year-end contributions or any instance in which timing is a key factor.

A payment by check is deductible in the year the check is mailed or unconditionally delivered to the charity, if it clears the bank within a reasonable time. Therefore, a check dated and mailed on December 31 is deductible in the year it is mailed. Although not specifically stated in the federal regulations, apparently a postmark showing the date the check was mailed would suffice (as it would prove the timely filing of a tax return). If a large contribution is mailed on December 31, it is advisable to use certified mail and retain the receipt to prove the mailing date.

Update on Employer-provided Cell Phones

A provision of the Small Business Jobs Act of 2010 (2010 Jobs Act) relaxed the onerous record-keeping requirements for business-provided cell phones. However, the 2010 Jobs Act did not alter the requirement that, in certain situations, personal use of an employer-provided phone would be treated as a taxable fringe benefit to the employee.

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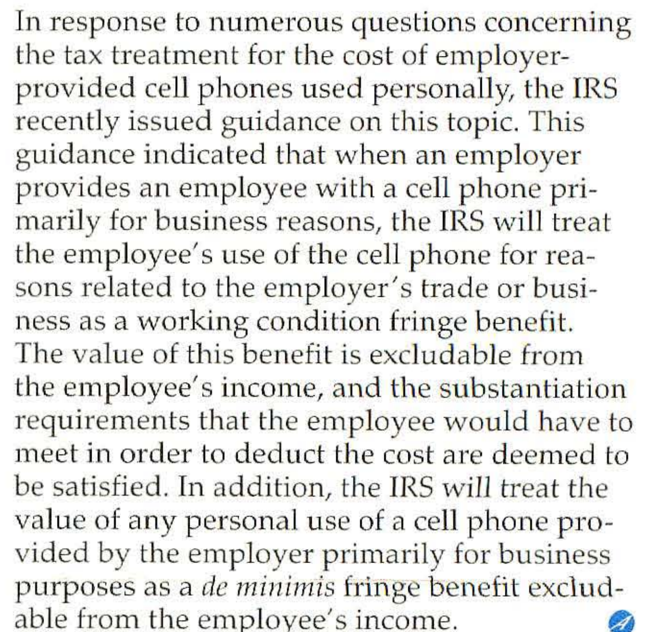


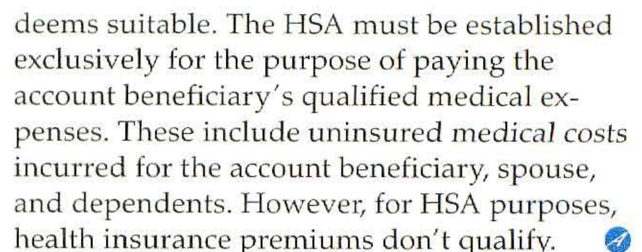
In response to numerous questions concerning the tax treatment for the cost of employer-provided cell phones used personally, the IRS recently issued guidance on this topic. This guidance indicated that when an employer provides an employee with a cell phone primarily for business reasons, the IRS will treat the employee's use of the cell phone for reasons related to the employer's trade or business as a working condition fringe benefit. The value of this benefit is excludable from the employee's income, and the substantiation requirements that the employee would have to meet in order to deduct the cost are deemed to be satisfied. In addition, the IRS will treat the value of any personal use of a cell phone provided by the employer primarily for business purposes as a *de minimis* fringe benefit excludable from the employee's income.

Health Savings Account (HSA) Benefits

(Continued from Page 1.)

deductible contribution. Specifically, the annual contribution limit is increased by $1,000 (in 2011 and 2012).

An HSA can generally be set up at a bank, insurance company, or other institution the IRS



deems suitable. The HSA must be established exclusively for the purpose of paying the account beneficiary's qualified medical expenses. These include uninsured medical costs incurred for the account beneficiary, spouse, and dependents. However, for HSA purposes, health insurance premiums don't qualify.

Voluntary Contractor Settlement Program (VCSP)

Worker classification has generated controversy between taxpayers and the IRS for decades—with businesses pushing for independent contractor status and the IRS pushing for employee status. Businesses argue for independent contractor status to reduce or eliminate the cost of fringe benefits and payroll taxes. The IRS, on the other hand, wants workers classified as employees to facilitate the collection of payroll and income taxes and monitor taxpayer income levels.

Through the years, the courts have developed the concept of common-law employees and common-law independent contractors in precedent-setting case law. Under this concept, *employees* are workers over whom the business may legally control and direct both (a) what must be done, and (b) how it must be done. *Independent contractors* are workers over whom the business may legally control and direct only what must be done. The business may not control how, when, or where the work is performed. From this case law, the IRS has identified common-law factors that it believes most clearly show the degree of control between the worker and the business, and have grouped these factors into three general categories of evidence: behavioral control, financial control, and the type of relationship between the parties. The IRS has not, however, provided a clear line between independent contractor and employee status.

Now there is some relief for a business owner who previously classified workers as independent contractors and desires to classify those workers as employees and, in addition, limit the exposure to back taxes, penalties, and interest. The IRS recently launched a program that allows the voluntary reclassification of workers as employees outside of the examination context: the Voluntary Contractor Settlement Program, or VCSP. "This settlement program provides certainty and relief to employers in an important area," said IRS Commissioner Doug Shulman. "This is part of a wider effort to help taxpayers and businesses and give them a fresh start with their tax obligations."

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To be eligible for the VCSP, a business must have consistently treated the workers in question as nonemployees and filed all required Form 1099 information returns for those workers for the previous three years. In addition, the business cannot currently be under an audit by the IRS or under an audit addressing the classification of the workers by the Department of Labor or a state government agency.

To participate in the VCSP, a business must agree to prospectively treat the class of workers as employees during future tax periods. The business must also pay 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates. In return for the 10% payment, the business will not be liable for any interest and penalties and will not be subject to an employment tax audit for those workers for prior years. However, a business participating in the VCSP must also agree to extend the period of limitations on assessment of employment taxes for three years for the first, second, and third calendar years beginning after the date on which the business has agreed to begin treating those workers as employees.

If the VCSP sounds a bit complicated, it is. But this may be a way to limit a business's past and future liability for taxes, penalties, and interest.

Please contact us if you have questions concerning the VCSP or any other tax compliance or planning issues.

Turning a Hobby into a Business

During this period of economic uncertainty, taxpayers may consider turning a hobby into a full-time business. Unfortunately, the IRS has a lot to say when it comes to the business vs. hobby decision. It's not a problem as long as the new business turns a profit. And, it may be fine as well if the business produces a loss and the taxpayer enjoys the activity; even better if the loss can offset other income. However, if the business consistently generates losses, the IRS could determine that these losses are actually nondeductible hobby losses.

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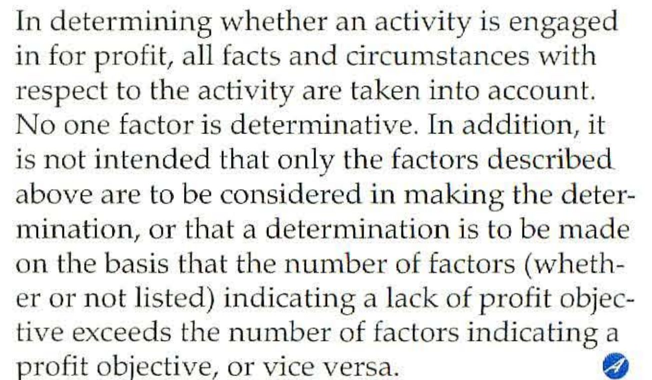
Many hobby loss issues center on the weekend farmer or rancher. However, the hobby loss rules are applicable to any type of activity in which the taxpayer might engage. In any case, to escape the hobby loss taint and avoid ending up with nondeductible losses, the activity must be conducted with the actual and honest intent of making a profit.

There are generally two ways to avoid the hobby loss rules. The first is to show a profit in at least three out of five consecutive years (two of seven years for activities involving horse racing, breeding, or showing). If the safe harbor is met, the burden of proof for lack of profit motive is shifted to the IRS. The second way is to run the venture in a manner that shows you intend to turn it into a profit-making business rather than operate it as a mere hobby. The IRS regulations themselves state that the hobby loss rules won't apply if the facts and circumstances show that you have a profit-making objective.

The best way to prove that you have a profit-making objective is to run the new venture in a businesslike manner. Specifically, the IRS and the courts will look to the following factors: how you run the activity; your expertise in the area (and your advisers' expertise); the time and effort you expend in the enterprise; whether there's an expectation that the assets used in the activity will rise in value; your success in carrying on other similar or dissimilar activities; your history of income or loss in the activity; the amount of occasional profits (if any) that are earned; your financial status; and whether the activity involves elements of personal pleasure or recreation.



In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are taken into account. No one factor is determinative. In addition, it is not intended that only the factors described above are to be considered in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa.

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