

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

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Dear Clients and Friends,

Summer time. Backyard barbecues, swimming, Friday afternoon golf, summer vacation at the beach, and, supposedly, a slower time for CPA firms. While admittedly, we don’t have the deadline pressure right now of April 15, September 15 or October 15, we are quite busy with extended tax returns, financial statements, structuring transactions, handling IRS and DOR matters, and doing ongoing planning for our clients

While there has been no major Federal tax legislation enacted since the last issue of our newsletter, there has been Georgia tax legislation enacted, and Federal tax cases and rulings of interest, as well as lots of proposed Federal tax legislation.

In this issue we will review potential tax legislation on the horizon, recently enacted Georgia tax legislation, rules pertaining to the

reporting of foreign bank accounts, a big win for taxpayers in a conservation easement case, recent cases dealing with the “passive loss rules”, and the IRS annual “Dirty Dozen” list of tax scams, and, as always, highlight a member of our firm and one of our clients.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges



Kent Bridges,
Managing Partner

Tax Legislation On The Horizon

Any time Congress is in session, tax legislation is likely to be on the agenda. Given the recent level of Federal spending designed to stimulate the economy and the current administration’s goal of universal health insurance, an increase in tax rates seems almost inevitable.

Tax rate on ordinary income – The highest current rate is 35%. Current proposals would return the highest rate to the pre-Bush rate of 39.6%.

Tax rate on capital gains and qualified dividends – The Tax Reform Act of 1986 equalized the tax rate on ordinary income and long-term capital gain at 28%. Over the years since then, we have seen the ordinary rate increase and the capital gains rate decrease (currently 15%). Dividends were, until a few years ago, taxed as ordinary income, but now (assuming “qualified”) are taxed at a maximum Federal rate of 15%. While we may see a favorable incentive rate for certain targeted types of gains (e.g. investments in small companies and start-ups), we probably now have the lowest rate on broad-based capital gains and dividends that we will see for quite some time. There is a good chance that the rate could return to 20%.

Alternative minimum tax – Repeal of this highly unpopular tax seems unlikely, but Congress will likely continue to increase the exemption in order to avoid having millions more taxpayers ensnared by it.

Deductibility of health insurance premiums – Employers get a tax deduction for the full cost of health insurance paid on behalf of employees, while employees have such excluded from their W -2 income. Current proposals would limit the amount of health insurance premium that can be paid on a tax-free basis.

Excise tax on employers not providing health insurance – One proposal calls for an 8% excise tax on the payroll of employers who do not pay at least 65% of the insurance premium for an employee’s family coverage. Another proposal calls for a flat fee of \$750 per year per employee if the employer does not pay at least 60% of the premium for basic coverage. Exemptions would likely be provided for very small companies.

Limit on itemized deductions – The tax benefit obtained from itemized deductions might be limited to 28%, notwithstanding that the taxpayer is in a higher marginal tax rate bracket.

Estate tax – Under current rules, the exemption from estate tax is \$3.5 million and the top tax rate is 45%. The estate tax is scheduled to disappear for 2010, and then reappear in 2011 with an exemption of only \$1 million and a top rate of 55%. This is obviously not palatable, and Congress will almost certainly have to act to reform the estate tax before then. In recent years there has been much talk about the possibility of repealing the estate tax. This now seems highly unlikely. What appears more probable is the exemption remaining at \$3.5 million and the highest rate remaining at 45%.



Brittany D. Johnson

Member in the Spotlight – Brittany D. Johnson

The first voice you usually hear when you call our office and the first face you see when you visit our office is that of Brittany Johnson. She is also the one who turns rough drafts of tax returns and financial statements into the nice finished package you receive, makes sure your tax returns get filed by certified mail, manages our incoming and outgoing mail, Federal Express, UPS and couriers, gets copies of your tax returns to your bankers when requested,

manages our file room, etc., etc.

Brittany, a native of Woodstock, Georgia is an Auburn graduate and enjoys exploring new places, working out, and spending time with family and friends.

Bridges & Dunn-Rankin is proud to have Brittany Johnson as a member of our firm.

Recent Georgia Tax Legislation

With respect to recent Georgia tax legislation, what was passed by the General Assembly but vetoed by the Governor is probably as significant as that which was actually signed into law. Tax legislation vetoed includes a 50% cut in the tax on capital gains and an increase in the maximum amount of credit which individuals may claim for donations to organizations providing scholarships for private school tuition (from the current limit of \$2,500 up to 75% of their income tax liability). Georgia tax legislation which was passed into law, however, includes:

Federal conformity – Georgia’s income tax law uses Federal taxable income as a starting point, then makes certain modifications. Over the past few years, Georgia has had a habit of not adopting favorable fixed asset expensing, bonus depreciation, and net operating loss carryback rules which the Federal government has enacted in an attempt to stimulate the economy. Georgia has adopted the higher section 179 fixed asset expensing limits (up to \$250,000), but did not adopt the 50% bonus depreciation rule or the extended 5-year net operating loss carryback period for losses from small businesses.

Quality jobs tax credit – Companies creating at least 50 new “quality” jobs in Georgia can claim a credit of up to \$5,000 per job per year for up to 5 years. The credit can offset the company’s income tax or withholding tax, and any excess can be carried forward up to 10 years. The amount of the credit for each job is based on its pay as a percentage of the average wage for the county.

Retraining tax credit – The current maximum credit of \$500 per employee per year (not to exceed 50% of the cost of the training) has been increased to \$1,250 for employees completing multiple training programs during the year. Certain types of training, however, will no longer qualify for the credit. Specifically, the credit is no longer available for training on commercially mass-produced software packages for word processing, database management, presentations, spreadsheets, email, contact management, or operating systems.

Time limit for claiming credits – Effective for tax year beginning on or after January 1, 2009, the jobs related credits and retraining credit must be claimed within one year of the date the related income tax return is filed or is due, whichever is earlier.

Research tax credit – Under prior law, it was very difficult for start-up companies to benefit from the Georgia research tax credit, due to a requirement that the company have positive net taxable income for the preceding 3 years. Georgia has now removed this requirement and changed the manner in which the credit is computed. Further, while the credit is generally limited to 50% of tax liability, the new law permits newly-formed companies to apply the excess credit against withholding tax liability for its first 5 years of operations.

Tax credit for purchase of residence – A credit of up to the lesser of 1.2% of the purchase price or \$1,800 may be claimed with respect to the purchase of a residence between June 1, 2009 and November 30, 2009.

Foreign Bank and Financial Accounts and Form TD F 90-22.1

There has for many years been a requirement that any US person with a financial interest in or signature or other authority over a foreign financial account file with the Treasury Department each year by June 30 a Form TD F 90-22.1, disclosing the details with respect to such accounts, if the aggregate balance of such accounts at any time during the prior calendar year exceeded \$10,000. Until a few years ago, the only penalties for failure to file a Form TD F 90-22.1 were for a *willful* failure to file. However, current law provides for a penalty of up to \$10,000 in the case of a *nonwillful* failure to file, and the civil penalty for a *willful* failure to file can be up to the greater of \$100,000 or 50% of the account balance.

The IRS has recently become increasingly concerned that US taxpayers are using offshore financial accounts to evade US taxes and has stepped up its enforcement in this area. As part of its stepped-up enforcement initiative, the IRS recently provided guidelines for those taxpayers who have failed to report income from foreign accounts to make voluntary disclosure of such in exchange for leniency. Further, the IRS has recently announced that taxpayers who have properly reported their income but inadvertently failed to file the TD F 90-22.1 have until September 23, 2009 to do so, without penalty.

Big Win for Taxpayer in Conservation Easement Case

Let's assume you have a tract of land which could potentially be developed into a residential subdivision, but you don't want to ever see the land developed, desiring for it to forever remain in its beautiful natural state. If you are willing to grant a perpetual conservation easement to a qualified organization (effectively giving up your rights to develop the property), then the tax law will reward you with a tax deduction. The amount of the deduction is the difference between the appraised value of the land assuming its highest and best use value before the granting of the conservation easement, and its value after granting the conservation easement. The IRS perceives that there has been a lot of abuse in this area and has been carefully scrutinizing deductions for conservation easements. However, the taxpayer scored a big win in a recent Tax Court case (*Kiva Dunes Conservation v. Commissioner*) involving such a donation.

This case involved a developer who granted a perpetual conservation easement, keeping property as a public golf course which otherwise could have been developed as residential lots. The taxpayer claimed a deduction of \$30.6 million. The IRS disallowed the deduction entirely, but the Tax Court allowed a deduction of \$28.7 million.

Recent Wins for Taxpayers in Passive Loss Cases

In 1986, concerned with the erosion of the tax base from the proliferation of tax shelters, Congress enacted the "passive loss rules" which provide, in general, that the losses from rental activities or businesses in which you do not "materially participate" (generally defined as at least 500 hours per year) cannot be used to offset income from other sources like W-2 wages, interest, dividends, capital gains or businesses in which you do materially participate. The rules as enacted provided that, except as otherwise provided in regulations, limited partners would be presumed to not materially participate in a business. At the time that those rules were enacted, LLCs and LLPs were virtually nonexistent, and under the laws of most states limited

Client in the Spotlight – Profisee Group, Inc.

Following the successful sale of Stratature, Inc., a business intelligence software and services company, to Microsoft in 2007, entrepreneurs Ian Ahern, Michael Soble, Adam Hanson, and John Leavitt began looking for their next opportunity to create and grow a technology-based business. Their latest venture, Profisee Group, Inc., is a specialized services company with expertise in financial analytics, operational analytics and master data management.

Profisee, which has partnered with a number of leading business intelligence industry software companies like IBM Cognos and Microsoft, assists large and mid-sized organizations in the design, implementation and operation of advanced financial systems, including operational applications which are key enablers for decision support, performance measurement, profitability

A few key points from the case:

- The Tax Court appeared to rely heavily on the taxpayer's appraiser, because such appraiser was apparently more qualified to appraise the property than the IRS' appraiser and apparently did a more thorough job.
- More than 10 years had lapsed between the time of purchase of the property and the granting of the conservation easement. This helped to avoid any issue with the fact the conservation easement deduction being claimed was many multiples of (52 times) the original purchase price paid.
- The taxpayer had already sold most of the property he owned around the golf course (limiting any value enhancement he was gaining by virtue of granting the conservation easement).
- Both parties agreed that the highest and best use of the golf course property was as residential lots, the property was zoned for such, and the market demand for such at the time was sufficient to absorb the hypothetical number of lots over a reasonable period of time. This might be a harder position to sustain in the current residential real estate market.

partners in LPs could not actively participate in a business without jeopardizing the legal liability protection that the LP format provided them.

In a recent case before the Tax Court, the IRS asserted that the taxpayers could not deduct losses from their LLCs and LLPs because the restrictive rules applicable to LPs applied to these entities as well. The Tax Court ruled in favor of the taxpayers. In a similar case, the Federal Court of Claims has likewise recently ruled in favor of the taxpayer.



improvement and process improvement initiatives. The company provides solutions to a wide spectrum of industries, including financial services, manufacturing, retail and telecom.

Bridges & Dunn-Rankin is proud to be associated with Profisee Group, Inc.

The “Dirty Dozen”

The IRS has released its annual “Dirty Dozen” list of tax scams it is on the lookout for.

1. *Phishing* – The IRS warns taxpayers to ignore e-mails they receive purporting to be from the IRS. The IRS does not contact taxpayers by e-mail, so any such e-mails you receive are from identity thieves seeking to acquire your personal financial information.
2. *Hiding income offshore* – The IRS is aggressively pursuing taxpayers who try to evade U.S. tax by hiding income in offshore banks, brokerage accounts or other entities or by the use of offshore debit cards, credit cards, wire transfers, foreign trusts, employee-leasing schemes, private annuities and life insurance plans.
3. *Filing false or misleading forms* – The IRS is seeing scam artists file false information returns reflecting withholding which they then claim as a credit on an income tax return.
4. *Abuse of charitable organizations and deductions* – The IRS continues to observe the use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur when a taxpayer moves assets to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets. Contributions of non-cash assets continue to be an area of abuse, especially with regard to overvaluation of contributed property.
5. *Return preparer fraud* – The IRS is targeting dishonest tax return preparers and their clients.
6. *Frivolous arguments* – Claims such as that the Sixteenth Amendment was never ratified, wages are not income, filing a return and paying taxes is voluntary, etc. don't fly with the IRS and the courts.
7. *Form 843 tax abatement* - This scam rests on faulty interpretation of the Internal Revenue Code. It involves the filer requesting abatement of previously assessed tax using Form 843. Many using this scam have not previously filed tax returns and the tax they are trying to have abated has been assessed by the IRS through the Substitute for Return Program. The filer uses the Form 843 to list reasons for the request. Often, one of the reasons is: "Failed to properly compute and/or calculate IRC Sec 83-Property Transferred in Connection with Performance of Service."
8. *Abusive retirement plans* – Some taxpayers have attempted to circumvent the annual maximum contribution limit on Roth IRA contributions by transferring to their Roth assets with an artificially low value.
9. *Disguised corporate ownership* – The IRS is aware that shell corporations are being formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity in order to facilitate the underreporting of income, non-filing of returns, money laundering, etc.
10. *Zero wages* – This scam involves a taxpayer filing a substituted W-2 or corrected 1099 showing little or no income in order to avoid being taxed on the income reported on the actual W-2 or 1099.
11. *Misuse of trusts* – With limited exceptions, any income earned by a trust is subject to income tax, either on the return of the trust or on the return(s) of the beneficiary(s), depending on how the trust is structured and whether the income was retained in the trust or distributed. The IRS is aware of attempts to avoid paying tax on income by placing assets in trust (onshore or offshore).
12. *Fuel tax credit scams* – The IRS is receiving claims for the fuel tax credit which are unreasonable.

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Shortened Extension Period for Partnerships, LLCs and Trusts

As a reminder, the extended due date this year for the income tax returns of partnerships, LLCs and trusts is September 15, not October 15 as it has been in previous years.

Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth families.

The information provided in this newsletter is presented for educational and informational purposes only, and is not intended to constitute legal, tax or accounting advice. The articles provide only a very general summary of complex rules. For advice on how these rules may apply to your specific situation, contact a professional tax advisor.