

## *This Month:*

- ◆ Tax Aspects of “Cash for Clunkers”
- ◆ Minimum Wage Increase Reminder
- ◆ No Business– No Deductions
- ◆ Employer Paid Disability Premiums
- ◆ Importance of Accountable Plans

### Minimum Wage Reminder



The federal minimum wage increased to \$7.25 an hour on July 24, 2009. But be aware that the minimum wage in the states you do business in may be higher. The U.S. Department of Labor has an interactive site that lists the minimum wage, planned increases and the hours threshold for premium pay for all the states at

[www.dol.gov/esa/minwage/america.htm](http://www.dol.gov/esa/minwage/america.htm).

### No Business - No Deductions

A recent Tax Court decision bolsters the IRS stance regarding deductible business expenses. Investigatory and start-up expenses were denied because the business had not yet begun an active trade. Also, the related training and education classes, which the taxpayer had taken to learn the new business (real estate investment, in this case), prepared the taxpayer for a new career and therefore were not deductible. Reviewing this Tax Court decision gives us a better understanding of what types of business expenses are allowed by the IRS under Code Section 162 and Code Section 195. Your local Padgett office has more information regarding this case, and an overview of the related tax laws which may affect your new business.

### Tax Aspects of “Cash for Clunkers”

Cash for Clunkers gives a cash incentive for individuals and businesses to trade in older gas-hogging vehicles for new, more fuel-efficient ones. The incentive takes the form of a voucher of \$3,500 or \$4,500 depending on the type of vehicle traded in and the fuel efficiency of the vehicle purchased. The new vehicle must be purchased between July 1 and November 1 of 2009.

The vouchers are not treated as gross income of the vehicle purchaser for Federal tax purposes. There-



fore, a business that utilizes the program is treated as if it traded in the old vehicle and received zero dollars for it. Its basis in the new vehicle would be the amount it pays, net of the voucher and any other rebates. If the purchaser is a business that has depreciated the old vehicle down to zero (or it has a very low basis), trading it generally would not result in recapture. The basis of the new vehicle would equal the amount paid for it.

For a business, trading in a qualifying vehicle with a low or zero basis definitely beats selling it for an amount equal to or less than the voucher's value. In fact, it may even pay to forego a higher sale price and instead trade in the old vehicle and get a tax-free voucher. For example, if a business paying tax at an effective tax rate of 30% sells a zero-basis truck for \$6,000, it would have \$4,200 left after paying a \$1,800 tax. If the business trades in the old truck and qualifies for a tax-free \$4,500 voucher under the new program, it would be \$300 ahead.

## Employer-Paid Disability Premiums

If you think that paying your employee's disability premiums is always a good thing, think again. If you provide your employees disability as a nontaxable fringe benefit, payments they receive upon their disability will be, in most cases, FULLY taxable to them!

Payments received due to disability are not taxable if:

- your employees paid the premiums on the policy with after-tax funds; OR,
- you paid the premiums but deducted the amount from their paycheck.

The cost of disability insurance - even over a good amount of time - can be far less than the tax due on the income received under the policy. Like all insurance, it all depends on whether you actually collect under the policy.

## Importance of Accountable Plans

If you often reimburse employees for job-related expenses they incur, accountable plans can offer significant benefits. Accountable plan reimbursements are not taxable to the employee and are fully deductible by the employer, with the exception of meal and entertainment expenses.

In one particular Field Service Advice (FSA), the IRS addressed the reimbursement of expenses of couriers. The couriers picked up and delivered packages in a certain geographic area. The employees used their own vehicles and the company reimbursed them for such use and paid them for their mileage expenses. However, the expense reimbursements were not based on the employees' actual expenses but rather a percentage of their commissions were to be allocated to wages and a percentage to equipment rental (i.e., use of the employees' vehicles). The employees were not required to submit mileage or expense documentation to the employer. The employees' wages were reported on their W-2s and the expense reimbursements were reported on Form 1099s.



The IRS found that since the employees did not report their actual expenses to the employer, the reimbursements were not part of an "accountable plan," so the full amount reported on the 1099 was subject to employment taxes.

While this FSA involved a delivery service, the rules apply to all businesses. Although some exceptions exist, it's best to either include the full amount in wages, or require employees to submit detailed expense reports for reimbursement under an accountable plan. Reimbursements must be for job-related expenses that the employee would reasonably expect to incur, and the employee must provide substantiation and return any excess reimbursements within a reasonable period of time.

PADGETT BUSINESS SERVICES®

WHERE YOUR SUCCESS TAKES ROOT<sup>SM</sup>



Padgett Business Services is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of small businesses in the retail and service sectors of the economy. This publication suggests general business planning concepts that may be appropriate in certain situations. It is designed to provide complete and accurate information to the reader. However, because of the complexities of the tax law and the necessity of determining whether the material discussed herein is appropriate to your business, it is important you seek advice from your Padgett office before implementing any of the concepts suggested in this newsletter.

**PENALTY NOTICE:** As required by U.S. Treasury regulations, you are advised that any written tax advice contained herein was not written or intended to be used (and cannot be used) by any taxpayer for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.