

This Month:

- ◆ IRA Conversions
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Assignment of Income

Personally earned income can't simply be reported on a corporation, partnership, etc. tax return, or vice versa. Compensation for services (whether wages, salaries, commissions, profit-sharing, pension, etc.) is taxable to the person who earns it. You can't escape taxation by arrangements and contracts to share earnings or to have them paid to someone else.



In a recent case, the taxpayer maintained that commissions were his S corporation's income—not his sole proprietor income. The Court found that the taxpayer failed to carry his burden of establishing that he had a valid business arrangement with the S corporation under which he was required to, and did, pay the commissions to the corporation.

IRS Eases IRA Conversion Rules

Beginning in 2010, an IRA conversion to a Roth IRA can be done regardless of income level. The previous AGI threshold of \$100,000 will be eliminated. Additionally, married filing separate taxpayers will be able to make the conversion to a Roth, which has previously been an unavailable option. These new rules will pose tax planning challenges and opportunities for the next few years.

There are advantages to converting a Traditional IRA to a Roth IRA. For one, unlike Traditional IRAs, qualified distributions from Roths are tax-free—including earnings. Additionally, the required minimum distribution rules do not apply to Roth IRAs.

Those who would benefit the most from converting their IRA into a Roth IRA include:

- Taxpayers with a number of years before retirement (to recoup the tax paid on conversion)
- Those who anticipate being in a higher tax bracket in future years.
- Those who can afford to pay the tax on the conversion without using cash from the retirement account.

Now for the fun part: Any income from the conversion to a Roth IRA in 2010 is automatically deferred. Half of it will be reported in 2011 and the other half will be reported in 2012. An election can be made to include the entire amount on your 2010 taxes. You don't want to overlook that option—especially if it is clear that you will be in a higher tax bracket for 2011 or 2012.

Contact our office to discuss whether an IRA to Roth conversion is right for you as expert tax planning will be required.

Got Debt Relief?

If a debt you owe is forgiven by the creditor, or you settle the debt for less than the full amount, the canceled portion is taxable income to you. However, there are exceptions and exclusions.

Canceled Debt that Qualifies for Exception to Resulting in Gross Income:

- Amounts specifically excluded from income by law such as gifts or bequests
- Cancellation of certain qualified student loans
- Canceled debt that if paid by a cash basis taxpayer is otherwise deductible
- A qualified purchase price reduction given by a seller

Canceled Debt that Qualifies for Exclusion from Gross Income:

- Cancellation of qualified principal residence indebtedness
- Debt canceled in a Title 11 bankruptcy case (Chapters 7, 11, 12, and 13)
- Debt canceled due to insolvency
- Cancellation of qualified farm indebtedness
- Cancellation of qualified real property business indebtedness (other than C corporations)

Banks, other financial institutions, and certain government agencies generally must report debt discharges (partial or complete) on Form 1099-C, *Cancellation of Debt*, if the discharge is \$600 or more.

Employee Wage Records

Many small business owners are confident in their knowledge of regulations concerning the retaining of receipts, canceled checks, bank statements, etc. for their business. But are you as cautious when it comes to keeping records for employee wages and personnel information? Although the rules vary from state to state, you should maintain a record of your employees' hours, wage rates, payments, withholdings, etc. for at least four years. (Some states require even longer retention periods.) States frequently audit unemployment tax records, and it's likely you'll be asked to produce payroll records if you're audited for income tax purposes. Also, in most states you're required to provide employees a detailed breakdown of their paycheck—gross, net, and the details of their withholdings. There can be penalties for failure to comply, so make sure that you are familiar with the regulations.

Reminder

The IRS reminds taxpayers of the special sales tax deduction for car purchases that is available through the end of 2009. A new car, light truck, motorcycle, and even a motor home could qualify – and you don't have to itemize to get the deduction. There are income limitations, and only tax on the first \$49,500 applies. Questions? Ask your Padgett representative.

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Padgett Business Services is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of businesses with fewer than 20 employees in the retail and service sector 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.