ARKANSAS SOCIETY OF ACCOUNTANTS

RESPECTED ACCOUNTING PROFESSIONALS SERVING OUR COMMUNITIES

Monthly Newsletter

April 2006

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• FROM YOUR PRESIDENT'S PEN •

Dear Members,

If only it were January 21st instead of March 21st. It seems that our most precious commodity these days is time. There never seems to be enough time to get done what we need to do.

In a few weeks, we will have April 17th behind us. As we slow down a little we will look back on the filing season and analyze the things we did right, and the things that we could have been done better. If your practice is like ours, we will also count the number of extensions we have, and try to figure out how we ended up with so many of them.

Take some time to visit the Arkansas Society of Accountant's web site, arspa.org. The "information links" section has several site links that have proven to be very useful in our practice. Also, visit the "event calendar" section of the website. Once there, you will notice a schedule of all of our upcoming CPE seminars, complete with dates and locations.

I am excited about two new events on tap for 2006. The fraud detection seminar scheduled for May in Little Rock, and the GearUp 1040 seminar scheduled for November 30th through December 1st, 2006 in Northwest Arkansas. As we continue to feel the effects from the highly publicized accounting scandals of recent years, fraud detection will be a valuable tool we can use to help protect our clients and ourselves. It has been a long time since the Arkansas Society of Accountants has sponsored a seminar outside of Little Rock. Northwest Arkansas is the fastest growing region of our State, so it only seems natural to choose the Fayetteville area to host one of our most popular seminars.

As tax season draws to a close, I hope to see each of you at the May seminar in Little Rock.

Sincerely,

Bryan K. Johnston. CPA
President, Arkansas Society of Accountants

LATEST THINKING ON LIFE INSURANCE

Life insurance offers some powerful tax advantages. Death benefits generally are free of income tax, while tax value policies permit investment income to accumulate untaxed.

Nevertheless, life insurance presents tax pitfalls as well. Here are the costliest traps to avoid...

Estate tax pitfall

Life insurance policies involve three parties besides the insurance company – the owner, the beneficiary, and the insured individual. If all three are different, tax disaster may result.

Example: John Smith wants $1 million in insurance on his life. He sets up a policy with his wife, Mary, as owner to keep the death benefit outside his taxable estate. Their son Paul is the policy's beneficiary.

Result: When John dies, Paul collects $1 million.

Trap: According to the IRS and established case law, Mary has made a$1 million gift to Paul. Mary's gift tax exemption will be reduced by that amount and gift tax may be payable, too as well.

Avoidance strategies: Such problems may be avoided by having Paul, rather than Mary, own the policy and pay the premiums. (Note: If John applies for the policy and pays the premiums, John will be considered the owner, which John should avoid.)

Alternatively, a trust could be created to own the policy and be the policy beneficiary. Paul could be the trust beneficiary.

A trust involves more complexity and expense. However, a trust can keep the death benefit outside an individual's taxable estate. It also can protect the policy's cash value from creditors of the beneficiaries.

Borrowing trouble

Borrowing against a policy's cash value to pay its premiums can seem an attractive option—but it may be a trap.

Background: Permanent life insurance policies (whole life, universal life, variable life) include an investment account known as cash value. Once sufficient cash value has accumulated, you can borrow against it to pay future premiums, saving yourself the out-of-pocket expense.

Although this appears to be a cost free process, it can be very costly.

Example: Alice Jones takes out a $2 million whole life policy, paying $40,000 per year in premiums. Once her cash value is great enough, she stops paying the premiums and sets up automatic loans from her cash value to make the payments.

Several years later Alice is notified that her cash value has eroded because of repeated loans, so she needs to put more money into her policy—there's not enough cash value to keep tapping for the required premiums. As often happens in such cases, Alice decides she doesn't need the insurance anymore, so she lets the policy lapse.

Trap: Such a policy lapse may trigger taxable income. The amount of taxable income will be the outstanding loan balance minus the policyholder's basis in the policy (typically, the basis is the total already paid in premiums).

If Alice has $400,000 in outstanding policy loans and her basis is $180,000, she will have to report $220,000 in taxable income (ordinary income, not capital gain).

Bear trap: If the policy lapses in 2006, Alice might not discover the extent of her tax problem until 2007, when the insurer sends her a Form 1099 reporting the income. By then, it's too late to make a payment to keep the policy in force and avoid the tax hit.

Avoidance strategy: If you borrow against your life insurance, pay attention to all notices you receive from the company. Often, it's better to put more money into a policy than let it lapse and face the tax bill, even if you no longer need the death benefit.

Eventual exit strategy: Keep the policy in force, if you have some need for insurance. If not, pay off the loan and exchange it, tax free, for a paid up annuity.

More tax problems

Additional problems with policy loans may arise if you remove an existing policy from your taxable estate.

Example: Jim Adams has an existing $5 million policy on his life, with Jim as owner and his daughter Wendy as beneficiary. His tax advisor suggests he give the policy to Wendy so that she will be the owner.

Rule: After such a transfer, if Jim lives for at least three years, the policy's death benefit will be excluded from his estate.

Problem: Transferring a cash value insurance policy may have gift tax consequences. The gift value of the policy tends to be close to its cash value. Thus, if Jim's policy has a $1 million cash value, transferring ownership to Wendy will be a gift of around $1 million.

Borrowing tactic: Jim can borrow against his policy before the transfer. Borrowing $900.000, for instance, would reduce the value of the $1 million gift to $100,000.

Trap: Borrowing from and then transferring the policy may result in taxable income to Jim. If Jim's basis in the policy is $500.000 (total premiums paid) and he is r4elieved of $900,000 in debt (he no longer owns the policy), he would have to report $400,000 in taxable income.

Caution: Such a transaction may also trigger "transfer of value" – the death benefit will be subject to income tax. A "transfer for value" simply means that a policy has been transferred in exchange for something of value. There are exceptions (such as transferring the policy to a partnership that includes the insured individual), but you should work with a skilled professional if you receive cash or debt relief for a life insurance transfer.

Avoidance strategy: Before such a transfer, keep total borrowing below the amount of your basis in the policy. In this example, Jim could borrow any amount as long as the loan balance transfer remains below $500,000.

That would still reduce the taxable gift, yet not generate any income tax for Jim. (Keeping the loan below the amount of Jim's basis also avoids the transfer-for-value problem.)

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IRS INVITES TAXPAYERS TO APPLY FOR TAXPAYER PANEL

Washington – The Internal Revenue Service is inviting civic-minded individuals to help improve the nation's tax agency by applying to be members of the Taxpayer Advocacy Panel. The panel provides a forum for citizens from each state to make suggestions regarding IRS decision making.

Taxpayer Advocacy Panel (TAP) members:

Provide opportunities for citizen input and make recommendations to the IRS and Treasury on customer-service issues.

Identify and prioritize taxpayer issues.

Report annually to Treasury, the IRS and the National Taxpayer Advocate.

Participate in meetings where taxpayers are invited to raise issues about their experiences with the IRS.

Refer taxpayers who contact the panels to the IRS offices best able to address their issues.

"As the IRS continues to examine taxpayers' needs in the area of service, the Taxpayer Advocacy Panel has emerged as a vital source for gathering and providing information from the perspective of taxpayers," stated Nina E. Olsen, National Taxpayer Advocate. "TAP's role will ultimately aid taxpayers by supplying them with the top service they deserve."

To qualify as a TAP member, applicants must be U. S. citizens and be able to commit 300 to 500 hours during the year to the panel. In addition, they must be current with their tax obligations and pass a criminal background check.

The application is available at *www.improveirs.org*. Interested parties may apply on-line or download the form and mail it to: Milwaukee TAP office, Stop 1006MIL, 310 West Wisconsin Avenue, Milwaukee, WI 52303-2221.
Those without access to a computer may call 1-8888-912-1227 for an application form.

Applications must be received by the TAP Office by April 28, 2006.

(Ed. Note) I felt that maybe some of you have senior citizen clients who might want to do this. For instance: If you know someone who is retired and still young enough to serve in this capacity, you could contact them and encourage them to do it. As the article states, they want persons from every state.

NEW PHONE TAX LAWSUIT

The IRS's collection of tax on all long-distance phone service—even though the Tax Code defines calls subject to tax as being those individually billed by both time and distance, as few are today—is not being challenged in two class lawsuits. Ten federal court decisions have awarded large refunds of such tax to big businesses. Now the class actions seek refunds for millions of individuals and small businesses.

Important: The Tax Code requires that refunds be requested by individual taxpayers. So if you have a potentially significant refund, apply for it yourself---don't rely on the class actions.

Avoiding penalties for return mistakes by blaming your accountant. Taxpayers have a statutory right to avoid an accuracy-related penalty (Internal Revenue Code Section 6662) by establishing reasonable cause and good faith as a defense if their tax return is audited and additional tax is owed. It's up to the taxpayer to prove that he/she provided all the necessary, and accurate, information to his preparer. If you hold back relevant facts or figures and your accountant makes an assumption that turns out to be wrong, you will not be relieved of a penalty. Blaming your accountant for not reporting income on your return rarely works unless you can establish that, even though you provided him/her with all the information to do the job correctly, he/she was sloppy or negligent.

Is your refund check really in the mail? The National Taxpayer Advocate—a position created by Congress to make sure that the Internal Revenue Service follows its own rules—has announced that IRS has held back some 1.6 million refund checks over the last five years from taxpayers suspect4ed of fraud. *How it works*: The criminal Investigation Division of the IRS has been intercepting and analyzing tax returns claiming refunds. Those refunds of taxpayers suspected of fraud were "frozen" subject to a more thorough examination of the tax of the tax return data. The taxpayers affected did not know they were being investigated. They only knew that they did not receive their refunds. Low-income taxpayers were the prime targets of the project, which defenders say saved billions of dollars of the public's money that would otherwise have been paid out in fraudulent refunds. If you have clients who have not received their refund checks, ask the Taxpayer Advocate's office to investigate on behalf of your client.

Back taxes of defunct corporations. What happens when a corporation owes a large amount of money to the Internal Revenue Service for unpaid income tax and goes out of business? Unless the IRS can establish that the corporation fraudulently conveyed its assets to another entity or person, there's not much they can do to collect—the corporation is out of business and has no assets. *Helpful*: Explain to the revenue officer exactly when the corporation ceased operations and closed its doors. Make sure that the corporation no longer maintains a bank account. In most cases, the revenue officer will confirm that no assets can be located and close the case.

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IRS ESTABLISHES e-MAIL BOX FOR TAXPAYERS TO REPORT PHONY e-MAILS

Washington—The Internal Revenue Service announced today that it has established an electronic mailbox for taxpayers to send information about suspicious e-mails they receive which claim to come from the IRS. Taxpayers should send the information to: *phishing@irs.gov.*

The IRS's new mail box allows taxpayers to send copies of possibly fraudulent e-mails involving misuse of the IRS name and logo to the IRS for investigation. Instructions on how to properly submit one of these communications to the IRS may be found on the IRS Website at *www.irs.gov.* Enter the term phishing in the search box in the upper right hand corner. Then open the article titled "How to Protect Yourself from Suspicious E-Mails" and scroll through it until you find the instructions. Following these instructions helps ensure that the bogus e-mails relayed by taxpayers retain critical elements found in the original e-mail. The IRS can use the information, URLs and links in the bogus e-mails to trace the hosting Web sites and alert authorities to help shut down these fraudulent sites.

However, due to the volume the new mailbox is expected to receive, the IRS will not be able to acknowledge receipt or reply to taxpayers who submit their bogus e-mails. The *phishing@irs.gov* mailbox is only for suspicious e-mails and not for general taxpayer contact or inquiries.

The IRS reminded taxpayers to be on the lookout for scam e-mails aimed at tricking the recipients into disclosing personal and financial information that could be used to steal the recipients' identity and financial assets.

"The IRS does not send out unsolicited e-mails asking for personal information," said IRS Commissioner Mark W. Everson. "Don't be taken in by these criminals."

The IRS has seen a recent increase in these scams, many of which originate outside the United States. To date, investigations by the Treasury Inspector General for Tax Administration have identified sites hosting more than two dozen IRS-related phishing scams. These scam Web sites have been located in at least 20 different countries, including Argentina, Aruba, Australia, Austria. Canada, Chile, China, England, Germany, Indonesia, Italy, Japan, Korea, Malaysia, Mexico, Poland, Singapore and Slovakia, as well as the United States.

The current scams claim to come from the IRS, tell recipients that they are due a federal tax refund, and direct them to a Web site that appears to be a genuine IRS site. The bogus sites contain forms or interactive Web pages similar to IRS forms or Web pages but which have been modified to request detailed personal and financial information from the e-mail recipients. In addition, e-mail addresses ending with ".edu" – involving users in the education community— currently seem to be heavily targeted.

The IRS does not send out unsolicited e-mails or ask for detailed personal information. Additionally, the IRS never asks people for the PIN numbers, passwords or similar secret access information for their credit card, bank or other financial accounts.

Tricking consumers into disclosing their personal and financial information, such as secret access data or credit card or bank account numbers, is identity theft. Such schemes perpetrated through the internet are called "phishing" for information.

The information fraudulently obtained is then used to steal the taxpayer's identity and financial assets. Typically, identity thieves use someone's personal data to empty the victim's financial accounts, run up charges on the victim's existing credit cards, apply for new loans, credit cards, services or benefits in the victims name and even file fraudulent tax returns.

When the IRS learns of new schemes involving use of the IRS name or logo, it issues consumer alerts warning taxpayers about the schemes.

For more information on phishing (suspicious e-mails) and identity theft, visit the IRS Web site at *www.irs.gov.*

For information on preventing or handling the aftermath of identify theft, visit the Federal Trade Commission's Web sites at
www.comsumer.gov/idtheft and
www.OnGuardOnline.gov (and click on topics.)

For schemes other than phishing, please report the fraudulent misuse of the IRS name, logo, forms or other IRS property by calling the Treasury Inspector General for Tax Administration's toll-free hotline at 1-800-366-4484.

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IRS limits vehicles for which cents-per-mile may be used to value personal use. When an employer provides an employee with a vehicle that is available for personal use, the value of such use is includable in the employee's wages. The simplest cents-per-mile valuation method may be used only for vehicles not exceeding a certain value. The IRS has now announced that for new vehicles placed in service in 2006, this value is $15,000 for a passenger vehicle and $16,400 for a truck or van.

IRS Revenue Procedure 2006-15

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THE REGISTRATION FORM FOR THE MAY 25, 06 FRAUD SEMINAR HAS BEEN POSTED ON THE WEB AT *WWW.ARSPA.ORG.*

APPLICATION FOR MEMBERSHIP IN THE ARKANSAS SOCIETY OF ACCOUNTANTS

P.O. Box 725
Newport, Arkansas 72112
longaspa@cox-internet.com
www.arspa.org

Last Name First Name Middle Initial Business Phone Home Phone

Business Address

How many years of accounting have you had?________ Date of Birth________

Sole Practitioner [ ] Partner [ ] Employee [ ] Corporate Officer [ ]

Name of Firm________ Number of Employees________

Name of Partner(s)________

Are you a Licensed, Registered or Certified Public Accountant?________ If yes, give License#________

Are you an Accredited Public Accountant?________ If yes, give Accreditation #________

Are you an Enrolled Agent________ If yes, give EA #________

Do you hold an Associate or Baccalaureate degree with a minimum of 24 semester hours in Accounting? Yes______ No______

Are you engaged in any other trade or profession?________ If yes, please describe________

Please list other accounting organizations in which you hold membership:________

I hereby state that the accompanying statements are correct to the best of my knowledge and belief. I further state that I will abide by the Constitution and By-Laws of the Society and will practice in strict conformity with the Code of Ethics and Rules of Professional conduct adopted by the Society.

Date________ Signature of applicant ________

Annual dues are payable IN FULL in advance and are prorated for credit by ASPA on a monthly basis to August 31 - the end of ASPA's fiscal year.

[ ] Membership Annual Dues $85.00 [ ] Firm Annual Membership $50.00 [ ]Diamond State Annual Dues $15.00 (Non-Residents only)

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State Member Approving Membership

Signature Title Date

Sponsor, If Any

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"State Society dues payments may be deductible as an ordinary and necessary business expense. However, they are not deductible as charitable contributions for Federal income tax purposes.

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ARKANSAS SOCIETY OF • ACCOUNTANTS
RESPECTED ACCOUNTING PROFESSIONALS SERVING OUR COMMUNITIES

LaVerne Long /EXECUTIVE SECRETARY
EXECUTIVE OFFICES:
908 HWY. 67 N. • P.O. BOX 725
NEWPORT, AR 72112
PHONE 870-523-5329 • FAX 870-217-0154
www.arspa.org

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