



# ARKANSAS SOCIETY OF • ACCOUNTANTS

RESPECTED ACCOUNTING PROFESSIONALS SERVING OUR COMMUNITIES

## Monthly Newsletter

May 2008

IRS is looking at a new form, 941X  
Winning the Lottery and Paying Taxes

Considering the statute of limitations

The Value of Professional Advice

### • FROM YOUR PRESIDENT'S PEN •



Dear Members

I hope that everyone who is reading this article had a successful and rewarding tax season. Now is the time to step back, take a deep breath, and admire all the good work you did for your clients this tax season. Your work will be there waiting for you, whether to you take a moment or not. Close your eyes for a moment and relax. Think pleasant thoughts. Are you doing that right now? OK, that's enough, there's work to be done!

Isn't that the way it feels right now? We don't have all those tax returns piled up by the desk anymore (or at least I hope you don't), but we have all those tasks that we put aside waiting to be completed. Those clients who were kind enough to wait until after tax season to press certain issues are now calling. Those contractor's license applications don't just complete themselves. Franchise taxes were due on May 1st. That pile of correspondence that you've been putting off has to get taken care of. You need to catch up on your review of bookkeeping clients. There's no way you can take a break now! Here's a little press release for all of us: The world will continue to function if we take a little time for ourselves and families!

I know we can't stop working and just spend the next month basking in our past accomplishments and let the world pass us by. We can have some fun though. We've earned it. Play some golf, go fishing, go on a vacation, go shopping and spend some of that money you made (Katherine certainly did), go eat at a nice restaurant, go to American Idol. What's the point in working hard if you can't enjoy the success? As I write this, I'm about to leave and play in a 3 day golf tournament with one of my best friends. We'll make some memories that will never be forgotten. Things like, "I remember when I hit my worst golf shot ever." Who cares? There's so much more to life than SSARS and IRS code sections. Life truly is like a vapor. Now is the time to enjoy it before it's too late.

I look forward to seeing you soon as we head into our time of board meetings and continuing education, beginning with the accounting seminar being put on by Bob Jennings on June 2nd and 3rd. It is an exciting time to be a part of the Arkansas Society of Accountants. Let's each continue to do our part to make the society better and stronger for many years to come.

Finally, to my good friends, the Woods' brothers. We're praying for you.

Brad Crain, C.P.A.  
President

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### **When Salary is Deemed to be a Dividend Payroll Tax is Refunded**

The IRS and Tax Court held that the salary paid by a corporation to its owner be excessive, therefore the company's deduction for it was disallowed. When the IRS submitted its calculation of tax due as a result of the disallowed deduction, the company and its owner protested that it didn't include a refund of the 1.45% Medicare payroll tax each had paid on the salary. The IRS said that the Tax Court does not have jurisdiction over the payroll tax disputes, so it cannot order a refund of the taxes. Tax Court Ruling: Where, as here, in an income tax case, payroll taxes must be recomputed to reach the correct tax result, the court does have jurisdiction. The refund is ordered. Menard Inc., 130 TC No. 4.

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### **Death Defeats Levy on Lawyer's Bank Account**

An attorney died while still owing back taxes. A state court then ordered that his business



bank account be distributed to clients for whom he had held funds and to trustees named to terminate the affairs of his law practice to cover their necessary costs and fees. But before the bank made distribution, the IRS issued a levy on the account. Court: After the state court's order, the deceased lawyer had no interest in the bank account and its funds, which now belonged to his clients, creditors, and the trustees as fees. Therefore, there was nothing for the IRS to levy to attach to. Jeffery D. Cooper, DC NJ, No. 1:07-cv-02776.

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### **Bar's Licensed Owner Shouldn't be Treated as Owner**

Chares Maney wanted to purchase a bar, but a felony conviction kept him from obtaining a liquor license. So, he reached a deal with his friend Ray Monk, who bought the bar, obtained its license, and opened the business accounts for it in his own name. Maney then ran the business as "Chuck's Place," and Monk moved 200 miles away. Maney paid \$2,500 a month to Monk that Monk treated as rent. Snag: The IRS audited Monk, said he was the bar's legal owner, and taxed its income to him. Court: The monthly \$2,500 payment did not vary, indicating it was rent, not profit sharing. In all other ways, Maney and Monk acted as tenant and landlord, so the bar's income was not taxed to Monk. Raymond L. Monk Jr., TC Memo 2008-64

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## The IRS is Looking at a New Form 941X

The IRS Office of Taxpayer Burden Reduction (TBR) initiated the Adjusted Employment Tax Return (941X) Project to reduce burden associated with correcting information previously reported on various types of employment tax returns. Currently, employers and payers use one form-941c, Supporting Statement to Correct Information-to correct the amounts they previously reported on forms 941, 943, 944 and 945. Form 941c is not a stand alone tax return. Presently, filers must attach Form 941c to their current employment tax return when making adjustments, or to Form 843 when claiming a refund of overpaid employment taxes.

Form 941c is complex and does not correspond directly to any employment tax return. Consequently, taxpayers often make mistakes completing and filing it, resulting in processing errors and delays. Additionally, because the taxpayer files Form 941c with the current employment tax return when making the adjustment, the IRS adjusts the tax for the current tax period but adjusts the wages for the calendar year being corrected. This makes it difficult for employers and the IRS to track taxpayers' account activity.

### Changes for 2009

A new set of dual-purpose forms for adjustments and refunds will reduce burden for employers, payers and the IRS. The IRS, with stakeholder input, is making the new forms as user-friendly as possible and implementing more accurate procedures for adjustments and refunds of employment taxes.

► **Forms:** Each stand-alone form will correspond to, and relate line-by-line with, the employment tax return it is correcting. For example, an employer who discovers an underpayment or overpayment error on a previously filed 941 will use 941X to make a correction. Since the form 941X is a stand-alone form, the employer will be able to file Form 941X when an error is discovered, rather than having to wait to file it at the end of the quarter with the next employment tax return.

The new forms being developed will correspond with Form 941, Employer's Quarterly Federal Tax Return; Form 943, Employer's Annual Federal Tax Return for Agricultural Employees; Form 944, Employers Federal Tax Return; Form 945, Annual Return of Withheld Federal Income Tax and Form CT-1, Employer's Annual Railroad Retirement Tax Return. Spanish versions of the new forms are being developed for Forms 941-PR, 944-PR, and 944(SP).

The IRS will also revise Form 941 and other employment tax returns for the 2009 tax year to eliminate prior period adjustment lines no longer needed after the implementation of the new forms.

Note: Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, is not being revised. Employers can continue to use Form 940 to file amended returns.

Under the proposed regulations, Form 941X will be used to make all adjustments and claim refunds. If an employer is correcting an overpayment for a Form 941, the employer will be able to either make an adjustment or

claim a refund. If an adjustment is made the amount of the overpayment will be applied as a credit to the quarter in which the form 941X is filed. Employers correcting underpayments of employment taxes that result in a balance due, can pay using EFTPS, credit card, or send a check along with Form 941X. The IRS will make both the tax and wage corrections to the actual tax period being corrected, resulting in a more accurate record.

After finalizing the new Form 941X, the IRS will continue developing additional forms for the remaining returns in the employment tax series. The entire set of forms will be available in early 2009 for use in correcting errors on employment tax returns discovered on or after January 1, 2009.

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**Winning the lottery and paying income tax.** It seems that any number of lucky individuals who have won millions of dollars in state-run lotteries acted recklessly when it came to paying tax on their winnings. Some have taken the tax position that they realized a tax-favored capital gain when they sold their right to receive future annual installments in return for discounted lump-sum payment. Various courts have ruled against the lottery winners by adopting the “substitute for ordinary income” doctrine, which says that capital gains treatment is not available for what would otherwise be received at a future time as ordinary income.

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**Consider the statute of limitations when the IRS proposes to assess additional tax.** The general rule is that the IRS must assess additional income tax within three years from the date your personal income tax return was filed. Two important exceptions: If you understated your gross income by more than 25%, then the IRS has six years to assess tax. And if your original tax return claimed false deductions or your or you intentionally failed to report income, then there is no statute of limitations—which means that the IRS can make you pay the extra tax, interest and penalties whenever it catches up with you. Fight back: If the IRS claims that your tax return was fraudulent, it is the IRS’s burden to prove so. Make the IRS meet its burden by insisting, for example, that each item of income it claims you did not report was really income (gifts, loans and return of capital are not income), and make the IRS prove that you failed to report the income fraudulently rather than because of an honest mistake on your part or an error on the part of your tax preparer.

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**DON'T FORGET!! REGISTER EARLY FOR THE BOB JENNINGS SEMINAR.**

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**Loss deduction allowed on home’s workshop.** A couple’s home was appraised at \$199,000 when they spent \$16,000 adding an attached workshop to it. They sold the home two years later for \$203,000. The home

sale was tax free, but the couple claimed a loss on the sale of the workshop while the IRS said that they had a gain. IRS: The workshop held 9% of the home's space, so 9% of the sale price was allocable to it—more than \$18,000. The workshop added only \$4,000 to the value of their home, so its sale value was only that much. Court: When the couple sold the home, the real estate agent obtained two appraisals of it that gave the average value to the workshop of \$6,500. That value will be used. Brian E. Mallin, TC Summary Opinion 2008-13.

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**Right to speedy trial violated.** Paul Mendoza was convicted of filing false tax returns but protested that his trial hadn't begun until 10 years after he was indicted, so his constitutional right to a speedy trial had been violated. IRS: Before being indicted, Mendoza had left the country for eight years, so it could not arrest or try him. Court of Appeals: The IRS had contact information for Mendoza but had done almost nothing to inform his of the indictment, so he hadn't "fled" and had even returned a call the IRS made to his wife. The IRS's lack of effort to inform him of the case was prejudicial, so his conviction if reversed. Paul Mendoza, CA-9, No.06-50447.

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**Getting expert advice saves penalties from abusive investment.** Three couples invested in a partnership that promised both business profits and tax benefits. The IRS later

held it be an abusive tax shelter and imposed negligence penalties on the couples. They replied that they had checked the bona fides of the business before investing. The IRS told the Court that other investors in the same shelter had been held liable for the penalties. Court: These couples showed that they had paid reputable professional advisers a reasonable amount relative to the size of the investments to investigate the partnership for them before they invested. So they hadn't been negligent. J. Thomas Allison III et al., Court of Federal Claims, Nos.99-419T, 99-726T, 98-718T.

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**Retiree doesn't owe tax on insurance policy owned by firm.** Joseph Dyer was a partner in a law firm that in 1978 bought an insurance policy on his life, payable to his wife, Mary, to pay her the value of his interest in the firm if he died. Joseph retired in 2001, and the firm let the policy lapse. The lapse resulted in \$18,000 of taxable income to the policy owner that the insurance company reported to Mary on a Form 1099, and that IRS thus taxed to the Dyers. They protested. Tax Court: The law firm had been the policy's owner—paying premiums and arranging the policy for its own benefit. There was no evidence that Mary had ever received an \$18,000 payment or benefit, so the Dyers escape the tax. Joseph P. Dyer, TC Summary Opinion 2008-23.

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**Improper deductions don't prove tax fraud.** Carlos Sala invested a large amount in what the IRS later ruled to be an illegal tax

shelter. The IRS sent a back tax bill and he paid it—but he later protested the IRS’s addition of \$1.5 million of interest that can only be imposed in fraud cases. The IRS answered that Sala’s investment had to be a tax fraud because the deductions he claimed from it were much larger than any amount he had at risk for the loss in the investment.

**Court:** “Fraud” requires acts of concealment or deceit that are committed against the IRS. The fact that a deduction is improper is not enough. Here, Sala had acted openly in making his investment and obtained a lawyer’s opinion about its propriety. He had not concealed the investment from the IRS and had cooperated in its investigation. So, there was no evidence that he had committed fraud, and he escapes the penalty. Carlos E. Sala, DC Colo., No:05-cv-00636.

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**Estate gets money back after refund deadline.** An estate held property that was the subject of litigation and difficult to value, making it impossible to determine the amount of estate tax that would be owed. So, before it filed its tax return or received any tax bill, the estate remitted \$165,000 to the IRS to stop penalties and interest from running on any tax it might finally be found to owe. Later, after the disputes were resolved, the estate filed a tax return showing no tax due and seeking the return of the \$165,000. But the IRS said that the deadline for requesting a tax refund had passed.

**Court:** At the time the \$165,000 was remitted,

no tax bill had been computed for the estate, and the IRS’s own rules say that a remittance made before a tax liability is proposed on a return is a “deposit,” not a “payment.” Deposits, unlike tax payments, can be reclaimed by a taxpayer at any time—so the estate gets its money back. Joan Huskins, Court of Federal Claims, No. 05-1273.

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**Business expenses are deductible even when not claimed on return.** A self-employed real estate broker didn’t file a tax return. When the IRS caught up with him, it filed a replacement return for him on which it allowed almost no business deductions. He protested and went to Tax Court. There, the IRS said that because he had no proof of any claimed deductions, none should be allowed.

**Tax Court:** A business can deduct expenses that it must have incurred to operate even if it has no proof of them. Here, the individual’s business was genuine, as the IRS itself indicated not only by attributing business income to him from it, but also by allowing him two deductions for essential expenses—his business license fee and real estate listing fees. Thus, estimated deductions are allowed for other expenses that the business must have incurred as well—advertising, driving costs, phones, education materials and depreciation. Duyet Minh Nguyen, TC Summary Opinion 2007-80.

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**APPLICATION FOR MEMBERSHIP IN  
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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.

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