

WINTER 2011

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Year End Tax Planning Tips

As 2011 approaches its close, we are bringing to your attention some last-minute tax-saving ideas. Before acting on these, consider that:

- Most strategies do not apply universally, but only in specific circumstances;
- Many strategies should take into account not just the current year's tax impact, but future years' impacts as well; and
- Strategies that may reduce your current year regular federal income tax may not reduce your overall federal income tax due to the alternative minimum tax.

In light of this, here are some planning matters that might impact you:

Accelerate taxable income into 2011? If available, you should consider doing this. Although tax rates are not scheduled to increase in 2012, rate increases or a surtax for next year seem not to be beyond the realm of possibility.

Accelerate deductions into 2011? Normally, we suggest that you consider accelerating paying deductible expenses (e.g., charitable contributions) that you otherwise would pay early next year. The prospect of higher future tax rates suggests, however, that deductions may be worth more in the future. Conversely, some of the current proposals designed to increase federal revenue serve to limit tax savings from existing deductions. So, the advisability of accelerating deductions into 2011 is highly unclear.

Realize net capital gains in 2011? For the same reasoning used above in assessing the wisdom of accelerating ordinary income into 2011, realization of capital gains in 2011 deserves consideration. Although taxes on capital gains are not scheduled to increase until 2013, Congress may act sooner. Using similar reasoning, realizing capital losses to offset long-term gains already realized this year may not be as beneficial as these losses may be in offsetting future capital gains.

First-year depreciation. The cost of most business equipment and furniture must be capitalized and depreciated over five to seven years. However, a special tax break is available to most small businesses. The Section 179 deduction permits immediate write-offs for up to \$500,000 of 2011 qualifying additions. If you haven't yet made 2011 equipment or furniture purchases up to this amount, consider accelerating next year's planned purchases into this year to fully utilize this provision. Items purchased, which may be new or used, must be "placed in service" by year end for the deduction to be available. These rules also apply to breeding or racing horses and to breeding cattle. Note that there are limits on the availability of the Section 179 deduction, the applicability of which you should ascertain before acting. Chief among these are that the deduction is only available to the extent of net business income, and the deduction is phased out dollar-for-dollar when qualifying property additions exceed \$2,000,000 in the year.

See the separate article titled "Some Tax Rates and Amounts for 2012" for a scheduled substantial decrease in the Section 179 deduction next year.

To the extent Section 179 deductions are not available for capital expenditures, bonus depreciation may be. For qualifying capital expenditures, 100% of cost can be deducted in the year assets are placed in service. Qualifying capital expenditures generally must have a cost recovery period of 20 years or less. In general, the business must acquire the property

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and place it in service during 2011, and the property's original use must have begun with the acquirer. The 100% bonus depreciation is scheduled to decrease to 50% in 2012.

S Corporation and partnership losses. If your S Corporation will generate a tax loss this year, consider whether you have enough basis in the stock (or in loans you've made to the corporation) to take the full loss. If you don't, additional investments should be considered. Similar considerations can arise in some situations with partnerships expecting tax losses.

Self-employed retirement plans. If you have self-employment income and don't have a retirement plan in place to shelter any of it, you may qualify to use a Self-Employed Retirement Plan. Even though the plan does not need to be funded until the due date for filing your 2011 income tax return, the plan must be established by year-end in order to deduct contributions for 2011. The prospect of higher future tax rates eroding some of the benefits of income deferral should be considered.

Charitable contributions. Always consider funding charitable gifts with appreciated marketable securities held for more than one year, resulting in gains being untaxed. You may also charge charitable contributions on your credit card; contributions posted to your account before year-end are deductible this year, even if you do not pay the charges until next year.

Annual gifting. You may give your children and others up to \$13,000 in 2011 without any gift tax consequences. This annual exclusion is a per person amount, and there is no carryover of any unused exclusion. Consider making year-end gifts to fully utilize the annual exclusion, and consider making your 2012 annual exclusion gifts early next year. The exclusion remains \$13,000 for 2012.

Required minimum distributions. Individuals with retirement plan accounts (employer qualified plans or IRAs) generally are required to take minimum annual distributions upon reaching age 70 1/2. Steep penalties apply to noncompliance, and not all IRA custodians or plan sponsors actively communicate the applicability of the rules to accountholders and plan participants.

C Corporation dividends. C Corporation dividends are subject to a 15% top federal tax rate, but this favorable treatment is scheduled to expire after 2012. Closely-held C Corporations should consider paying dividends before the end of this year.

W-2 & 1099 Form Preparers - Tips and Reminders

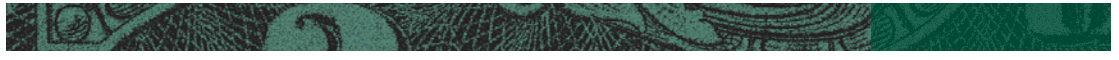
Special S Corporation W-2 Rule: Health insurance premiums and other fringe benefits paid by S Corporations on behalf of greater than 2% shareholder-employees (including certain family members) must be reported as wages for income tax purposes on the shareholder-employees' Form W-2s. These benefits are not subject to Social Security or Medicare (FICA) or to unemployment taxes. The additional compensation is included in Box 1 (Wages) of Form W-2, but not in Boxes 3 and 5 of the form.

1099 Payments to Law Firms: Payments by businesses of \$600 or more for the year to service providers must be reported on Form 1099-MISC, unless the payee is a corporation. However, such payments to law firms, even incorporated law firms, must be reported.

Mandatory Electronic Filing: If you are required to file 250 or more information returns, you must file electronically. The 250-or-more requirement applies separately to each type of 1099 form.

Form 1099-K: If you've paid for independent contractors' services with a credit card, debit card, gift card or used another electronic payment medium (e.g., PayPal), you no longer need to send them Forms 1099-MISC. Instead, the payment settlement entity (usually the bank that's contractually obligated to pay the payee) sends them Form 1099-K.

Status of W-2 Reporting of Health Insurance Coverage: The IRS has delayed the requirement to report on W-2 forms the cost of health insurance benefits provided to employees until 2013 (reporting 2012 coverage costs on 2012 W-2 forms). Thus, employers will need to start compiling the required information in 2012 for reporting in January 2013. This reporting is for informational purposes only. The amount reported does not impact tax liability, as the value of the employer contribution to health coverage continues to be excludable from an employee's taxable income.



IRS Offers Employers a Break on Misclassified Workers

The IRS has announced a new program that allows eligible employers to voluntarily reclassify workers as employees, rather than as independent contractors, for future tax periods. In exchange, the employers' liability for potential past payroll tax obligations is reduced substantially. The Voluntary Classification Settlement Program (VCSP) is intended to increase tax compliance and reduce the tax and administrative burdens on employers with misclassified workers.

Employee vs. independent contractor issue

An employer enjoys several advantages when it classifies a worker as an independent contractor instead of as an employee. For example, it isn't required to pay payroll taxes, withhold taxes, pay benefits, or comply with most wage and hour laws. The services of independent contractors also are easier to terminate and, when terminated, don't impact the employer's unemployment tax account.

However, there's a potential downside: If the IRS determines that workers have been improperly classified as independent contractors rather than as employees, the employer can be subject to significant back taxes, interest, and penalties.

Without getting into the details that distinguish between employees and independent contractors for tax law purposes, we can report (and the IRS acknowledges) that proper classification often is not clear.

VCSP eligibility

The VCSP is available to employers that currently treat their workers, or a class or group of workers, as independent contractors. To be eligible, the employer must have consistently treated the workers as nonemployees and have filed required Form 1099s for the workers for the previous three years.

The employer cannot currently be under audit by the IRS or under audit concerning the classification of workers by the Department of Labor (DOL) or a state governmental agency. Employers that were previously audited by the IRS or DOL on classification issues are eligible for the VCSP only if they complied with the audit's results.

The employer isn't required to reclassify all of its nonemployee workers as employees. But, after an employer chooses to reclassify some of its workers, all workers in the same class must be treated as employees.

The terms

In exchange for reclassifying workers as employees, the employer's liability for past payroll obligations is cut to 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under Section 3509 of the Internal Revenue Code.

Under Section 3509, the tax rate for compensation up to the Social Security wage base (\$106,800 for 2010 and 2011) is 10.68% in 2010 and 10.28% in 2011. The rate for compensation above the Social Security wage base is 3.24%. Because the amount due is based on compensation paid in the most recent tax year, the 10.68% rate applies under the VCSP in 2011, and the 10.28% rate applies in 2012. The 3.24% rate applies for each year.

The IRS provides the following example: Consider an employer that paid \$1.5 million in 2010 to workers who are being reclassified, all of whom were compensated at or below \$106,800. The employer submits its application on Oct. 1, 2011, and proposes to reclassify the workers beginning on Jan. 1, 2012. (The application must be filed at least 60 days before the desired reclassification date.) In that case, 2010 is the most recent tax year, so the employment taxes under Section 3509 would be \$160,200 (10.68% of \$1.5 million). Under the VCSP, the employer must pay only \$16,020 (10% of \$160,200).

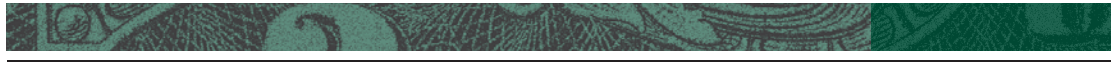
In addition to enjoying significant tax savings, the employer won't be liable for any interest or penalties and won't be subject to an employment tax audit on the classification of the workers in prior years. The employer, however, will be subject to a special six-year statute of limitations on the assessment of employment taxes for the first three calendar years following the date of reclassification. This doubling of the usual three-year limit provides a strong incentive for employers to continue correctly classifying workers going forward.

Review your worker classifications now

Before entering into the IRS's VCSP, employers should consider state and local tax implications as well.

If your company needs help determining how to properly classify workers, please call us. We can also help you decide whether you could benefit from the VCSP.

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Doing More Than Skiing: A Case Study

In May, Vail Valley Medical Center (VVMC), located in Vail, Colorado, contacted our firm to provide interim leadership to its Patient Accounting Department. VVMC needed someone who could immediately fill that void and work with its management and back-end staff while it conducted a search for a permanent replacement.

For four months, we provided weekly on-site management of the department. Our first priority was to work with VVMC Human Resources personnel to update the organization chart and job descriptions for everyone within the department. We empowered two supervisors to make daily decisions. Employee morale quickly improved after expectations and responsibilities were clearly defined.

Second, we provided guidance and oversight for initiatives designed to strengthen back-end processes and accelerate cash collections. Every open account balance was assigned to an internal team member or external agency for review and resolution. Aged accounts were reviewed for collectability and processed accordingly, while current accounts were prioritized and received aggressive, proactive, and diligent follow-up.

After the first 90 days of the engagement, it was evident that key performance indicators, including exceeding budgeted cash collection goals for the period, had greatly improved. Additional improvements included reducing total accounts receivable (A/R) and improving days in A/R and overall A/R aging.

	5/31/11	10/31/11
Total Accounts Receivable	\$51.1M	\$38.2M
Days in A/R	76.4	57.8
Third party A/R > 90 days	41%	26%

We were pleased to play a role in the success of VVMC during this recent transition period, and the effort, focus, and determination of VVMC's staff proved invaluable.

Charlie Crevling, VVMC's CFO, has this to say about our engagement:

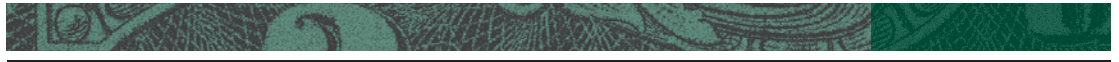
"When Vail Valley Medical Center needed leadership and expertise for our Patient Accounting Department, we turned to Dean Dorton Allen Ford. They have been a fantastic asset to our organization and have exceeded expectations with their results-driven approach. In addition to restructuring and streamlining our back-end revenue cycle processes, they exhibited the flexibility to adapt to the nuances associated with our people, processes, and technology. Thanks in part to their leadership and expertise, Vail Valley Medical Center was able to increase cash collections, reduce days in A/R, and improve A/R aging."

(Note: Vail Valley Medical Center management approved our publication of this case study.)

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Recent Federal Tax Legislation

- In 2005, Congress enacted legislation requiring **3% federal income tax withholding** on federal, state, and local government payments to contractors providing property or services. The effective date of this requirement was delayed many times and finally was repealed in November.
- Two expanded tax credits provide **added incentives for businesses that hire certain military veterans**. The "returning heroes" credit is up to \$2,400 for hiring a post-September 11, 2001 veteran who has been unemployed at least four weeks, increased to a cap of \$5,600 if the veteran has been unemployed for at least six months. The "wounded warriors" credit is up to \$4,800 and applies to a veteran with a service-related disability who has been unemployed for at least four weeks, increasing to \$9,600 if the veteran has been unemployed for at least six months. The credits are 40% of wages paid to qualifying veterans by the end of 2012.



Some Tax Rates and Amounts for 2012

FICA Base - Annual compensation to which Social Security applies increases to \$110,100 for 2012, up from \$106,800 for 2011. The Medicare tax continues to apply to all compensation.

Social Security Benefits - Individuals who are drawing Social Security benefits prior to attaining full retirement age will begin to suffer reductions in payments if they have earned income exceeding \$14,640 in 2012, up from \$14,160 in 2011.

Adjustments for Retirement Accounts - The maximum annual addition to a defined contribution plan increases to \$50,000 from \$49,000 for 2012. The maximum amounts that individuals can elect to contribute to employer-sponsored plans and IRAs for 2011 and 2012 are shown below.

Year	IRAs		SIMPLE Plans		Other Employer Plans	
	Annual Contribution	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution
2012	\$5,000	\$1,000	\$11,500	\$2,500	\$17,000	\$5,500
2011	\$5,000	\$1,000	\$11,500	\$2,500	\$16,500	\$5,500

The maximum amount of compensation that can be considered as the base for retirement plan contributions increases to \$250,000 from \$245,000 for 2012.

Section 179 Deduction - The maximum Section 179 deduction for 2012 is \$139,000, subject to a dollar-for-dollar phase-out range of \$560,000 to \$699,000 of qualifying property purchases in the year.

Estate Tax - As we write this, the maximum federal estate and gift tax rate for 2012 remains 35%. These transfer taxes apply to cumulative taxable transfers exceeding \$5,120,000 in 2012.

Gift Taxes - The annual exclusion for gifts per donee remains \$13,000 for 2012.

DDAF People News

Congratulations to **Nathan Plack**, who has successfully passed all sections of the CPA exam.

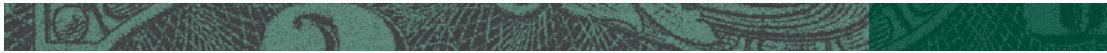
Mike Wade has joined our firm as a Director of Tax Services in Louisville. Mike graduated from Bellarmine University. Mike has considerable experience working with CPA firms and private industry. Most recently, he was Tax Managing Director at KPMG in Louisville. We welcome Mike as a member of our firm.

Lisa Blum has joined us in Louisville, where she is working with our Client Accounting and Payroll Services group. Lisa has ten years of experience in accounting and finance roles, mostly recently with Churchill Downs.

We also welcome **Natalie Calkins**, **Matt Jones**, and **Amy Miller**, each an experienced professional who will work from our Lexington office. Natalie graduated from the University of Kentucky, where she earned her BS and MS degrees in Accounting. She has been working with Deloitte in Cincinnati and she now is working with our Tax Services Group. Matt graduated from Asbury University with a BA in Accounting and then earned his MBA in Finance at Indiana University. Matt has joined our Assurance Services Group. Matt is glad to be returning to Lexington after living and working in Indianapolis. Amy is a University of Kentucky graduate with BS and MS degrees in Accounting. She has worked with another CPA firm for the last 6 years in Barbourville, KY, and now is working with our Tax Services Group.

We are pleased that **Brian Perry** and **Megan Mason** have re-joined our DDAF client services team.

Mike Good has joined our firm in Lexington as an IT Project Manager. Mike comes to DDAF with over 25 years experience in technology. His most recent experience with the Forcht Group included leading a team of System Administrators, implementing new infrastructure, and managing system-wide, large-scale projects.



DDAF People News
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Kevin Cornwell presented “Prepare for the Worst: Disasters & Technology” at the KY Non-Profit Leadership forum.

Doug Dean has joined the American Horse Council’s Tax Bulletin Advisory Committee and will be a contributor to its bi-monthly Tax Bulletin.

Doug Dean presented “Current Tax Topics for Construction Companies and Their Owners and Managers” at the Ohio Valley Construction Conference organized by the Kentucky Society of CPAs.

Mike Shepherd was re-elected to the Lexington Humane Society Board of Directors.

DDAF presented its annual Accounting Update at the Embassy Suites in Lexington. Attendees learned about the newest and pending accounting standards impacting public, private, and governmental entities. Additionally, we discussed the role of ethics in corporate culture and its importance in preventing fraud. Presenting were: **Richard Dorton, David Richard, Lance Mann, Crissy Fiscus, Elizabeth Woodward, and Jim Tencza.**

The matters discussed in these articles provide general information only. You should consult with us about your specific situation before undertaking action based on such general information.

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