



Memorandum

To: Clients, Associates & Friends of Pro@ctive CPA
From: Mark Wyssbrod, Managing Member
Date: September 6, 2011
Re: S-corporation & Small Business Economic Update

Introduction

I am still bullish for the small business environment for the remaining part of 2011. However, it is worth noting that individuals are becoming fatigued. Financial stress and exhaustion of modern life has led many people to mental stress. Under mental stress human behavior changes and people rationalize actions which are irrational to the average person under normal circumstances. In many cases, the situation has become desperate. As Horatio Nelson stated "Desperate affairs require desperate measures." But what is occurring is more sinister: desperate people are taking desperate actions. These irrational and desperate actions will prolong any recovery and extend this economic challenging era.

Be careful what you wish for! Many people wanted lower gas prices. Well we received them, but the cost what a stock market crash were billions of dollars of net worth was lost and a less robust economy. Perhaps high gas prices is the worse part of a good economy?

Another recession is looming! Historically, a recession occurs every four to five years (47 since 1790 in the United States). Before 2007 we had not had a recession for a number of years. Perhaps the average will catch up and we will have the next recession earlier than expected. Additionally, it should be noted, average tenure of a recession is misleading; the deeper the economic slow-down the significantly longer the resulting recession.

On a final note, banks cannot foreclose on many properties because they lost the original documentation and/or cannot prove they own the mortgage. Additionally, the US Federal Reserve stated it would hold interest rates low throughout 2013. My theory is banks will become very liberal for refinancing home mortgages. Individuals think they are getting a great deal (a super low long-term interest rate and banks are actually going to give them money). On the other hand, the banks will now be able to have the documents to prove they own the mortgage.

Take advantage of the current market opportunity and be ready to play defense very soon.

Best wishes,

Mark W.



S-corporation Update

With deficits overhanging our government Congress has given the green light to the Internal Revenue Service (IRS) to pick up enforcement. The IRS has targeted small business for their easy audit adjustments. The past several years the IRS rhetoric has increased especially in the s-corporation arena. S-corporation owners take heed!

- Officer compensation
 - The tax code requires officers of s-corporations to be compensated. Officer compensation must be "reasonable". Reasonable compensation may be translated into what is the fair market value of the compensation or what would you have to pay someone else for the same work.
 - The IRS has 40 years of tax court cases to prove the government has the right to set the officer compensation. The IRS wins the majority of the court cases with one basic premise: the company has rewarded the owners, but not the managers. As a result the equity distributions (not subject to Social Security and Medicare) get reclassified to compensation (subject to Social Security and Medicare)
 - What is a reasonable balance of officer compensation to equity distributions? Every situation is different, so what might be a good balance for some might not work for everyone. Generally speaking, a fair balance is no less than 50% in officer compensation and 50% or less in equity distributions.
- Shareholder Health Insurance
 - S-corporations have always been required to report greater than 2% owners employee benefits on their W-2
 - IRS Notice 2008-1 issued in December 2007 re-enforces this position
 - If the s-corporation wants to deduct employee benefits to these owners it must include them in the owners W-2. This includes health insurance and long-term care insurance. Generally speaking, the owner can then deduct these benefits on their individual return directly deductible against their income. If these benefits are not reported on the W-2 they may be indirectly (and limited) deduction against income.
- Equity Distributions
 - The IRS has demanded s-corporation behave as legal entities. This means each equity distribution must have a board meeting, vote and documentation of consent.
 - The IRS has successfully reclassified equity distributions to officer compensation (subject to Social Security and Medicare) when these formalities have not been followed.



- Shareholder Loans
 - The IRS has demanded all debenture notes be documented and approved by the board.
 - A loan document generally has the following components: lender, borrower, address, amount, interest rate, collateral\security and payment terms. Some loan documents have more complexities.
 - Imputed interest rate
 - If you have a related party loan with 0% (zero) interest rate and a balance over \$25,000 the IRS tells you how much interest you have to impute on the tax return. The imputed interest rate is based on IRS published schedule of the Federal Applicable Rate.
 - Therefore, if a shareholder has a loan to the s-corporation for over \$25,000, even if the s-corporation does not deduct interest expense on the loan, the shareholder is required to claim the interest income on their individual return.
 - If the shareholder has been advanced over \$25,000 at 0% documented loan, the s-corporation is still required to report interest income even though no interest will be collected from the shareholder

These are just a few of the major updates for s-corporation. To learn more and be more specific to your s-corporation call us.

Deadline Reminder

- 9/15/2011 - Final corporation, s-corporation, partnership and trust tax return filing deadline for 2010
- 10/1/2011 - Final day to set up SIMPLE retirement plan for 2011
- 10/15/2011 – Final individual tax return filing deadline for 2010
- 10/20/2011 – Georgia sales tax returns are due
- 10/31/2011 – 3rd quarter payroll tax returns are due
- 12/31/2011 – S-corporation shareholders (owner of 2% or more) must report their employee benefits in their W-2 (i.e. health insurance, dental insurance, HSA contributions, etc.)
- 12/31/2011 – Deadline to set up SEP, 401(k) and other retirement plans. You may need to fund the plans by this date as well



Black Swan Events

- August 2011 - US Congress waits to the final second to sign an agreement not to default on US debt obligations. Perhaps Congress should learn how to plan for major events instead of last minute reactions?
- August 2011 - Wide ride on Wall Street. As Main Street is stabilizing, Wall Street swung widely moving more than 500 points during the day for 6 consecutive days. Down ~5% and then up ~5% multiple days in a row. Does anyone know what anything is worth? Confusion leads to opportunity!

Date	Open	High	Low	Close	Point Range
11-Aug-11	10,729.85	11,286.39	10,729.85	11,143.31	556.54
10-Aug-11	11,227.92	11,227.92	10,662.04	10,719.94	565.88
9-Aug-11	10,810.91	11,251.08	10,588.55	11,239.77	662.53
8-Aug-11	11,433.93	11,433.93	10,779.05	10,809.85	654.88
5-Aug-11	11,384.29	11,634.04	11,126.32	11,444.61	507.72
4-Aug-11	11,893.79	11,893.79	11,365.74	11,383.68	528.05

Financial Ratio of the Month

Inventory Days (ID) is a measurement of the amount of inventory in days you have on hand. If you are a business that works with inventory, this will be an important ratio for you to follow.

The ID equals $(\text{Inventory}/\text{Cost of Goods Sold}) \times 365$

Generally speaking the lower the ratio the better (i.e. you are managing inventory effectively). However, too low of a ratio could indicate you do not have enough product on hand to meet demand.

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