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BIZ Spotlight

Don't You Believe It

by Martin C. Daks

With all of the complexity of the federal tax code—and the desire of so many people to minimize their financial liability under it—perhaps it's natural that some myths have developed around the subject. But acting on them can get you or your company in trouble, says Martin H. Abo, a principal in the Voorhees CPA firm of Abo and Co.

"One big issue is salaries and Subchapter S corporations," he says. Named after a section of the federal tax code, Sub S companies generally provide a degree of liability protection for their shareholders/officers and pass through the company's profit or loss to the individual owners.

"Some Sub S officers think that they'll save on Social Security, Medicare and federal and state unemployment taxes—which can exceed 22%—if they don't take a salary. Instead they'll call the payments S Corporation Distributions, or perhaps Officer's Loan," Abo says. *"They think they're being smart, but showing little or no salary expense on a Sub S return is like waving a red flag in front of an IRS agent."*

Instead, he says, salaries should be reasonable, based on the size of the organization and the responsibilities of its shareholders/owners.

Another myth Abo skewers is "audit roulette," or betting that IRS doesn't have the manpower to chase down every shady-looking return.

"Don't believe it," he warns. *"The IRS and state tax officials across the nation have established partnerships designed to combat abusive tax shelters and other schemes. For example, one category that's getting attention is automobile dealerships. The IRS says it has identified an increase in scams and fraud involving the automotive-sales industry and that its criminal investigation divisions is in the process of conducting investigations relating to tax evasion, employment tax fraud, money-laundering conspiracies and violations of the Bank Secrecy Act."*

Another popular myth concerns non-corporate consultants or independent contractors who don't get a 1099 form—a statement of miscellaneous income that goes to the IRS and to the person who received the revenue. Some people think the absence of a 1099 means they can forget about reflecting the income on their tax return.

"Taxable income is required to be reported on your tax return regardless of whether or not a 1099 is issued," Abo says. *"Besides, there are a number of ways to be 'caught' by IRS sophisticated software and audit techniques that will look at people other than the actual taxpayer."*

And don't even think of suggesting that a payer "forget" to issue a 1099. *"That one will put the contractor and his or her company at risk for serious penalties and scrutiny,"* Abo says. *"The federal and state taxing authorities are increasingly focusing their attention in this area and are imposing tough penalties that otherwise might be avoided."*

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