



IRS audit focus is on worker classification

One of the biggest headaches for business owners is the classification of their workers. If the wrong choice is made, the IRS could step in and assess additional taxes, penalties, and interest.

• **Most employers would rather hire contractors**, paying them as “independent” people and avoiding the imposition of any payroll taxes, worker compensation insurance, or other payroll-related benefits. This method is much cheaper for the employer and can be accomplished with much less paperwork. The IRS, on the other hand, stresses that workers that are truly employees must be classified as such, with the employer paying appropriate payroll taxes and benefits.

• **Simply calling an employee a “contractor” isn’t good enough.** There must be a reasonable basis to treat a worker as a contractor. If the IRS reviews worker classifications, they will be looking at the amount and type of control an employer has over the workers. If the IRS determines that workers who were classified and paid as contractors are really employees, additional payroll taxes (both the employer and employee portion), penalties, and interest can be assessed against the employer. Make

no mistake: these can be serious amounts of money.

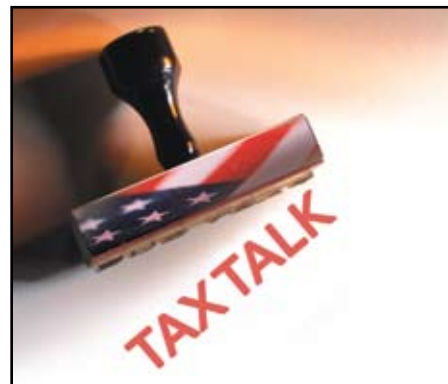
• **The IRS has developed twenty factors which are used** on a case-by-case basis to determine if a worker is an employee or contractor. No one factor determines the classification. Instead, all of the factors are weighed, and the preponderance of those factors determines the correct classification.

Some of those factors include the instructions and training given to the worker, if the worker performs services for other clients, the location where services are performed, how the worker is paid (hourly indicates an employee), if the worker has his own tools, etc. You should review all of the factors for any of your questionable workers.

The IRS is looking to reduce the tax gap (the difference between taxes owed and taxes paid). Therefore, the proper classification of employees (and the imposition of additional payroll taxes and penalties) has become a priority issue for the IRS. Don’t get caught in their sights. Make sure that your workers are classified correctly. Call us for assistance in walking the tightrope to the proper classification of all your workers. ♦

CLIENT UPDATE

This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.



Vehicle depreciation limits

The IRS has issued the depreciation limits for business vehicles first placed in service in 2008. Recent legislation allows higher limits for new vehicles that will qualify for 50% bonus depreciation.

The first-year limit for new cars is \$10,960; for used cars, it’s \$2,960. Depreciation limits for later years are the same for both new and used cars: \$4,800 in year two, \$2,850 in year three, and \$1,775 in all following years.

The 2008 first-year depreciation limit for trucks and vans is \$11,160 for new vehicles and \$3,160 for used vehicles. Limits for both new and used vehicles in year two are \$5,100, in year three \$3,050, and in each succeeding year \$1,875.

For details relating to your 2008 vehicle purchases, contact us.

Tax scam warnings

The Justice Department’s Tax Division recently announced the creation of a national “tax defier” initiative to “investigate, pursue, and, where appropriate, prosecute those who take concrete action to defy and deny the fundamental validity of the tax laws.” The IRS reminds taxpayers to be wary of scams and promises to avoid paying taxes that seem too good to be true, saying, “There is no secret formula that can eliminate a person’s tax obligations.” Taxpayers also need to be alert to tax-related scams designed to steal their identity for fraudulent purposes. ♦

Client UPDATE



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SUMMER 2008

Look for tax-saving options in new 2008 rules

The tax law seems to change year-to-year. This year is certainly no exception. With careful planning, you can take advantage of new tax-saving opportunities in 2008

while avoiding potential pitfalls. Here’s a summary of several key provisions.

■ Capital gains and dividends

The maximum tax rate on net long-term gains and qualified dividends for taxpayers normally in the 10% or 15% regular income tax brackets is reduced from 5% to 0% for 2008. Under current law, the 0% rate will remain in effect through 2010.

This may be a good year to have your children sell securities that have appreciated in value. However, such sales may trigger “kiddie tax” complications.

This tax break isn’t strictly limited to lower-income taxpayers. If you can push your taxable income for 2008 below the cut-off point for the regular 25% tax bracket – perhaps by increasing charitable gifts or 401(k) contributions – your long-term capital gains and dividend income could qualify for the 0% rate.

■ Small business assets

Under the new economic stimulus

law, your business can currently deduct up to \$250,000 of business assets placed in service in 2008. Previously, the inflation-indexed amount for this “Section 179 deduction” was \$128,000. In addition, a business may elect “bonus depreciation” in 2008 equal to 50% of the cost of qualified assets.

If handled correctly, your business can combine the enhanced Section 179 deduction with bonus depreciation. Regular depreciation deductions may be claimed for any remainder.

■ Mortgage insurance

Congress previously approved a one-year deduction for mortgage insurance premiums in 2007. A full deduction was available for taxpayers with an AGI of \$100,000 or less. Once income exceeded \$100,000, the deduction was phased out.

The new mortgage relief law extends this tax break for three years through 2010. Therefore, you may qualify for a 2008 deduction for amounts paid or accrued this year.

■ Kiddie tax

Under the kiddie tax, a child’s investment income above an annual threshold (\$1,800 for 2008) is taxed at the top tax rate of his or her parents. Prior to this year, the kiddie tax applied to children under age 18. But now the rules have changed.

Beginning in 2008, the kiddie tax generally applies to your children who are under age 19 or full-time students under age 24 if they can be claimed as your dependents.

To minimize the tax damage, try to keep investment income of children below or near the \$1,800 threshold. For example, you might have a child switch funds into tax-deferred or tax-free investment vehicles.

■ IRA contributions

If you contribute to an IRA, the contributions may be fully or partially deductible. Although deductions are generally not available to high-earning taxpayers if either spouse participates in an employer’s retirement plan, con-



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New 2008 rules
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tributions may still grow on a tax-deferred basis until withdrawn.

The contribution limit for the 2008 tax year increased from \$4,000 to \$5,000. Plus, if you're age 50 or older, you can add a "catch-up contribution" of \$1,000. The contribution deadline for 2008 is April 15, 2009, but you may earn more by contributing earlier.

Finally, a word about the new economic stimulus payments the IRS has been distributing: These rebates aren't available until you've filed your 2007 return, so taxpayers with extensions have to wait. Certain individuals who normally aren't required to file returns – such as those receiving social security benefits – may follow a simplified filing procedure.

Contact our office for details or guidance with your 2008 tax planning. ♦



MARK YOUR CALENDAR...

JUNE
16 – Second quarter 2008 individual estimated tax is due.
16 – Second quarter 2008 estimated tax is due for calendar-year corporations.

JULY
31 – 2007 retirement and employee benefit plan returns are due for calendar-year plans.

SEPTEMBER
15 – Third quarter 2008 individual estimated tax is due.
15 – Third quarter 2008 estimated tax is due for calendar-year corporations. ♦



YOUR RETIREMENT

Think before breaking your 401(k) nest egg

With today's shrinking home values, rising adjustable mortgage rates, and tighter loan

standards, many people are turning to their 401(k) plans as sources of needed cash. But early withdrawals can exact a heavy price, and even borrowing from a 401(k) can have adverse consequences.

- **Due to the tax effect, withdrawing funds** from a qualified retirement plan is not like taking cash out of your bank account. A 401(k) withdrawal is taxed as ordinary income, and if you're under age 59½, a 10% penalty usually will be added to the tax. Borrowing from a 401(k) generally is preferable to simply withdrawing the funds, because no tax applies to the loan proceeds.

However, many plans either restrict their participants' borrowing or don't allow borrowing at all. Where loans are permitted, they're individually limited to the lesser of \$50,000 or one-half of the borrower's plan assets. Most 401(k) loans require interest at one or two points above the prime rate, and the loans must be fully repaid within five years, unless the proceeds are applied to a personal residence. The borrower must sign a legally enforceable loan agreement and adhere to the agreement's terms.

- **If you leave your job with a 401(k) loan outstanding**, you'll generally have 30 to 90 days to either fully repay the loan or face being taxed (and penalized, if

you're under age 59½) on the outstanding balance.

When you repay the loan, you'll be paying with after-tax dollars, and you'll be taxed again on those dollars when you withdraw them upon retirement. And unlike ordinary mortgage interest, the interest paid on a 401(k) loan used to buy or improve a home is not deductible.

- **Borrowing from a 401(k) is an especially bad idea** for funding an ongoing cash need. For example, using the proceeds to offset a hike in your adjustable mortgage payments would only compound the problem. You'd be burdened with an additional loan, the proceeds eventually would run out, and the mortgage payments almost certainly would not go back down.

- **Finally, borrowing from your 401(k) tends to defeat the purpose** of participating in the plan in the first place – to accumulate funds for a comfortable retirement. Removing money from a fund slows its growth, particularly since most people must cut back on current contributions in order to make repayments.

Call us if you're thinking about borrowing from your 401(k) or you'd like to discuss other funding sources. We'll help you make the decision that's right for your individual circumstances. ♦

MANAGING YOUR BUSINESS

Customer Service: Does your business just say it or do it?

Many companies know how to SAY customer service; they just don't know how to DO customer service. Yet, good customer service leads to repeat sales and

referrals, which lead to higher revenues and profits. The result is a stronger, more secure business.

Your sales staff knows this well. Their results are directly affected by customer perceptions. Other employees, such as those in support and back office functions, may not think of themselves as serving the customer. But the fact is that every employee has an impact, direct or indirect, on the customer's experience. An incorrect shipment, a late delivery, or a mistake on an invoice, all result in poor service. A goal of your business should be to meet, and preferably exceed, customer expectations as often as possible.

How do you teach every employee that customer service is part of their job? The answer is a combination of communication, training, and good management.

- **Communication.** Make all employees aware of the importance of customer service to the business as a whole. Explain the role they play in achieving good service. Consider posting measures of sales for all to see. If appropriate, develop measures of accuracy or error-free performance and track and share the results.

- **Training.** Every employee with customer contact should be trained on good service, whether it's a salesperson, a receptionist, or a delivery driver. For those in support roles, emphasize how cooperation and teamwork can contribute to good service. Instill a culture that serving the customer is everyone's job.

- **Good management.** As the owner

or manager, your actions and your priorities set the tone for the company. Employees will follow your lead and pay attention to the things you consider important. Look for ways to measure customer satisfaction and show your employees that you're monitoring it. And don't overlook the other way to improve customer service – minimizing

the things that go wrong. Make sure you're aware of errors and complaints. Set goals for improved performance and hold people to them.

Finally, involve your employees. Make it clear that better service is a shared goal and ask for their suggestions. You might be surprised how well they respond. ♦



Turn a complaint into an opportunity

Nobody in business wants an unhappy customer, but when a customer complains, think of it as three opportunities in one.

- An opportunity to get free feedback on something that's not working right in your organization.
- An opportunity to convert a disgruntled customer into a loyal customer.
- An opportunity to head off negative publicity as the complainer shares his gripe with others.

How do you turn a complaint to your advantage? Here are the four steps you need to take.

1. The initial response.

The initial response to a complaint should be respectful and helpful, not defensive or "it's not our fault."

2. **Understanding the complaint.** Make sure you really understand the true com-

plaint. This is perhaps the most important part of the process. By allowing the customer to vent, you'll defuse a large part of the hostility and ill will. Also, this step provides valuable feedback to pinpoint the exact problem and find out exactly what went wrong.

3. **Fixing the problem.** Employees must know clearly who has the responsibility and the authority to fix a problem. You may choose to compensate the customer for inconvenience, but at a minimum, you must remedy the customer's immediate concern.

4. **The follow-up.** A supervisor or higher-level manager should always follow up with the customer to make sure that the problem has been resolved. This is a key step in turning the customer from "disgruntled" back to "loyal."

For assistance with this or any of your business concerns, contact our office. ♦

