Small Business
August 2010 – Special Issue
TAX STRATEGIES
Grow your profits—pay less tax
Business Management Daily

Action Line

■ **Expand your party guest list.** Are you hosting a get-together and inviting a few top-echelon employees? Invite the entire workforce instead. *Reason:* You can write off 100% of your cost instead of the usual 50% limit for entertainment deductions.

■ **Make it a tax-deductible sea cruise.** The IRS permits you to deduct up to $2,000 when attending a business convention or seminar held aboard a U.S.-flagged cruise ship. To qualify, you must establish that the cruise ship is U.S. registered and all ports of call are in the United States or its possessions. The business meeting must be the trip's primary purpose.

■ **Take the easier path to employment tax filing.** If your company expects to owe less than $1,000 in employment taxes annually, it can file Form 944, *Employer's Annual Federal Tax Return*, once a year rather than filing the quarterly Form 941.

■ **Use the new IRS web tool for retirement plans.** Uncle Sam has developed another interactive web tool for employers. Now you can determine your company's responsibilities under the Employee Retirement Income Security Act (ERISA) online. Access the ERISA Fiduciary Advisor at **www.dol.gov/elaws/ERISAFiduciary.htm**.

INSIDE

Create tax breaks: Buy parents' home, rent it back to them

Say your aging parents live in a home that has appreciated in value, but they're no longer reaping any of the homeownership tax breaks during their retirement years. Sound familiar?

Good news: With one stroke of the pen, both you and your parents can win: They'd gain instant access to their home equity (without moving) and you'd pick up some generous new tax deductions.

How? Buy your parents' house, and then rent it back to them—at the going rate.

Reasons for the sale/leaseback. Under the current homeownership setup, your combined family unit is overpaying the IRS.

Your parents' mortgage is either paid off or the payments represent mostly principal at this point. Even if they still take interest deductions, your parents' tax bracket might be low in retirement, so those deductions don't provide much tax savings. In fact, many retirees take the standard deduction rather than itemizing.

Here are two good reasons for your parents to opt into this plan:

1. It puts cash in their pockets without them having to refinance or dip into a home equity loan.

2. It allows them to put their money into safer investments than the real estate market.

Transferring the house. To avoid gift-tax complications, pay a fair price for the home. Support the buying price with a qualified and independent appraisal.

Continued on top of page 2

Grab 5 quick tax perks: Put spouse on payroll

Does your business need trustworthy and reliable employees? You may not have to look any farther than across the dinner table.

Strategy: Hire your spouse to work as an official employee. Why put your spouse on the payroll? Because you can gain five tax benefits:

1. Build up tax-favored funds for retirement

If you meet the tax-law requirements, your company can deduct contributions made to a qualified retirement plan on your spouse's behalf. The annual limits are quite generous. If your company has a defined contribution plan, you can deduct contributions up to 25% of compensation or $49,000, whichever is less.

With a 401(k) plan, another dollar limit applies: Your spouse can defer up to $16,500 to the plan (plus an extra $5,500 if he or she is age 50 or older). Your company can match those contributions wholly or partially up to tax-law limits.

2. Shift taxable income away from the company

If you operate a C corporation, any compensation you pay to your spouse would have to stay with the company. Assuming your corporation is in a higher tax bracket than your personal tax bracket, you'll save tax overall if your spouse draws a salary. But don't look for any income-shifting tax benefit—possibly a drawback—if your

Continued on bottom of page 2

Parents' home (Cont. from page 1)

Then, both sides should enter into a lease at a fair rental value.

One benefit: Courts have said that landlords can reduce their fair-market rent by 20% when renting to relatives. That lower rent reflects the savings in maintenance and management costs. (*L.A. Bindseil,* TC Memo 1983-411)

But don't set the rent too low; the IRS might say the rental home is really for your personal use. In that case, your deductions might be limited to mortgage interest and property tax, the same as if you owned a vacation home.

Taking deductions. Once you own your parents' house, you're entitled to reap the tax benefits of owning rental property.

That includes taking write-offs for operating expenses, such as utilities, maintenance, insurance, repairs and supplies.

You also can claim depreciation deductions for the home, but you can't depreciate the cost of the property apportioned to land.

So obtain an appraisal allocating the price paid between the depreciable structure and the nondepreciable land.

You can use these deductions to offset the rental income received from your parents. Any allowable tax loss will phase out for people with adjusted gross incomes between $100,000 and $150,000. You can take any suspended losses when you sell the house.

Bonus benefit: Once you own the house, you may be able to write off occasional travel expenses you incur when visiting the house (your rental investment).

Endgame: Eventually, your parents won't be able to live in the house. Then, you can sell it, rent it to another tenant or move in. If you move in and make it your principal residence for at least two years, you can sell it and shelter another $250,000 or $500,000 worth of capital gains: a true tax bonanza!

Grab 5 tax perks (Cont. from page 1)

company falls in a lower tax bracket than your personal bracket.

Note: S corporation owners and sole proprietors don't pay corporate income tax. You report business income on your personal return whether or not you pay your spouse a salary. So this could be a wash.

3. Get more tax mileage from business trips

Generally, you can't deduct the travel expenses attributable to your spouse if he or she accompanies you on a business excursion. However, if your spouse is a bona fide company employee and goes for a valid business reason, you may deduct his or her travel costs, including air fare, lodging and 50% of the meal expenses. The benefit also is tax-free to your spouse.

4. Cure health insurance coverage ills

If you're already paying more to cover your spouse under your company health insurance plan, hiring him or her shifts the expense to your company. Typically, your company can deduct your spouse's full health insurance cost.

Even self-employeds can write off 100% of the cost under a so-called Section 105 medical-reimbursement plan.

5. Join the employer-paid life insurance group

Your spouse is entitled to the same group-term life insurance coverage as your other employees.

Key point: The first $50,000 of employer-paid, group-term coverage is tax-free to an employee.

However, one catch for S corp owners: Generally, you can't deduct fringe benefits, such as group-term life insurance, for any employee who owns 2% or more of the company.

By extension, that rule also applies to an employee-spouse.

Stockpile Section 529 funds for the future

The amount you transfer to a Section 529 plan on behalf of a beneficiary qualifies for the annual gift-tax exclusion. Under the exclusion, you can give away up to $13,000 a year—or $26,000 for joint gifts made by a married couple—to an account for the beneficiary without paying any gift tax.

Strategy: Front-load your contributions to a Section 529 plan. The tax law allows you to give the equivalent of five years' worth of contributions up front with no gift-tax consequences. The gift is treated as if it were spread out over the five-year period.

For instance, you and your spouse might together contribute the maximum $130,000 (5 x $26,000) on behalf of a grandchild this year without paying any gift tax. If you have five grandchildren entering college soon, together you can contribute $130,000 to their Section 529 plans, completely free of any gift-tax consequences.

Tip: Any excess above the annual gift-tax exclusion may be sheltered by the $1 million gift-tax exemption.

Goodbye, income limits; hello, Roth: Convert or not?

The buzz about Roth IRA conversions is getting louder. And why not: Beginning in 2010, the IRS eliminated the prior restriction that disallowed conversions for taxpayers with an adjusted gross income (AGI) above $100,000.

Also, you can split the taxable income triggered by a 2010 Roth conversion evenly over 2011 and 2012. (You report 50% of the income in each of those years).

But should you convert to a Roth? That's another story.

Strategy: Crunch all the numbers. Don't assume that a conversion is right for you just because you can do it for the first time.

Also, if it makes sense, you might convert only part of your traditional IRA assets and leave the rest alone.

What's in the pot at the end of the rainbow? Qualified distributions from a Roth (e.g., distributions after age 59½ and after having a Roth IRA in existence for more than five years) are federal-income-tax-free.

Plus, you're not required to take minimum distributions after age 70½ like you are with a traditional IRA. These future benefits offer plenty of incentive to convert to a Roth this year.

Example: Say the total of the assets in all your traditional IRAs is currently valued at $500,000. You're 55 years old, married and you estimate that you'll be in the 35% tax bracket in 2010.

You also expect to begin taking withdrawals from your IRA in 15 years when you will be in the 28% tax bracket. Assume a 6% annual rate of return on your IRA investments.

Using Bank of America's Roth IRA Conversion Calculator (*see box at right*), the estimated future value of your traditional IRAs in 15 years is $914,527.

In contrast, if you convert to a Roth in 2010, the estimated future value is $950,092—or $35,565 more than if you leave the assets in your traditional IRAs.

On these facts, you will owe $175,000 in federal income tax in 2010 if you pay the full amount of the conversion tax liability this year. However, you can elect to defer the taxable income and spread it evenly over 2011 and 2012. This would result in a lower tax bill if your tax rate in those years goes down but a higher tax bill if it goes up. (You always have the option of reporting all the income from a 2010 conversion on this year's return if that looks like the better deal.)

This scenario seems to indicate you should go full steam ahead with a conversion of 100% of your assets. But there are other variables to consider. For example:

- **The calculation assumes** that you'll be paying the full amount of tax on the conversion with funds outside of your IRA. However, if you have to use some or all of the IRA assets to pay the tax piper, this will dilute or even wipe out the benefit of the conversion. In our example, you would be left with $825,614 if you had to pay the tax with IRA funds—$88,913 less than the amount you'd have if you left the IRAs alone.
- **The numbers will also change** if you've contributed to IRAs on a nondeductible basis. There's no tax on the portion attributable to these contributions.
- **Consider the impact** of any state and local income taxes owed in addition to federal income tax. This is especially critical if you live in a high-tax state.
- **The additional tax liability** on the conversion could push you into a higher tax bracket. Conversely, if you delay the conversion until you're in a lower tax bracket, you might benefit.

This doesn't have to be an "all-or-nothing proposition." A partial conversion may be preferable.

Let's go back to our example. Suppose you can afford to pay the entire $87,500 tax out-of-pocket if you convert 50% of the traditional IRA balances, or $250,000. Thus, the Roth conversion will produce a net benefit of $17,783: $475,046 with a Roth compared to $457,263 with the traditional IRAs.

But, the payoff for a Roth conversion will be significantly greater if you don't need to take any withdrawals. If your main objective is to preserve the biggest possible nest egg for your heirs, converting is almost a no-brainer. In the end, do what's best for you.

Online Resources

Here are several online Roth IRA conversion calculators:

- **http://moneycentral.msn.com/investor/calcs/n_roth/main.asp**
- **www.calctools.com/RothConversion.htm**
- **www.bankofamerica.com/retirementcenter**
- **https://www3.tiaa-cref.org/iracalcs/comparison_calc.jsp**

Crank up your 401(k) plan this year with auto-enroll feature

While many 401(k) plan participants jumped ship following the stock market's plummet in late 2008, some have slowly been returning to the fold.

Strategy: Add an "automatic enrollment feature" to your 401(k). This will generally encourage those employees still on the bubble to participate in the plan. In turn, you may be able to stockpile more money for your own retirement.

The Pension Protection Act of 2006 (the PPA) included several provisions designed to accommodate such plans. New final regulations issued in 2009 provide additional guidance.

But here's the rub: To qualify for the tax benefits, the plan can't discriminate in favor of highly compensated employees (HCEs).

The 401(k) plan must meet the participation and vesting rules applicable to all qualified plans. In addition, it must pass an actual deferral percentage (ADP) test for pretax contributions and an actual contribution percentage (ACP) test for matching contributions.

If the plan fails on either count, the employer is required to make corrective distributions to HCEs or kick in extra contributions for non-HCEs.

Thus, a low participation rate could trigger adverse consequences for you.

How automatic enrollment works: Instead of making employees go to the trouble of electing to make salary-reduction contributions to the plan, they are automatically enrolled for contributions unless they proactively opt out. The automatic contributions are allocated to qualified default investments (*see box for basic contribution requirements*).

Among other changes, the PPA created two types of automatic enrollment plans: qualified automatic contribution arrangements (QACAs) and eligible automatic contribution arrangements (EACAs).

Under the PPA, your company may limit the automatic enrollment feature to new hires or extend it to all employees. Also, you can automatically increase the percentage of salary allocated to employee accounts. For instance, the minimum contribution may increase from 3% in the first year of participation to 4% the second year, 5% in the third year and to 6% in the fourth year.

As long as the plan satisfies the safe-harbor nondiscrimination and notice requirements, it will be treated as a QACA. The new final regs clarify that the minimum QACA percentage depends on when the employee initially makes contributions under a default election. The default percentage must be applied uniformly if it is increased midway through the year. An employee may be excluded from a default election only if he or she made an affirmative election before the QACA became effective.

Notice for a QACA must be given within a "reasonable" period before the beginning of each plan year. The new regulations allow a window of 30 to 90 days.

The new regs also address the requirements for EACAs. An EACA allows participants who have made default contributions to choose to withdraw those contributions. Generally, the choice must be made no later than 90 days after the date of the first automatic contribution. The distribution is taxable to the employee in the year it occurs, but he or she won't be hit with the 10% penalty tax that generally applies to pre-age-59½ withdrawals.

The other requirements for EACAs, including default deferral rates and notices, are generally similar to the rules for QACAs.

Tip: Despite the new clarifications, this area remains a potential minefield. Consult a benefits pro for assistance.

Requirements for automatic-enrollment 401(k)s

Elective Deferrals By Employees	Employer Contributions
Automatic deferral must equal between 3% and 10% of compensation with: • At least 3% in the first year of participation • At least 4% in the second year of participation • At least 5% in the third year of participation • At least 6%, but not more than 10%, in any subsequent year of participation.	100% vesting after no more than two years under either of the following two options: **Option 1:** Matching contributions for nonhighly compensated employees (non-HCEs)* must equal 100% of elective deferrals up to 1% of compensation + 50% of elective deferrals of more than 1% up to 6% of compensation. **Option 2:** Automatic employer contribution must equal 3% of compensation.

*Matching contribution rate for highly compensated employees (HCEs) can't exceed matching contribution rate for automatically enrolled non-HCEs.

Tip: Employers must provide annual notice how the contributions will be invested in the absence of employee investment instructions.

Tax Court approves tuition deduction for MBA

A taxpayer who represented herself in a Tax Court tussle with the IRS has prevailed in a surprising new decision. *(Singleton-Clarke, TC Summary Opinion 2009-182)* The Court allowed the taxpayer to deduct almost $15,000 of tuition incurred to attain a master's degree in business administration (MBA).

Alert: The new case may open the door to deductions in similar situations. In the past, the Tax Court generally has interpreted the complicated rules on business education in favor of the IRS.

For example, if you take additional courses to better yourself at work, you may now qualify for big deductions—even if the education leads to a new degree.

Here's the whole story: You can deduct the cost of education as a business expense only if you pass one of these two tests:

1. The education is required by your employer or by law to keep your current job.

2. The education maintains or improves skills needed in your present work.

On the other hand, you can't deduct your expenses—whether or not you qualify under either test—if the education is needed to meet pre-existing minimum educational requirements of your current employment or if it qualifies you for a new trade or business.

This sounds simple enough, but the lines can become blurry when you apply the rules to real-life situations. In particular, it's often difficult to distinguish education that "maintains or improves" current job skills from education that qualifies you for a "new trade or business."

The Tax Court has traditionally treated coursework toward a master's degree as education that qualifies the student for a new trade or business. But there have been several noteworthy exceptions. Here's the latest example.

New case: The taxpayer worked as a registered nurse for 24 years at a number of hospitals, medical centers and long-term care facilities. In 2005, she began taking courses online from an accredited university. The taxpayer graduated with an MBA in health care management in 2008.

Although the MBA was not required for her job, the taxpayer believed the advanced degree would give her greater credibility and make her more effective in her present and future role as a quality-control coordinator.

The Tax Court ruled that the education did not qualify the taxpayer for a new trade or business. The MBA may have improved her pre-existing skill set, but she was already performing the tasks and activities of her trade or business. Therefore, the education expenses were deductible.

If you qualify under these rules, you can deduct the education expenses as business expenses. For employees, unreimbursed business expenses are deductible as miscellaneous expenses on Schedule A, subject to the 2%-of-AGI floor. Self-employed individuals deduct the expenses in full on Schedule C.

The expenses you may deduct as business education include:

- Tuition, books, supplies, lab fees and similar items
- Certain transportation and travel costs (*see box*)
- Other related expenses (e.g., costs of producing term papers or school projects).

However, you can't deduct personal or capital expenses, such as the cost of a new laptop or the value of leave time you use to attend classes.

Tip: If an employer pays for an employee's education expenses under a qualified educational assistance plan, the employee can receive up to $5,250 of annual tax-free reimbursements.

Commuting to school? Keep tax meter running

Don't forget to deduct the cost of your transportation to and from school as work-related education. This includes amounts spent for bus or train fares, cab fares and automobile expenses.

Strategy: Take the tax shortcut for deducting auto expenses. For 2010, you can use the standard mileage rate of 50 cents per mile, plus tolls and parking fees, for education-related travel. This saves you the hassle of tracking your actual commuting expenses to school.

Let's say you travel 50 miles round trip three nights a week for two semesters, with each semester lasting 16 weeks. The annual campus parking pass costs you $300. Under the standard mileage rate, you're entitled to deduct $2,700 (50 cents x 4,800 miles + $300).

Note that you also can deduct the transportation expenses incurred between your workplace and school if you go directly to school after work. Also, the cost of transportation from school to work is deductible if you attend school early in the day and go from class to work.

Tip: There are no tax-law limits on the distance you travel. So you can attend the school of your choice and deduct whatever it costs to go back and forth.

Shave employment taxes on shared employees

Maybe you've acquired separate companies or you split off a subsidiary from your initial operation. In either event, you own two or more business entities on the books.

Potential problem: If some of the employees work for more than one of the companies, you could be paying more employment tax than required.

Strategy: Assign a "common paymaster" for payroll matters. If you pay the shared employees from a single source, you won't overpay employment tax anymore. And employees don't have to wait until they file their tax returns to recoup their shares of any excess taxes.

It's a win-win situation for employers and employees.

Here's the whole story: Both employer and employee must pay an equivalent share of FICA employment tax. For 2010, the Social Security portion of the tax is 6.2% against a wage base of $106,800. Any amount above the wage base is still subject to the 1.45% Medicare portion of the tax. So, the entire FICA tax in 2010 for each employee is 7.65% on the first $106,800 of wages; 1.45% above that.

With a common paymaster, you pay less employment tax for shared employees who earn more than the wage base.

Example: You own a development company with a marketing subsidiary. The top marketing officer works for both companies and earns a total of $130,000 a year. She earns $100,000 from the development company and $30,000 from the subsidiary.

Because neither company pays the officer more than the annual wage base, both companies are responsible for employment taxes on her wages. The development company pays $7,650 for the year (7.65% of $100,000) and the subsidiary pays $2,295 (7.65% of $30,000) for a total of $9,945. The officer must pay an equivalent share of the FICA tax via withholding from her wages.

Better idea: If you designate the development company as the common paymaster, all of the officer's wages are paid from a single source. Now the combined business operation owes employment tax of $8,506 on her wages of $130,000 (7.65% of $106,800 and 1.45% of $23,200, the difference between $130,000 and $106,800). That's a savings of $1,439 ($9,945 – $8,506) for just one employee.

What about the employee? Normally, she would overpay employment tax for the year and file for a refund on her tax return. With the common paymaster arrangement, she gets the use of the money right away instead of "lending" it to Uncle Sam.

To qualify for this tax break, you must meet three requirements:

1. At least 50% of the officers of one company must also be officers of the other company.
2. At least 30% of the employees of one company must work for the other company.
3. One or more of the companies must own at least 50% of the other companies.

Tip: All employees, including those who work for only one company, are paid by the common paymaster. The primary company should draw the paychecks on a single account and keep the appropriate records.

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10 common tax return errors and how to avoid them

Don't rush through your tax return. Your haste can come back to haunt you in the form of penalties, interest and missed tax-saving opportunities. According to the tax pros, here are 10 common mistakes that plague individual filers.

1. Fuzzy math: By far the most common tax return error is faulty math. Numbers often are transposed, left out or added or subtracted incorrectly. And when a math error is repeated throughout your return, it can have a domino effect. Even if you use tax software, you're not immune. For instance, you may have entered the wrong numbers in the first place.

Tip: Double-check your entries. Don't take any calculations for granted.

2. Incorrect ID numbers: These nine-digit identifiers are the "passwords" to your return. It's easy to write down the wrong identification number for you or your spouse. Remember to check ID numbers for dependents such as your children or an elderly relative.

Tip: A mistake here could delay your return or, even worse, cost you a credit or deduction.

3. Discarded IRS labels: If you're still filling out a paper return, use the preprinted label with your name and address the IRS sent you. Even if the label is wrong—for example, you might have moved in the past year—correct it by hand. Similarly, use the proper address label for refunds or payments.

Tip: Using the preaddressed label also will ensure your return is directed to the proper processing site.

4. Wrong 1040 forms: There are three types of 1040s. Most of our readers must deal with the longer 1040, but other filers, such as your children, may be able to use the simpler 1040A or 1040-EZ. But the long Form 1040 includes more tax goodies.

Tip: You don't have to fill out every line on the form—just those that apply to you.

5. Omitted forms: Remember to include all W-2 forms (Copy B) to avoid delays in processing your return. Similarly, if you received a Form 1099-R reporting federal income tax withheld, you must mail Copy B of that form, too. Other forms required for extra tax deductions or credits are often omitted.

Tip: Put forms in the proper order following your 1040. Each form has an attachment sequence number in the upper right corner.

6. Unreported investment income: Based on your Social Security number, the IRS can keep tabs on your annual interest and dividend income. The information on the 1099s it receives may be cross-checked against the income you've reported on Form 1040.

Tip: If you receive a bunch of 1099s, it's easy to misplace one or inadvertently omit it. Keep them all organized to avoid any oversights.

7. Tax table entries: Watch out for the small print in the tax tables. You could easily misread the figures or use the wrong column for your tax filing status.

Even worse: You might use the wrong tax table if you're not careful.

Tip: Capital gains and losses require a separate computation on Schedule D. Work through a "sample" before you actually enter the figures.

8. Payment problems: If you owe a tax payment, make the check payable to the U.S. Treasury—not the IRS. Be sure the check is signed. Then simply include it in the envelope.

Tip: Don't staple the check to your Form 1040. When an IRS staffer pulls it off, it could rip or obliterate other items.

9. Missing signature: It's last but not least: Don't forget to sign your tax return. The IRS won't process a tax return that lacks a signature. This won't hurt as much if you filed early, but it could cost procrastinators a penalty on taxes due.

Tip: Before you seal the envelope, take one last look at the entire return.

10. Tardiness: Unless you're stranded on a desert island somewhere, there's no excuse for missing the tax filing deadline. The failure-to-file penalty is generally 5% of the tax owed for each month, or part of a month, for up to five months (maximum penalty of 25%). If your return is more than 60 days late, the minimum penalty for late filing is the lesser of $100 or 100% of the tax owed.

Tip: If you need extra time, file Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, for an automatic six-month extension (but this is not an extension to pay tax). Find Form 4868 at **www.irs.gov/pub/irs-pdf/f4868.pdf**.

Online Resources

Do you want more tax return assistance than you can get from **www.irs.gov**? Here are several other reputable Web sites:

- **www.unclefed.com**
- **www.taxmama.com**
- **www.taxsites.com**
- **www.fairmark.com**
- **www.taxhawk.com**
- **www.taxadmin.org**
- **http://taxes.yahoo.com**

Mail Call

Q I received an invitation for a free meal at an investment seminar. Is this taxable, if I go? B.R., Tinton Falls, N.J.

A No. The event is governed by the tax rules for meal and entertainment expenses. Therefore, as the recipient of the meal, you don't owe any income tax on this benefit. But it's not completely "free": Undoubtedly, you'll have to listen to a sales pitch from a financial planner, plus you may have to endure follow-up contacts.

Tip: If you pay to attend an investment seminar or convention, you can't deduct the cost, either.

Home office deductions: Stand on firm ground

Q In a previous issue, you stated that you could deduct home office expenses based on the number of rooms in the home. Do you have any authority for this statement? J.R.M., Largo, Fla.

A Yes. Typically, home office deductions are based on the percentage of business use (square footage of the business portion of the home divided by the total square footage). But the IRS says in Publication 587, *Business Use of Your Home*, a taxpayer *can* base the percentage on the number of rooms if the rooms are about the same size. Say you use one room of an eight-room house for business. The room is 300 square feet out of a total of 3,000 square feet. In this case, the "rooms method" (12.5%) yields a bigger deduction than the square-footage method (10%).

Tip: Access Publication 587 at **www.irs.gov/pub/irs-pdf/p587.pdf**.

Tap unique tax break on company stock

Q When my friend retired several years ago, she didn't roll over her company stock into an IRA. (She had bought some of the stock and her employer gave her some.) If she sells the stock, will it be taxed as capital gain? F.G., King of Prussia, Pa.

A Partially. Assuming your friend holds the company stock in a qualified retirement plan, she's eligible for a unique tax break: If a retirement plan distribution is paid in company stock, the retiree is taxed at ordinary income rates on the stock's original cost. Any appreciation is untaxed. When she sells it, the difference between the sales price and the original cost is taxed as capital gain.

Deduct education costs for child/employee

Q My kids work for my business and also attend college. I found a course on family business at a different college that I'd like them to take. If I pay for the course, can I deduct the cost? A.C., Oxnard, Calif.

A Based on this information, the costs would be deductible if they clearly improve the skills necessary for your children's current jobs or if you simply treat the company-paid costs as additional compensation paid to your kids. If you personally pay the tuition as a parent, you can't take the deduction. That's why it's best to have the company pay the course expenses.

Dividing the spoils of a spousal IRA

Q I retired in 2006, but my wife is still working. I'm now 66, and my wife is 62. We both have IRAs and we file a joint tax return. Can we both still contribute to our IRAs this year? A.K., Margate, N.J.

A Yes. Since you qualify for a "spousal IRA" and you're both over age 50, you have until April 15 to jointly contribute up to $12,000 to your IRAs (assuming either of you earned at least that much in compensation during the year). That maximum $12,000 contribution can be divided among your IRAs in any manner in which you see fit as long as no more than $6,000 is allocated to either account. You have until your tax return due date to make the annual contribution.

Tip: To delay mandatory distributions from the IRA, allocate more of the contribution to the younger spouse.

Submit Mail Call questions to: SBTSeditor@NIBM.net.

The Tax Ticker

Beware of phony e-mail from 'IRS.' We've said it before; we'll say it again: Never send personal financial data in response to unsolicited e-mail. The IRS says scam artists are sending e-mails to random people, telling them they're due a refund or under investigation. The message directs people to a fake IRS web site that asks for personal data. In reality, the IRS won't contact you via e-mail.

Need an old tax return fast? Contact your tax advisor. A new IRS service lets tax practitioners receive transcripts of clients' tax returns electronically in minutes. Taxpayers can still receive a free paper transcript of their returns within seven to 10 days by calling the IRS at (800) 829-1040.

Know the difference between gifts and compensation. If you give a favorite employee a big check at Christmas, you might consider it a gift, but the IRS will likely consider it income. That could be true even if the employee and owner are family. In one case, the IRS said payments to an owner's daughter (who was an employee) were for past services, not a gift. Talk with your tax pro if you face a similar dilemma.