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New Accounting Standard Would Require Leases To Be Booked As Assets And Liabilities

To Become Effective in 2013

While the focus over the past 12 months has been on the economy, health care and the expiration of the Bush tax cuts next year, the Financial Accounting Standards Board (FASB) has been working with the International Accounting Standards Board to merge its generally accepted accounting principles (GAAP) with international standards. One of the changes under consideration is how companies account for leases, which will have a significant impact on business financial statements.

Currently, leases of property or equipment are treated as operating or capital based on their terms. Operating leases (such as a lease for office space) result in the recognition of rent expense in the Company's financial

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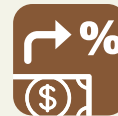
Dividend Taxes Set To Rise – Or Not

As Tax Cuts Expire, Tax Rate Changes Remain Unclear

According to The New York Times, "death may be certain, but taxes have never been less so." With the so-called Bush tax cuts set to expire at the end of this year, there is intense speculation as to what Congress will do between now and the end of the year. Will tax rates soar, as some expect and as many members of Congress seem to desire? Or will reason prevail? Given the current partisan atmosphere in Washington, the answer is far from clear – and the coming November elections may change the landscape dramatically.

As the current tax rate reductions expire at the end of this year, one of the more significant potential changes is the tax rate on qualified dividends. Under present law, qualified dividends are taxed at a maximum rate of 15% (for purposes of this article, state taxes and the effect of the alternative minimum tax are not considered). As of 2011, this preferential rate is set to expire and qualified dividends will be taxed at ordinary income rates which could be as high as 39.6%.

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IRS Announces Changes to Federal Tax Deposit Program

The IRS has proposed regulations expected to take effect on January 1, 2011 that would eliminate the rules for making federal tax deposits by paper coupon at local financial institutions. The paper coupon system will no longer be supported by the Treasury Department after December 31, 2010.

This change affects the way that businesses deposit payroll, corporate income and other federal taxes with the IRS. It does not change any of the rules for determining when tax deposits should be made, or for whether a payment can be mailed with a tax return.

As an alternative to the coupon system, the IRS operates the Electronic Federal Tax Payment System (EFTPS). This can be accessed via the internet at www.eftps.gov. Once enrolled, both individual and business taxpayers can securely transmit tax payments to the government. There are no fees charged by the government for this service. As an alternative, many banks via their on-line banking systems have provisions for transmitting federal and state tax payments for customers. You should check with your individual bank to see if this service is offered, and if there are any fees associated.

Many businesses that utilize outside payroll service companies figure that these are the only tax payments that need to be made, and are therefore already handled electronically. However, we find that occasionally, there is a need for a different tax payment to be made, so the need for an additional service exists.

The enrollment process for EFTPS takes time, so it is recommended that enrollment take place well before the end of the year, so that everything is in place to start the new year. ■



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New Accounting Standard Would Require Leases To Be Booked As Assets And Liabilities

statements with future rental payments disclosed in footnotes as a commitment. Under a capital lease, the underlying property is treated as if the lessee purchased and financed the item. An asset and related liability are recorded on the balance sheet, and instead of rent expense, amortization and interest expense are reported on the income statement.

The proposed new standard, which will be completed in 2011 and enacted in 2013, will require all leases to be accounted for as capital leases for both lessors and lessees. This can have a significant impact on the financial statements of many companies and could have significant implications for dealing with lenders and financial covenants.

As an example, a company enters into a lease for office space for a ten year period at a rent of \$100,000 per year. As of the date of signing, the lessee will record an asset and related liability for \$1 million. Most loan agreements contain covenants restricting the incurrence of additional debt, leverage (the total amount of liabilities in relation to equity) and debt service coverage (the amount of income which must be generated to cover future principal and interest pay-

ments). Most existing covenants were not formulated to allow for material changes in financial statements that may result from the recording of leases as capital leases. Without changes in documents, many of these covenants may be violated when these additional liabilities are recorded.

As currently written, the proposed standard contains no grandfathering clause, which means that any active lease will have to be recorded on the balance sheet immediately upon enactment of the standard. Companies will be required to record the cost of rent over the remaining term of the lease as a liability and record their right to use the space as an asset.

Landlords will also be affected by these new rules. At the time a lease is signed, lessors will be required to record a lease receivable and deferred revenue for the term of the lease.

If adopted as proposed, this new rule will become effective in 2013. Companies should begin evaluating the potential effect of this standard on their financial statements and considering these changes when either new financing or renewals of existing financing are made. Your representative at DHL&S can guide you through this process. ■

DHL&S Family News and Events

- Adam Formus has been promoted to Manager effective July 1, 2010
- Congratulations to Katie Regan on her marriage
- DHL&S 20 year anniversary is November 26, 2010
- Welcome new staff – A hearty DHL&S welcome to Adam Sterczala who has joined the tax staff and Dan Bresnick, Tony Wimperis and Jackie Bahi who have joined the accounting and auditing staff.
- Daisy Acervida rejoins the firm this month as a Senior Accountant.

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Dividend Taxes Set To Rise - Or Not

If you operate your business as a regular "C" Corporation, or even as an "S" Corporation, you may consider paying a dividend this year in order to minimize future tax liabilities. In addition, a provision of the recently passed health care reform will subject income from interest and dividends to the Medicare tax at a rate of 3.9% beginning in 2013.

As an example, assume a Corporation pays a dividend in 2010 of \$100,000 to its shareholder. That shareholder will pay \$15,000 of federal tax on the qualified dividend. If that same dividend is paid in 2011, that shareholder may pay as much as \$39,600 in federal tax (an increase of \$24,600 or 164%). Many current "S" Corporations were originally formed as regular "C" Corporations and have accumulated earnings that, if withdrawn, would be taxed as dividends. Prior to paying a dividend you also need to consider the impact on the Company of the distribution, whether it is allowed by the Company's lenders and the overall Company and personal tax situations of the owners.

There are several proposals in Congress to address these tax rate changes, but as of the current date, none have passed, and it is becoming more likely nothing will happen until after the November elections, leaving decisions to the lame duck Congress. What will happen then, once the new Congress is in place is unclear.

If you would like to discuss the impact of paying a dividend before the end of the year, or discuss other strategies to protect your company and family in this uncertain environment, please contact us. ■