Pittsburgh ▪ Columbus

OnPoint

A publication of Schneider Downs & Co., Inc.

SCHNEIDER DOWNS

INSIGHT ▪ INNOVATION ▪ EXPERIENCE

Winter 2008 ▪ Volume 26 ▪ Issue 1

>> IN THIS ISSUE — CONTENTS

1 S Corporations Under the Microscope
2 Certain Taxpayers Might Benefit from a 0% Tax Rate
3 Reducing Costs in a Tightening Economy
4 Corporate Finance Seminar a Success
4 Wealth Management: Question of the Quarter
5 SD in the News
5 New Hires
6 Professional News

KEY TAX DATES

MARCH

31

Information Returns - Electronic Filing. Due date for filing Form 1098 (for reporting receipt of mortgage interest) or Form 1099 (for reporting certain payments) with the IRS electronically (not by magnetic media).

APRIL

15

Individuals. Income tax and self-employment tax returns of individuals for calendar year 2007 (Forms 1040, 1040A or 1040EZ).
Last day for calendar-year individuals to file application (Form 4868) for automatic six-month extension to file 2007 income tax return.

Estimated Tax. Calendar-year corporations pay 25% of estimated tax if requirements are met before April 1, 2008. Payment of first installment of 2008 estimated taxes by calendar-year individuals.

Partnerships. Last day for filing income tax return (Form 1065) for calendar year 2007.

Trusts and Estates. Fiduciary income tax return (Form 1041) for calendar year 2007.
Last day for calendar-year estates and trusts to file application for automatic six-month extension to file 2007 income tax return.

FEATURE STORY

S CORPORATIONS UNDER THE MICROSCOPE: TWO HOT ISSUES

by Kathy D. Petrucci, Senior Tax Manager

The IRS has its hands full with S corporation noncompliance. As a result of IRS concerns, S corporation audits increased 26% in 2007.

With such increased attention, S corporation shareholders should be aware of these two hot issues:

- Reasonable Shareholder Compensation
- Shareholder "Open Account Debt"

Reasonable Shareholder Compensation

Although the issue of reasonable compensation is not a new concern for the IRS, it continues to be the main driving force behind the increase in S corporation audits. The reason is that the IRS is hoping to recover unpaid payroll taxes on shareholder wages disguised as distributions.

Since wages are subject to payroll taxes and S corporation distributions are not, some S corporations are reducing shareholder wages and increasing shareholder distributions, as a tactic to reduce payroll taxes. If the amount of compensation paid to a shareholder-employee is below a "reasonable" amount, the IRS might attempt to reclassify the distributions as compensation subject to payroll taxes. In that case, significant penalties and interest can be incurred.

To avoid such reclassification, compensation for shareholder-employees should be based on the same criteria as is salary for non-shareholder employees. Factors would include the shareholder-employee's qualifications and role in the company; complexities of the business; amount of hours worked; prevailing market rates; and so forth. Compensation is considered to be reasonable if a non-shareholder would be willing to accept the job at the proposed salary level. No compensation or compensation that is below a reasonable amount is problematic, and will likely attract the attention of IRS auditors.

Generally, the IRS will grant the S corporation some latitude in setting compensation for shareholder-employees. However, try not to give the IRS ammunition for reclassifying distributions as wages. Avoid problems by paying a reasonable salary, and if distributions based on stock ownership are made, document them as such in the corporate minutes.

Shareholder "Open Account Debt"

Proposed regulations issued in April of 2007 add new heat to this old IRS headache.

The proposed regulations would limit the use of "open account debt" used to deduct shareholder losses. The regulations are a response to a loss the IRS suffered in the 2005 Brooks v. Commissioner tax court case (Brooks).

In Brooks, the shareholders of an S corporation advanced funds to their S corporation to deduct losses. The shareholders then withdrew the funds at the beginning of the next year, and then again advanced funds at the end of that year in order to deduct that year's losses. This situation continued over several years, allowing the shareholders to defer income recognition over and over. The IRS took the position that the multiple loans were separate transactions, and should not be considered to be open account debt. However, the tax court held that the multiple advances by the shareholders and repayments by the corporation constituted open account debt under the current regulations

Continued on Page 6

Certain Taxpayers in the 15% Income Bracket Might Benefit from a 0% Tax Rate on Capital Gains

by Nancy L. Skeans, Schneider Downs Wealth Management Director and George E. Adams, Senior Tax Manager

A little extra income tax planning may go a long way in 2008 through 2010 for certain taxpayers.

The 0% tax rate on long-term capital gains and qualified dividends first appeared in the Jobs and Growth Tax Relief and Reconciliation Act of 2003 (JGTRRA). That Act created the 15% rate on long-term capital gains and qualified dividends for higher income taxpayers through 2008, plus the 5% rate in 2007 and 0% rate in 2008 for lower income taxpayers. In May of 2006, President Bush signed into law the Tax Increase Prevention and Reconciliation Act of 2006 (TIPRA), extending these rates through 2010.

Specifically, in 2008 through 2010, taxpayers in the 15% income tax bracket and below will pay 0% federal income tax on some or all of their long-term capital gains from the sale of stocks or mutual funds. This 0% rate also applies to qualified dividends. At the end of 2010, these special rates expire and income tax rates revert back to the rates in place as of 2002.

For single individuals to take advantage of these rates, taxable income must be below $32,550. For married individuals, taxable income must be below $65,100, and for individuals qualifying as heads of household, taxable income must be below $43,650.

A few words of caution: (1) the realized capital gains and qualified dividends are included in taxable income, so one's taxable income from other sources must be fairly low for a benefit to be derived, (2) Congress shut the door on taking advantage of this 0% rate with college-aged children by extending the kiddie tax rates in 2008 to children as old as 24 if they are still full-time students and dependents of their parents, and (3) the special rate does not apply to an individual's collectibles gain, Code Section 1202 gain, or unrecaptured Code Section 1250 gain, all of which are taxed at 28%, 28% and 25% respectively.

Although it may sound unlikely that this 0% rate can benefit you, don't stop reading yet. We have a few planning opportunities that just might work for you or a family member.

Scenario 1 – You are self-employed and have the ability to shift your taxable income into the future.

Scenario 2 – You are recently retired or you retired early and have a small pension or no pension. Perhaps you were thinking about using that IRA to help meet your living needs in 2008 – 2010, but you have the ability to defer taking distributions. This might also be the case with social security – you have the ability to start claiming social security benefits as early as age 62, but perhaps you can meet your cash flow needs if you delay that starting point.

Scenario 3 – Your have a single or married child who is making less than the taxable income limit, and you have the ability to help them by making a gift of appreciated stock that can then be sold by the child.

If the income limit is close, how can this individual further reduce their income to try to take advantage of the 0% tax rate? If employed for a company with a 401(k), have the child contribute as much as possible to the company's retirement plan. If the child's employer does not have a 401(k), keep in mind that up to $5,000 can be contributed to an Individual Retirement Plan (IRA).

The benefits in this planning scenario can be two-fold. If you have the ability to help your child in this manner, not only will less tax be paid to the U. S. Treasury, but by coupling the gift with increased contributions to a retirement plan, you are also helping lay the groundwork for a more secure retirement for that child.

Scenario 4 – Gift appreciated securities in lieu of cash to a parent or sibling or a low-income individual who you are already helping to support. Again, this individual would sell the stock and report the gain on his tax return.

If you believe that your income is below the taxable income levels provided, or if you have some ability to control your taxable income, ask your tax preparer to run the numbers for you. Additionally, if you are in a position to make gifts of appreciated securities to someone else who can benefit from these rates, please talk to your tax preparer first. Keep in mind, when making gifts to others, the gift tax rules also apply.

Nancy Skeans is Director of Schneider Downs Wealth Management. She has over 15 years of experience providing financial and individual tax planning services to corporate executives and high-net-worth individuals. George Adams is a Senior Tax Manager. He has advised clients with the Firm since 1997 and has 13 total years of experience in all areas of tax planning, research and compliance, accounting and financial reporting matters for closely held businesses.

FEATUREARTICLE

Reducing Costs in a Tightening Economy *by Richard X. McKenna, Technology Advisors Manager*

Depending on who you listen to, the economy may or may not be falling into a recession, or at the very least, a general slowdown. In either case, now is the time for organizations to identify ways to reduce costs in day-to-day operations.

The challenge then becomes: "Where do I begin?" Here are some proven suggestions for lowering costs and saving money.

Energy-Saving Initiatives

Motion-sensitive light switches: Install motion-sensitive switches that automatically turn off lights when a room in not occupied. This simple technology can be employed throughout your location, especially in the lunch room, rest rooms, conference rooms, tool rooms, and offices—for significant cost savings.

Energy-efficient light bulbs: Depending on your situation, the simple act of replacing traditional light bulbs with energy-efficient bulbs can bring huge savings. In fact, the government is offering programs to encourage employers to switch to high-efficiency light bulbs. The savings are especially significant for larger manufacturing or warehousing facilities.

Alternative fuels: Depending on your organization, you might want to consider implementing some percentage of alternative fuels into your operations. As technology improves, alternative fuels are becoming more attractive and more readily accessible.

Cost-Saving Initiatives

Waste Management: A huge cost-saver! Examine each step in your processes, and determine which resources or materials can be recycled or reduced. Upon examination, you'll likely find that material waste, labor waste, and other elements can be drastically reduced. Simple things like reducing interoffice paper use, using double-sided copies, and report printing can bring a significant return in cost-savings.

Consignment Inventory: Depending on your industry, you may be able to talk to your suppliers about using consignment inventory. A consignment program allows you to keep inventory at your location, but only pay for it when you use it. Such arrangements have become a common means to increase cash flow, and many suppliers will discuss consignment programs with you.

Insurance Deductibles and Co-pays: Although there is risk associated with this suggestion, you can consider reducing your insurance premiums by increasing the amount you pay as a deductible. In order for this strategy to be effective, you will need to have a strict risk management program in place. If you provide healthcare coverage to your employees and their family members, another strategy is to have the employees share more in the cost of the healthcare insurance via increased co-pays.

Richard X. McKenna
Manager
SCHNEIDER DOWNS TECHNOLOGY ADVISORS

Outsource: Move cost and overhead out of your organization. Identify operations within your business that you might outsource to derive greater value. The internal audit function, human resources, payroll processing and IT support are typical areas to evaluate. In fact, outsourcing basic services such as landscaping, plant maintenance and fleet vehicle maintenance could be cost beneficial to your company. Any activity that does not have a direct impact on the product or service you provide might be less expensive if you outsource it.

People Initiatives

Employee Wellness Programs: Some insurance companies are offering reductions or incentives on their premiums if you implement a wellness program for your employees. Activities that improve employee health might reduce injuries or sick days, and could result in a reduction of premiums and an increase in productivity.

Limit Overtime: Unchecked, overtime can be costly. Implement a program that eliminates all overtime unless it is approved by management. Before approving overtime, managers need to analyze: "What is the benefit of working overtime?" Authorize overtime only when the benefit is significant.

Reduce Employee Turnover: A constantly changing workforce is expensive. You have time and money invested in your employees. You need to keep them. Otherwise, lack of experience and lack of training will detract from production and effectiveness. Implement an employee retention program that addresses all areas of retention including pay, work schedules, benefits and other concerns.

Contract Employees: Depending on your organization, positions might exist that can be filled by contract employees. Typically it is less expensive to hire contracted employees than to hire full-time employees. Some positions in IT, claims, or accounting can be filled by contract employees.

Your organization might be able to take advantage of some of these ideas. We suggest forming a task force that is charged with identifying potential areas of cost savings and define a rewards program for goals achieved.

Richard McKenna is a manager with the Technology Advisors. He has worked in a wide variety of industries, including sales, hospital administration, manufacturing and distribution, trucking, aircraft maintenance, machining, project management and productivity improvement consulting.

NEWS YOU NEED

Corporate Finance Seminar a Success

On December 5, Schneider Downs Corporate Finance hosted its 7th annual Pittsburgh Mergers & Acquisitions Seminar, "Building and Preserving Value in a Family Business."

The panel consisted of Stan Sheetz, President & CEO of Sheetz, Inc.; Ann Dugan, Founder, Executive Director and Associate Dean of the Institute for Entrepreneurial Excellence, part of the Joseph M. Katz Graduate School of Business at the University of Pittsburgh; and Tricia Warrick, Managing Director of Schneider Downs Corporate Finance. Peter Lieberman, Managing Director of Schneider Downs Corporate Finance, served as moderator.

Mr. Sheetz, Ms. Dugan and Mrs. Warrick talked about their experiences with family businesses to an audience of more than 100 people. Mr. Sheetz, a family business owner, talked about the challenges he faces running the business alongside other family members. Ms. Dugan discussed her experiences providing consultation to family business owners and the common roadblocks they face. Mrs. Warrick, an investment banker, strategic advisor, and family business participant, discussed situations that commonly affect family businesses.

Schneider Downs Corporate Finance will be hosting its annual Columbus seminar in the spring. For information regarding either seminar, please contact Peter Lieberman at (412) 697-5364 or plieberman@schneiderdowns.com.

Q & A

Schneider Downs Wealth Management Advisors, LP

Question of the Quarter

Q. How should long-term investors deal with market volatility?

Although the ups and downs we are currently experiencing in the equity markets may seem abnormal (and certainly feel disquieting), when compared to historical market volatility, recent events are not abnormal at all. Stock market declines are a normal part of investing. If we look back at the Dow Jones Industrial Average from 1900 through 2006, here are a few interesting data points we find:

(1) The Dow Jones Industrial Average loses 5% or more on average three times each year.
(2) On average, it loses 10% or more about once a year.
(3) A 15% or more loss occurs about once every two years, and
(4) A 20% or more correction occurs about every 3.5 years.

Ultimately, after each loss, the Dow Jones Industrial Average has recovered. The average recovery period varies upon the depth of the loss; the greater the loss, the longer it takes for the recovery to occur. In the worst case, a loss of 20% or more, the recovery period is generally 332 days, or less than one year.

Will this time be any different? What if the U.S. has a recession? What if there is a global recession? We really do not have to look back very far to find a recent experience to draw upon. The U.S. economy did experience a recession from March 2001 through November 2001. What followed, beginning in late 2002, were several years of very positive market returns around the world.

What can we learn from market declines? Market declines are hard to predict, perhaps impossible, so trying to time when to be in or out of the market is just as impossible. Therefore, the best lesson that investors can take away from experiencing this recent period of volatility is to ensure that their investment portfolios are structured to meet their short term and long term goals. Fear, speculation and greed influence investors and investment returns. They propel short-term investors to chase what is working regardless of valuation and to throw out the good with the bad when signs are troubling. Long-term investors, unfortunately, have to survive these periods too. Individuals who periodically sit down with their financial advisor to examine goals, time horizons, risk tolerance, and financial circumstances are more prepared financially and mentally to deal with the inevitable bouts of market volatility.

A second lesson for investors is to ensure that their investment portfolios are broadly invested both within an equity size and style and across many types of asset classes. Although it currently feels like nothing in the equity markets is working right now, i.e., it appears that all equity classes, U.S. and internationally, have gone down, this is a short-term reaction to recent events and concerns. As the extent of the "real" problems are identified, equities in the non-problem areas will start to become attractive again, as will equities of countries that are experiencing growth. We believe that the broadly diversified investor will lose less in periods of volatility such as we are currently experiencing, and ultimately will recover more quickly in the long term.

SDANNOUNCES

SD IN THE NEWS

Ann Giacobbi, a manager in Internal Audit, has begun teaching a course this semester at Saint Vincent College in Latrobe, Pennsylvania. The course, "Seminar in Advanced Audit," is team-taught alongside Dr. Robert DePasquale, who is a professor of accounting at Saint Vincent College. The course is in its novice year, as is Ann's teaching career. She and Dr. DePasquale developed the course for graduate students at Saint Vincent. Ann is thrilled to be teaching the course, and even hopes the course will cross into the undergraduate program.

The course centers on case studies and life experience. Students are asked to choose experiences from their careers and apply aspects of what they are learning. This makes the class more hands-on and involved: Instead of relying on examples that students might not relate to, the students get to put what they learn into practice, using experiences that are familiar to them. The course also focuses on the Sarbanes-Oxley Act and how it affects different processes. Ann says she's excited to teach and would like to continue to do so in the future, teaching a night class here and there.

New Hires

Our people are our greatest strength. We welcome our October, November and December new hires:

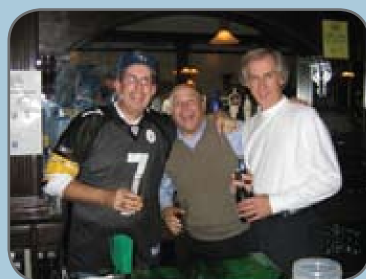
Sarah E. Ault
Christopher R. Debo
Natalie K. Friend
Jonathan B. Giglio
Michael J. Hain
Matthew M. McKinnon
Nicholas P. Nelson
Bridget A. O'Brien
Roselyn C. Ogbonnaya-Odor
Charles A. Oshurak
Susan M. Paulauskas
Debra A. Ries
Christopher L. Watson
Christopher F. White

WELCOME

Around SD

Annual United Way Campaign

Schneider Downs held its annual United way campaign this past fall in both the Pittsburgh and Columbus offices. Together the offices raised more than $86,000 from a series of activities including Jeans Days and various raffles and auctions. The Pittsburgh office also held a Guest Bartender Night, a pot-luck luncheon and a casino night. The Columbus office held a chili cook-off, a bakery cart, an office chair race, a candy-counting contest and an "Identify the Baby" contest.



The guest bartenders: Ray Buehler, Tim Hammer and Paul Matvey.

Ray serves a patron at the Pittsburgh office's Guest Bartender Night. Tips collected were donated to the United Way.

Caricature artist Sam Thong created this portrayal of the three guest bartenders.

Maria Stromple, Mary Richter and Judy Due contribute to the United Way fundraiser.

Darlene Nelson gets ready to take over for Carrie Giffin, during the Columbus office's office chair race.

Nick Nelson and Jessica Cooper race around the corners and past Matt McKinnon, to the benefit of United Way..

Winter 2008 • Volume 26 • Issue 1

ONPOINT

CHANGE SERVICE REQUESTED

Schneider Downs

1133 Penn Avenue
Pittsburgh, PA 15222-4205
TEL 412.697.5200
FAX 412.261.4876

Huntington Center, Suite 2100
41 South High Street
Columbus, OH 43215-6102
TEL 614.586.7200
FAX 614.621.4062

www.schneiderdowns.com

S Corporations

Continued from Page 1

and as such, only the net debt balance at the end of the year mattered. By restoring the basis in their debts, the advances that the shareholders made to the S corporation shielded them from realizing gain on loan repayments made during the year.

The proposed regulations would split open account debt into multiple loans if the balance of the open account debt exceeds $10,000 on any given day. The principal amount of the debt on that day would be treated as a single debt. Future advances would not increase that debt, but would start a new debt. Thus, a shareholder would have taxable income when the S corporation repays the single debt to the extent the repayment exceeds the shareholder's debt basis in that debt. Debt under the $10,000 amount will be treated the same as it is under current law.

As of December 31, 2007 these regulations were still in proposal form, however, final regulations should be forthcoming sometime in 2008.

PROFESSIONAL NEWS

Eric Wright, Technology Advisors Shareholder, James B. Yard, Internal Audit Shareholder, and Donald R. Owens, Director, Internal Audit and Risk Advisory Services, conducted a seminar on Sarbanes-Oxley for the Central Ohio Chapter of The IIA.

Gennaro J. DiBello, Tax Shareholder, was profiled by Vault.com for "View From the Top: Advice from Finance Professionals."

Jeffrey A. Wlahofsky, Tax Shareholder, John R. Null, Audit Shareholder, and M. Kent Moorhead, Tax Senior Manager, attended the AICPA's First Annual Oil and Gas Conference in Denver, CO.

David E. Kolan, Audit Shareholder, attended the IGAF European Tax and Corporate Finance Meeting in Brussels, Belgium.

Jennifer R. Cowles, Tax Manager, attended the Federal Real Estate Conference in Washington, D.C.

Karl W. Kunkle, Wealth Management Shareholder, and Jeffery A. Acheson, Director of Retirement Planning and Employee Benefit Services, attended a 401(k) Summit in Orlando, FL, sponsored by ASPPA.

Eugene M. DeFrank, Audit Shareholder, was quoted in the *Pittsburgh Business Times* article "U.S. Takes Steps to Switch to Global Standards."

Mary D. Richter, Tax Shareholder, presented Transfer Pricing Rules and R&D Credit at the Columbus Chamber's "Business Seminar Series: Accounting" in November.

Eugene M. DeFrank and John R. Null, Audit Shareholders, attended the IGAF Annual Accounting and Auditing Conference in Scottsdale, AZ. John was the key speaker for the Accounting and Auditing update.

Jeffrey A. Wlahofsky, Tax Shareholder, attended the 28th Annual Tax Conference and presented the Federal Tax Update.

Timothy D. Adams, Director, State and Local Tax Services, served as the Co-Chair of the Western Pennsylvania Tax Conference. Susan M. Kirsch and Mark E. Cobetto, Tax Shareholders, were presenters.

Paul M. Matvey, Tax Shareholder, has been appointed to the Duquesne University Athletic Advisory Board and the Central Catholic High School Board of Directors.

Beth L. Friday, Audit Senior, has been appointed to the Duquesne University Athletic Advisory Board.

Ann M. Giacobbi, Internal Audit Manager, received the Alumna Achievement Award at the Alumni of Distinction Dinner at Saint Vincent College.

Daniel P. Phillips, Tax Shareholder, was quoted in the *Pittsburgh Business Times* article "Tax Fix Temporary Patch, Could Hit More in '08."

Mary D. Richter, Tax Shareholder, and Michael S. Collins, Assistant Director of Human Resources, spoke to the Beta Alpha Psi chapter at the University of Pittsburgh regarding careers in public accounting.