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# Client Update

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**Higher Social Security Tax Base for 2009**

Up to \$106,800 in earnings will be subject to Social Security tax in 2009, a jump of \$4,800 from the 2008 ceiling of \$102,000. According to the Social Security Administration, the increase in the tax base will mean higher taxes for about 11 million taxpayers out of the estimated 164 million workers who will pay Social Security in 2009. The increase is based on the rise in average wages. The increase in the tax base accompanies a 5.8% increase in monthly Social Security benefits for 2009, the largest benefit increase since 1982.

**Employees.** Employees earning \$106,800 or more in 2009 will have the maximum Social Security tax of \$6,622 (6.2% Social Security rate x \$106,800) withheld from their wages. The 1.45% Medicare tax applies to all wages with no ceiling.

**Self-employed individuals.** Self-employed individuals pay both the employer and employee portions of the Social Security and Medicare tax on Schedule SE (Form 1040), after reducing net earnings by 7.65%. For 2009, the 12.4% rate for Social Security will apply to the first \$106,800 of net earnings (after the 7.65% reduction), for a maximum of \$13,243. In addition, the 2.9% Medicare rate applies to all net earnings (after the reduction). As in prior years, an income tax deduction will be allowed on Form 1040 for 50% of the self-employment tax liability figured on Schedule SE.

**Social Security benefits reduced for earnings before full retirement age.**

Eligible individuals who are at least age 62 may begin to receive reduced Social Security benefits. Earnings from work reduce the benefits for the months before full retirement age reached. Full Social Security retirement age is 66 for those born in 1943-1954. For benefit recipients who have not reached full retirement age in 2009, benefits will be reduced by \$1 for every \$2 of earnings over \$14,160. If full retirement age will be reached in 2009, \$1 of benefits will be withheld for every \$3 of earnings over \$37,680, but the reduction applies only for months prior to attaining full retirement age. There is no reduction for earnings starting

with the month in which full retirement age is reached. The reduction formula will be adjusted if 2009 is the first year for receiving benefits. In that case, a full benefit may be received for any month in which earnings do not exceed ½ of the annual limit. Thus, if full retirement age will be reached after 2009, a full benefit will be received for any month in 2009 for which earnings do not exceed \$1,180, even if the annual earnings exceed the \$14,160 limit. If full retirement age will be reached in 2009, the earnings limit for the months prior to reaching full retirement age will be \$3,140 (½ of \$37,680).



*J.K. Lasser's Monthly Tax Letter, November 2008.*


**Definition of Qualifying Child**

As part of a new law that provides federal incentives for states to move children from foster care to adoptive homes, Congress has slightly restricted the definition of a "qualifying child" for tax purposes. The restrictions, which take effect for tax years starting after 2008, were included as revenue raisers in the adoption statute (Fostering Connections to Success and Increasing Adoptions Act of 2008). Starting in 2009, a person generally can be a "qualifying child" for dependency exemption, child tax credit, dependent care credit, earned income credit, and head of household purposes only if, in addition to the other requirements for the particular tax benefit involved, he or she is younger than the taxpayer claiming the benefit (Code Section 152 (c)(3)(A)). This rule does not apply if the person being claimed as a qualifying child is permanently and totally disabled. In addition, an individual who is married and files a joint return cannot be considered a qualifying child unless the joint return is filed only as a refund claim. The tiebreaker rule for claiming a qualifying child has been amended to provide that if a parent and a non-parent are both eligible to claim a child as a qualifying child but the parent does not claim the child, the non-parent may do so only if his or her adjusted gross income (AGI) is higher than the AGI of any eligible parent (Code Section 152 (c)(4)(C)).



*J.K. Lasser's Monthly Tax Letter, November 2008.*

### **Noncustodial Parent Can't Claim the Exemption**



A noncustodial parent may be awarded the right to claim a dependency exemption by a divorce court, but the IRS will disallow the exemption unless the custodial parent signs a written waiver. That's what happened in a recent case. A couple with two daughters divorced. Both girls lived with the mother but, under the terms of an order of child support, each parent was to claim one exemption. The father, the noncustodial parent, paid his requisite child support payments and claimed the one exemption; he did not attach a signed waiver from the child's mother to his return. The IRS disallowed his deduction and the Tax Court agreed. The tax law limits the dependency exemption for parents who are divorced to the custodial parent or, if both parents have custody, to the parent with custody for the greater part of the year. In order for the noncustodial parent to claim the exemption, the custodial parent must sign Form 8332 or its equivalent and the noncustodial parent must attach the written waiver to his or her return (Code Section 152(e)). The tax law does not ask why the noncustodial parent did not obtain the waiver, only whether he or she obtained the waiver. The father also could not claim the child tax credit for his daughter. Had he obtained the Form 8332 waiver from the mother, the daughter would have been considered his "qualifying child" for credit (Code Section 24(c)(1)) as well as exemption purposes. Without the waiver, the father would have to establish that his daughter was his qualifying child under the regular exemption rules, something he could not do.

*J.K. Lasser's Monthly Tax Letter, October 2008.*

### **Independent Contractor or Employee?**

It is critical that you, the employer, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. Before you can determine how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be: an independent contractor, an employee (common-law employee), a statutory employee, and a statutory nonemployee. In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

**Common Law Rules.** Facts that provide evidence of the degree of control and independence fall into three categories:

*Behavioral:* Does the company control or have the right to control what the worker does and how the worker does his or her job?

*Financial:* Are the business aspects of the worker's job controlled by the

payer? (These include things like how worker is paid, whether expenses are reimbursed, who provided tools/supplies, etc.)

*Type of Relationship:* Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another. The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

**Who is Considered Self Employed?** You are self-employed if either of the following applies to you: You carry on a trade or business as a sole proprietor; or you are a member of a partnership or limited liability company that files a Form 1065, U.S. Return of Partnership, that carries on a trade or business. You are also self-employed if you have a part-time business, in addition to your regular job.

**Independent Contractor.** The general rule is that an individual is an independent contractor if (the person for whom the services are performed) has the right to control or direct only the result of the work, and not what will be done and how it will be done or method of accomplishing the result. People such as lawyers, contractors, subcontractors, public stenographers, and auctioneers who follow an independent trade, business, or profession in which they offer their services to the public, are **generally** not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The earnings of a person who is working as an independent contractor are subject to Self-Employment (SE) tax.



<http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>

### **Direct IRA Payouts to Charity**

For 2008 and 2009 seniors get back a tax break they lost at the end of 2007: Tax-free IRA payouts to charity. But take note: The break is only available to IRA owners 70½ or older. No more than \$100,000 a year can be donated tax-free. Contributions can't go to charitable remainder trusts, donor-advised funds or supporting organizations. The distribution check must go straight from the IRA to the nonprofit you've listed. You don't get to claim a charitable deduction for the gift, too, but keeping the money out of your taxable income is a better deal.

*Kiplinger Personal Finance Adviser, November 2008.*