



# Lisa A. Scarazzo, CPA, PC

## Annual Business Tax Newsletter

### November 2007

#### **BUSINESS UPDATE: Tax Planning Tips & Tax Law - Fall 2007**

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#### **Taxes & Licenses**

**Personal Property Taxes & Business Licenses** - All businesses must file annual personal property tax returns. These are filed with the county where both your business and assets are located and in the county where you perform work and maintain assets. The due date of these returns varies from jurisdiction to jurisdiction. Charges for personal property tax are based on the year of asset purchase and should match the assets that are depreciated on the business income tax returns. All businesses should be registered for a business license. In Prince William County, there are no taxes due for the BPOL (Business & Professional Occupational License) tax until a business has gross revenues of more than \$100,000 annually. The BPOL form is due March 1st. Please be aware that as a business owner, you are responsible for filing these annual forms. Our office can help you handle these filings at your request.

**Estimated payments** - Final 2007 estimated payments for corporations are due 12/15/07. Final estimated payments for taxpayers who are self employed are due 1/15/08. Please contact our office before the end of the year if you have concerns regarding your estimated payments.

#### **Employment Related Issues**

**W-2s** - If you mail a W-2 to an employee's last known address and it is returned, you are required to keep that W-2 on file for four years.

**W-4s & I-9s** - Employees should fill out new W-4s in January. Employee names and social security numbers must match their social security cards exactly. Employers will be penalized if numbers are incorrect or missing. The IRS has adopted a zero tolerance policy for incorrect filings of the W-2s. As an employer, you can call the Social Security Administration to verify an employee's social security number at 800-772-6270. W-4s can be found at the IRS Web site [www.irs.gov](http://www.irs.gov). Once on the IRS Web site, search Forms & Publications for: "W-4." We can provide copies of the W-4 if you do not have Internet access. It is very important to stay current with employees' address changes.

All new employees should have filled out an I-9, which verifies the employee's citizenship. The employer penalty for not having the I-9 form on file starts at \$100.00 per employee and can go as high as \$1,000 per employee. The I-9 form must be on file by the end of the third business day after the employment date and must be retained for the longer of 3 years or 12 months after termination. I-9s can be found at [www.ins.usdoj.gov/graphics/formsfee/forms/i-9.htm](http://www.ins.usdoj.gov/graphics/formsfee/forms/i-9.htm). Our office can provide copies of the I-9 if you do not have Internet access.

**Minimum Wage** – The minimum wage is \$5.85 per hour until 7/23/08. It will increase 7/24/08 to \$6.55 and will increase again on 7/24/09 to \$7.25.

**Independent Contractors** - If you are paying an individual as an independent contractor instead of an employee, be sure to have a written agreement that spells out the terms of the work along with the individual's address and social security number for reporting purposes. **Important** - All independent contractors should fill out IRS form W-9 (Request for Taxpayers Identification Number & Certification) and submit it to you. If the subcontractor does not pay taxes on his or her earnings, the IRS can come back and **charge you up to 30% backup withholding taxes!!** Let us know if you need any blank Form W-9s. Go to my Web site at [www.lascpa.com](http://www.lascpa.com) for a sample of a generic copy of the Independent Contractor's agreement. The business owner is required to issue a 1099-Misc to any individual or attorney that is paid more than \$600 annually on a timely basis to the IRS or be subjected to penalties.

**Workers Compensation** - Virginia law requires every employer who employs three or more full-time or part-time employees to purchase and maintain workers' compensation insurance. Employers with fewer than three employees may voluntarily comply with the Act. If you are interested in further Virginia employer obligations, visit: [www.vwc.state.va.us/employers\\_guide.htm](http://www.vwc.state.va.us/employers_guide.htm)

### **Employee Benefits**

**Health Insurance Premiums & Medical Reimbursement Plans** - Health insurance premiums for the self-employed and S Corporation shareholders are 100% deductible as a reduction to adjusted gross income. This includes long-term care premiums, subject to age limitations.

**Tax Tip** - If a spouse works in the business of a sole proprietor and receives W-2 earnings, the premiums may be deductible on Schedule C which will reduce social security and Medicare taxes for the business owner. In addition, if the spouse is a legitimate employee, the company can set up a medical reimbursement plan. This would not be advantageous if the sole proprietor had other employees because the medical plan must be non-discriminatory.

**Insurance** - If you are shopping around for new insurance policies, you may want to start your research at these web sites: [www.insure.com](http://www.insure.com), [www.iii.org](http://www.iii.org), [www.insuremarket.com](http://www.insuremarket.com), or [www.insurancequote.net](http://www.insurancequote.net).

**Employing Your Spouse & Children** - If you are operating as a sole proprietorship, it may be beneficial to employ your spouse and/or children. You do not have to withhold social security and Medicare taxes if your child is under the age of 18. Both the spouse and the children are exempt from federal and state unemployment taxes. To the extent family members earn income, they can contribute to IRA accounts on their own behalf. Even better, a retirement plan can be set up to reduce the federal tax liability of the sole proprietor and defer income of the employees (the spouse and children). Having a spouse as an employee can also provide deductions for health insurance premiums and other medical expenses through a medical reimbursement plan.

Even if you are incorporated, you may want to consider employing your children for minimal clean-up work so that they can earn at least \$4,000 per year to put into a Roth IRA. If they have no other earnings, there should be no federal or state tax liabilities; and when the money is withdrawn, it will be tax-free. Money that is earned in the Roth IRA will never be taxed!!

**Retirement** - Retirement fund contributions are an excellent way to defer or reduce taxes. There are some types of retirement plans that can be set up and funded until the extension due date of the return. Example: The tax return can be prepared with a retirement contribution deduction, but the taxpayer does not have to fund the contribution until the extension due date of the return. In order to take advantage of tax breaks associated with retirement funds, the fund must comply with IRS rules. Meeting with a financial advisor may be helpful so that your specific needs may be addressed. There are severe penalties if you have set up a retirement plan and it is not being funded, maintained, or deducted on your income tax return properly.

**Automobiles** - An automobile must be used more than 50% in the taxpayer's trade or business to be considered qualified business use and to be eligible for accelerated depreciation. If you purchased, sold or traded a vehicle during the year, you need to provide us with the documentation of the transaction so we can properly record it for tax purposes. Written documentation should be kept recording your business vehicle usage. Reimbursements for personal use of vehicles owned by employees or owners can be made under the standard mileage rate or actual cost method if you have an accountable plan.

**Mileage rate** - The business standard mileage rate for 2007 is **48.5 cents per mile**. This has been increased for 2008 to 50.5 cents per mile. All business owners with vehicles should record their odometer readings as of 12/31/07 and record business miles for the year. The IRS requires written records if either the standard mileage rate method or the actual expense method is used. If you have employees, see both Accountable Plan for Employee Expenses below and Automobiles above.

**Accountable Plan for Employee Expenses** - Most employers cover their employees' business expenses by reimbursing them. The expenses can be a deduction for the company and non-taxable income to the employee if the reimbursements are made in accordance with a written accountable plan that requires employees to substantiate all expenses and return any advances in excess of the expenses incurred. **If an accountable plan is not followed, the employer is responsible for adding the reimbursements to the employee's wages as compensation.** This also hurts the employer because the employer will have to match the social security and Medicare on the additional compensation. If you are in need of a written accountable plan to be in compliance, please contact our office for samples.

**Meals** - The deduction for meals and entertainment is 50% of the expense. Occasional meals provided to your employees may be 100% deductible. If the meals are on an occasional and infrequent basis (such as a holiday party), or are provided for the employer's convenience (for emergency work or during a particularly busy time when employees are required to stay on the job during mealtimes). An accountable plan should be in place to cover meal reimbursements paid to your employees. You should choose between an actual cost reimbursement or a per-diem rate based on federal guidelines.

### **Other Business Expenses**

**Section 179 Depreciation** - Section 179 allows a business to speed up the depreciation deduction and take the full purchase price of an asset, subject to limitations, in the first year that the asset is placed in service. The limit for the Section 179 depreciation expense for assets placed in service during 2007 has increased to \$125,000. See below for auto limits.

**Tax Tip** - Place assets in service by 12/31/07 to take advantage of Section 179 if there is a profit in the company.

**Vehicle Depreciation** - Most passenger vehicles have limited depreciation for the first year they are placed into service **unless** they have a 6,000 lbs. loaded gross vehicle weight, which includes many heavy sport utility vehicles. What does this mean to the business owner who uses his or her vehicle more than 50% of the time for business? You can purchase one of these vehicles and use the Section 179 deduction or regular depreciation. The Sec 179 amount that can be written off for most vehicles in the first year is now \$25,000. Please note that there are some down sides to using this tax break.....1) The majority of the depreciation would be used up in the first year whereas it might be better tax wise to spread it out over the 5-year class life of the vehicle, 2) If the business use falls below 50% or the vehicle is disposed of, there will be a recapture of income for the amount of depreciation that was taken for years it is not in service.

Please see my Web site at [www.lascpa.com](http://www.lascpa.com) (click on the 'Information Center' button) for a detailed list of vehicles that qualify as having a gross vehicle weight of 6,000 lbs or more.

**Leases** - If a corporation rents or leases property owned by the shareholder, the lease should be in writing and the rent charged must be at fair market value.

**Business Gifts** - The maximum deduction for a business gift is \$25.00 per gift. Any amount greater than \$25.00 for the purchase of a gift is considered to be nondeductible. Note: This IRS limit has been remained the same for **43** years!

**Home Office** - To qualify for a home office deduction, you must exclusively use a portion of your home to carry on a trade or business. If you are unable to permanently segregate a room, you should at least use some sort of screen or divider to establish exclusive use of one section. Also bear in mind that to obtain a home office deduction under the exclusive use rules, you must use your home office computer 100% of the time for business. Even using it occasionally for personal purposes can cause your home office to be non-deductible.

### **Corporate Issues**

**Shareholder Loans** - Closely held corporations are regularly subjected to IRS scrutiny because of loans made to stockholders. The IRS often takes the position that the loans are really disguised dividends - especially in the case of loans that remain on the books year after year. This could result in the loan being included in the recipient's income. This can be avoided by having a more formal loan agreement or promissory note in place. S Corporation shareholder loans must be put in writing with set repayment dates in order to justify basis in the company – documenting these loans ultimately could allow for the deduction of losses on the shareholder's personal income tax return. If the loan is used as a basis to deduct losses, the loan repayment may result in taxable income. Each loan should have a separate agreement. Contact us to make sure your loans are properly documented to avoid this problem.

**Corporate Minutes** - Keeping complete and accurate minutes of your shareholder's meetings may seem like a bothersome task. But the time spent now can save your corporation a great deal of money later on. Please take a few minutes to update your corporate books before year-end.

### **Privacy Statement**

Federal law requires that once a year I inform you of our Privacy Policy. As you know, we collect certain personal information about you in order to prepare your tax returns. The information is either provided by you or obtained by our office with your permission. No personal information will ever be disclosed about you to anyone outside our firm except that which is already public or permitted by law or as necessary to complete your work.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here. The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account.

Procedural, physical, and electronic safeguards will be maintained in compliance with federal standards regarding non-public personal information. We are committed to retaining your confidence and want to assure you that any information you give us remains safe and confidential.