Lisa A. Scarazzo, CPA, PC
12904 Harbor Drive
Woodbridge, VA 22192

Business Update Newsletter

December 2019

Website: www.lascpa.com | (703)492-6829, Fax: (703)491-2794 | Email: lisa.scarazzo@lascpa.com

Tax Due Dates for Partnership & Corporate Income Tax Returns:

- Partnerships and Limited Liability Companies (LLCs) that are taxed as partnerships (Form 1065) are due on March 15, 2020.
- S Corporation tax returns (Form 1120S) are due on March 15, 2020.
- Corporate tax returns (Form 1120) are due on April 15, 2020.
- Business extensions would provide an additional 6 months to the due dates listed above.
- Accounting data should be submitted no later than January 31, 2020 to prepare business tax returns timely.

Tax Rate Changes:

One of the big changes with the tax act was the reduction of the corporate tax rate to a flat 21%. This can be beneficial to some, but C-corporations with profits under $50,000 will now actually pay a higher tax (previously taxed at 15%). If you fall into this range, it might be better for you to pay additional wages before the end of the year to reduce the corporation profit if your personal rate is lower than 21%.

Qualified Business Deduction:

- **Business Classification:**
  The tax changes also provide an opportunity to re-evaluate your business classification. In some cases, it may be beneficial to convert to a C-corporation due to the new lower flat rate, but C-corporations remain subject to double taxation issues, so it is not a clear cut-choice; pass-through entities still will be preferred in many cases. High earning sole proprietors with no employees may want to consider conversion to an S-corporation or LLC in order to take advantage of the QBI discussed below.

Qualified Business Deduction Continued:

- **Qualified Business Income (QBI) Deduction:**
  This 20% business deduction can be used by ALL individual taxpayers (with business income from sole proprietorships, S Corporations, partnership or rental properties) that have taxable income less than $321,400 (if filing jointly) and taxable income less than $160,700 (for all other filers). Rental properties can qualify as a trade or business if they meet some stringent guidelines that include meeting minimum hour requirements that must be adhered to.

  There are phase-outs for the 20% deduction for taxable income over $321,401 (filing jointly) and taxable income over $160,701 (all other filers). Specified service businesses are treated differently than non-specified service businesses for this phase-out calculation.

  Specified service businesses are defined as any trade or business that involves health, law, consulting, athletics, financial services, brokerage services, accounting, performing arts, actuarial services, and any business where the principal asset of such business is the reputation or skill of one or more of its employees or owners. Determining if a business is a specified service business may be challenging in some consulting entities and the IRS is looking to the NACIS codes that are stated on the tax return as one of the determining factors.

Independent Contractors:

- **1099-Misc Reporting:**
  If you pay any individual or unincorporated business $600 or more for a business expense, then you are required to issue a 1099-misc to report the payments. The recipient copy and IRS reporting copies must be mailed by January 31, 2020 or there will be **late filing penalties ($270 per form). We need the data to prepare the 1099s no later than January 8th to file timely.** The IRS is cracking down on non-compliance for filing 1099s and requires that you attest to the filings on your business income tax return. You should REQUIRE any individual or unincorporated business to complete Form W-9 prior to paying them. There will be a **NEW Form 1099-NEC** (Non-Employee Compensation) for Independent Contractors paid more than $600. There is also proposed legislation to change the limit from $600 to $1,500.

- **Independent Contractors:**
  The IRS can reclassify payments to individuals that have had no payroll withholdings if they determine that the individual is an employee instead of an independent contractor. Individuals **are employees** if they are working under the company's control: working per the instructions of the company regarding where to work, how to work, and using the company's equipment. Independent contractors are paid by the job or on commission. 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 or a generic copy of an Independent Contractor's agreement.

Employees:

❖ W-2s:

Due date for filing is **January 31, 2020**. 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-2s & 1099s:** There will be a $270 penalty per form for each W-2 or 1099 that is not filed timely or is prepared incorrectly.

❖ W-4s & I-9s:

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 W-2s.

The 2020 W-4 has been revised again and it has several questions that may seem like an invasion of privacy - for instance, your total excepted income if filing jointly, other income you may have or other deductions. Employees may not want to share with their employers and there is no mandatory requirement to tell an employer this information. The IRS suggests that employees visit this website: **www.irs.gov/W4/APP** to determine their correct withholdings. We can assist clients to complete their W4s charged at our consulting rates of $100 per hour.

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 $110.00 per employee and can go as high as $1,100 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.uscis.gov/files/form/i-9.pdf**.

❖ Social Security Taxes:

The maximum earnings that are subjected to social security tax for 2020 = $137,700. An individual receiving social security between the ages of 62 and full retirement age may earn up to $18,240 of wages during 2020 before they start to lose part of their social security benefit.

❖ Employing Your Spouse & Children:

If you are operating as a sole proprietorship, it may be beneficial to employ your spouse and/or children if they are performing valid work and paid reasonable wages for the work performed. 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 and self employment taxes of the sole proprietor and defer income of the employees (the spouse and children). But beware if you have other employees they would have to be covered as well.

Accountable Plan for Employee Expenses:

Most employers cover their employee's 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 within 60 days. **If an accountable plan is not followed, the employer is responsible for adding the reimbursements to the employee's W-2 wages as compensation.** This also hurts the employer because the employer will have to match the Social Security and Medicare on the additional compensation. A generic written accountable plan can be obtained from our offices. This form should be used for any employee that you provide reimbursements to – without this proper documentation your company could be denied tax deductions which could be very expensive and detrimental to the livelihood of your business. **Beware, this is expected to be a hotbed issue with the IRS looking for patterns of abuse, so getting ahead of this with a written accountable plan is highly recommended.**

No Entertainment Deductions:

Entertainment expenses are no longer deductible for a business including the following:

- Tickets to sporting events
- License fees for stadium or arena seating rights including private boxes
- Theater tickets
- Golf club dues or company golf outings for customers
- Hunting, fishing or sailing outings
- Movie tickets

Meals Deductions:

❖ Business meals are still 50% deductible by the employer and office holiday parties will remain 100% deductible. Meals for the convenience of the employer have been reduced from 100% to 50% deductible.

Depreciation and Capitalization:

❖ **Depreciation (for 2019):**

- Both new property & used qualified property will now be eligible for 100% bonus depreciation, so an asset can be written off in the first year it is purchased (vehicles are still limited, but also have a higher bonus depreciation allowance under the new laws). Many states do not allow the bonus depreciation deduction, so be prepared for a state add-back which could increase your state taxable income if bonus depreciation is elected on the federal return.
- IRS Code Sec 179 allows a business to deduct in the current tax year the full purchase price of an asset. The new limits allow a business to use Sec 179 to deduct up to $1,000,000 with a phase-out beginning at $2,500,000 of qualified assets placed in service. This may be preferable over the bonus depreciation because Virginia does not follow the IRS bonus depreciation rules which can create an add back for VA tax calculations.
- The SUV limit for Sec 179 depreciation is still $25,000 but if the vehicle is used for 100% business use, it can be written off 100% with the new bonus depreciation for federal income tax purposes if the gross vehicle weight exceeds 6000 pounds or is a cargo or shuttle van.

❖ **Capitalization Policy:**

The IRS issued final regulations allowing a de minimis safe harbor election which allows businesses to immediately expense up to $2,500 of property that would otherwise have to be capitalized. This policy needs to be in effect as of the beginning of the year. We recommend all businesses adopt this policy. Bear in mind that the assets still need to be listed on your personal property tax return, so you should provide us with information on assets purchased during the year in a timely manner so the new assets are included.

Business Vehicles:

❖ **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 (see above). Personal usage worksheets must be completed for all clients for whom we prepare payroll reports before W-2s are prepared.

❖ **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 maxed at $25,000 or regular depreciation. Please note that there are some down sides to using the Sec 179 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 (go to the 'Information Center') for a detailed list of vehicles that qualify as having a gross vehicle weight of 6,000 lbs or more.

❖ **Mileage:**

The standard business mileage rate for 2019 is 58 cents per mile. All business owners with vehicles should record their odometer readings as of 12/31/19 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' and 'Automobiles' above. Personal vehicle usage of company vehicles by owners or employees must be included as compensation and reported on W-2s. Please contact us if you need help determining this prior to the issuance of your last payroll in December.

Retirement:

Retirement fund contributions are an excellent way to defer or reduce taxes. SEP (Simplified Employee Pension) plans can be set up and funded until the extended 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 extended due date of the return. The 401K deferral amounts **for 2019 = $19,000 & for the 2020 year = $19,500** (under age 50). If 50 years or older by December 31st the maximum deferral is $25,000 for 2019. The limit on catch-up amounts for those 50 or older increases to $6,500 for the 2020 year; therefore, if you are 50 or older your maximum 401K deferral is $26,000 ($19,500 + $6,500).

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.

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 $6,000 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 within the Roth account guidelines, it will be tax-free. Money that is earned in the Roth IRA will never be taxed under current tax laws if the guidelines are followed!!

Small Business Issues:

- **Reasonable Salary:**
  Owners and officers of corporations are considered to be employees per the IRS Code and they should not attempt to avoid paying employment taxes by taking distributions, loans, or paying personal expenses out of the corporation instead of taking a salary. They are required to take reasonable salaries based on their training, experience, duties, time, effort, dividend history, manner of payment to other key employees, and comparable services paid by other businesses to perform the same work. Distributions should never be taken in place of wages. This also becomes critical in the calculations for the new Qualified Business Deduction. Reasonable compensation is established by determining what the shareholder/employee does for the business.

  An S Corporation shareholder/employee has to be paid a wage that would be similar compensation if they hired a person to fulfill their position. The wage should be established, documented in minutes, and received on a regular pay schedule before distributions are paid. Distributions should be paid out of profits and can not be taken to solely avoid paying Social Security & Medicare taxes. We are anticipating this to be a hot audit item for the IRS due to its part in the Qualified Business Deduction calculation. Reasonable Compensation can be calculated for a fee at https://.RCReports.com.

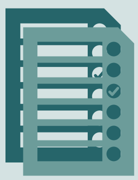
- **Shareholder Loans:**
  Closely held corporations are regularly subjected to IRS scrutiny because of loans made to stockholders. The IRS often takes the position that the loans are really disguised dividends - especially in the case of loans that remain on the books year after year. This could result 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, future loan repayments 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. This should be reviewed every year.

Small Business Issues Continued:

- **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. If you use exclusive areas in your home for your business, you should consider reimbursement from the business for the office in home (this can include storage). This can be done as part of your accountable plan, but should be well documented.
- **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.

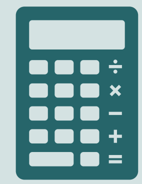
Didn't see what you were looking for? Click a topic to jump to more info:

DUE DATES:



QUALIFIED BUSINESS DEDUCTIONS:

INDEPENDENT CONTRACTORS:

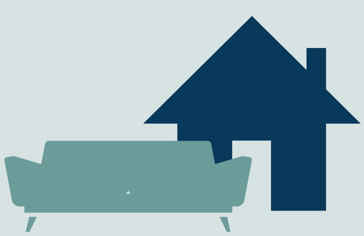


EMPLOYEES:

ACCOUNTABLE PLANS:

VEHICLES:

RETIREMENT:



SMALL BUSINESS ISSUES:

FIND OUT MORE AT OUR WEBSITE:

WWW.LASCPA.COM

Need more info? Please go to our website: WWW.LASCPA.COM

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 by law or 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 your personal information. We are committed to retaining your confidence and want to assure you that any information you give us remains safe and confidential.