

BUSINESS OWNER'S UPDATE - Fall 2001

W-4 & 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. As an employer, you can call the Social Security Administration to verify your employee's social security number for accuracy at 800-772-1213. W-4s can be found at the following website: <http://www.irs.gov>. Once on the IRS website, click on Forms & Publications and then look for Forms & Instructions.

All employees should also have filled out an I-9 which verifies an 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 the following website: <http://www.ins.usdoj.gov/graphics/formsfee/forms/i-9.htm>

Personal Property Taxes & Business Licenses - All businesses must file annual personal property tax returns. These are filed with the county that your business is located in and are usually due by April 15th. Charges for this tax are based on the year of purchase of the assets 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 grosses more than \$100,000 annually. Please be aware that as a business owner, you are responsible for filing these annual forms. Our offices can help you handle these filings at your request.

Estimated payments - Estimated payments for corporations are due 12/15/01. Estimated payments for taxpayers who are self employed are due 1/15/02. Please contact our offices before the end of the year if you have concerns regarding increasing or decreasing your estimated payments.

Buying Equipment & Assets Before 12/31/01 - One of the best ways to reduce your profit before year-end is to buy assets. Your company may be able to expense the total amount of purchased assets up to \$24,000 for 2001. However, vehicles have limitations to the amount of depreciation that is allowed each year. The election to expense up to \$24,000 can be used only if the vehicle has a gross vehicle weight of more than 6,000 lbs.

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 all conditions along with the individual's address & social security number for reporting purposes. We advise having the independent contractor fill out IRS form W-9 (Request for Taxpayers Identification Number & Certification). The business owner is required to issued a 1099-Misc to any individual or attorney that is paid more than \$600 annually.

Minimum Wage - Minimum wage is currently at \$5.15 per

Health Insurance - Health insurance for the self employed is 60% deductible for 2001

as an adjustment to the taxpayer's total income. It goes up to 70% in 2002 and 100% in 2003. This adjustment is not only available to Schedule C filers, but also to 2% 1120S shareholders.

Employing Your Spouse & Children - If you are operating a sole proprietorship, it can be beneficial to employ your spouse and 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. Since family members are earning income, they can contribute to IRA accounts on their own behalf. Even better, a retirement plan can be set up which would 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.

Retirement Plans - Just a reminder that retirement funds are an excellent way to defer/reduce taxes. In order to take advantage of the tax breaks associated with retirement funds, it is necessary to have the fund set up properly within IRS compliance. Meeting with a financial advisor may be helpful so that your specific needs can 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.

A new tax credit has been established regarding retirement plans for small businesses for the 2002 year. An eligible employer will be allowed a tax credit of 50% of the start up costs (maximum credit of \$500 for 2002) when a new retirement plan is setup.

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 for the area.

Meals - The deduction for meals & entertainment remains at 50% for 2001. Occasional meals provided to your employees may be 100% deductible as long as they are on an occasional and infrequent basis, or when they 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). As discussed below in the travel section, a plan should be in place to cover meal reimbursements paid to your employees. You should choose between an actual cost reimbursement or a pre-diem rate based on federal guidelines.

Travel 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 an 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 employees wages as compensation. This also hurts the employer because the employer now has 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.

Vehicle Mileage Rate - The standard mileage rate for the 2001 year is 34.5 cents per mile. Remember to record your odometer reading on 12/31/01 for ending and beginning

mileage documentation. Any personal use of a business owned vehicle should be reported to our offices by 12/31/01. The standard mileage rate increases beginning 2002 to 36.5 cents per mile.

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.

Business Gifts - The maximum deduction for a business gift is \$25.00. Any amount greater than \$25.00 for the purchase price of a gift is considered to be nondeductible.

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. Using a portion of your home for personal and business use will not qualify. If you are unable to permanently segregate a room, you should at least use some sort of screen or dividers 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. If necessary, locate your computer outside of your home office so it does not interfere with the exclusive use rules.

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 results 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. Contact us to make sure your loans are properly documented to avoid this problem.

Corporate Minutes - Keeping complete and accurate minutes of your shareholders' 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.

If you need any forms to fulfill any of the requirements we have mentioned in this update newsletter, please contact our offices.