Starting a Business

The Purpose of a Business Plan

A business plan is a written document created to detail all aspects of a business on a comprehensive level. Many banks and investors require a written business plan before lending to, or investing in, a business.

Executive Summary

The executive summary is a summary of the entire plan. It should be written when all other sections of a business plan are complete and should be less than one page in length. The executive summary should include enough detail to allow a user to read the summary and gain a basic understanding of the business.

Mission, Vision, and Description

- ***Mission statement.*** The mission statement should be less than 30 words and describe why a business exists, as well as its fundamental purpose at present.
- ***Vision.*** The vision statement defines the intended future state of an organization. It sets a high, long-term goal which is used to guide decisions of management and ownership.
- ***Description.*** The description section defines goals and objectives, business philosophy, target market, industry, and the legal entity under which the business will operate.

Products and Services

Provide a detailed description of the products and services the business will offer. Include pricing, unique features, and the required level of quality. Create an appendix for any photos, technical specifications, drawings, or brochures.

Marketing Plan

The marketing plan is developed by conducting (or having conducted) market research to define the clientele of a business and how to best market products and services.

Sales forecast. The sales forecast is the final element in a marketing plan. It forecasts over a 12-month period the quantities of each product or service expected to be sold. It is the base from which the financial plan will develop.

Operational Plan

The operational plan details the day-to-day operations of a business. Items discussed in an operational plan should include issues such as location, licensing, personnel, inventory, suppliers, credit policies, and managing payables.

Management and Organization

- ***Key employees.*** The term key employee refers to a person or persons who will manage the business on a daily basis. Include in the list the key employees' talent, experience, and distinctive competencies brought to the business. Incorporate job descriptions of key employees, as well as resumes of the owners and key employees if using a business plan to seek financing.
- ***Management continuation plan.*** Management continuation planning involves determining how a business will continue should one or more of the key employees be lost or become unable to fulfill his or her duties. The

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plan should specify the exact procedures for transferring duties when required, including arrangements with vendors, banks, employees, and owners.

Personal Financial Statement

A personal financial statement (PFS) is a balance sheet for each owner on an individual basis. It includes values and detail of all assets owned, as well as amounts and terms for all debt obligations.

Business Agreements

- **Incorporation agreements.**
- **Partnership agreements.**
- **LLC agreements.** Consult an attorney to ensure compliance with state laws when forming a business entity.

The following issues should be addressed in an agreement to form a business entity.

- **Name and address of business.**
- **Names and addresses of owners.**
- **Description of business purpose.** Products, services, market.
- **Contributions to capital.** Loans to the business, repayment guarantees.
- **Special allocations for partnerships.**
- **Number and duties of employees.**
- **Responsibilities of owners.** (1) Administrative duties; (2) Services to be performed: Hours dedicated to business, time off, length of commitment, wages/guaranteed payments, contributions to retirement funds, other payments.

- **Divisions of responsibility.**
  - Authority to: *Hire and fire employees, train employees, make loans, purchase inventory and supplies, enter into contracts, incur business debt.*
  - Books and records: *Responsibility for bookkeeping, accounting, and tax compliance, location of books and records, fiscal or calendar year, accounting method, tax elections, responsibility for legal compliance*

- **Payment of expenses not covered by business operations.** Stop loss agreements, percentage contributions in case of shortfall, expenses to be paid personally by owners, provisions for additional capital contributions
- **Draws.** Scheduled draws, limits on draws, restrictions on draws
- **Amendment provisions.** Circumstances, authority, procedures
- **Rights of owner withdrawal or transfer of interest.** Ability to withdraw, requirements for sale of interest, rights of first refusal, ability to sell to outside party, advance notice of retirement, methods of evaluating owner's share.
- **Death of an owner.** Buy/sell agreements, succession plan, rights and authority of relatives, location of each owner's will, right to divide interest of owner.
- **Decisions/disagreements.** Situations that will require a vote, majority or unanimous vote requirements, arbitration agreement.
- **Amending the agreement.** Situations where amendment is mandatory, situations where amendment is a choice, vote required for amendment.

Financial Plan

- ***Capitalization.*** Capitalization is the source of cash used for start-up costs, including professional consulting, asset acquisition, and buying or leasing business property. Information about any debt or equity financing should be included in this section.
- ***Forecasting cash flow.*** For new businesses, cash flow, more than profit, is the best indicator of whether a business will survive. It determines whether a business will be able to pay its expenses and debts as they come due. A business plan should contain a statement of projected cash flow for the first 12 months of the business. Lenders or investors may require customized reports indicating cash flow and profit projections.

Starting a Business Checklist

✓ **Done.** Skip any item which does not apply to the business.

1) __ Develop a business concept
2) __ Select and retain accountants and attorneys
3) __ Select a business entity
4) __ Determine ownership structure
5) __ Complete a business plan
6) __ Obtain initial start-up capital
7) __ File for organization with state
8) __ Hold first board of directors meeting
9) __ Apply for a federal employer identification number (EIN) by submitting Form SS-4
10) __ Apply for S corporation status by filing Form 2553
11) __ Establish accounting procedures
12) __ Choose an accounting software
13) __ Input all transactions from the beginning of business development into accounting software
14) __ Apply for business financing and solicit investors
15) __ Open business bank accounts
16) __ Apply for required permits or licenses
17) __ Select an insurance agent
18) __ Purchase insurance
19) __ Select a commercial real estate agent
20) __ Locate and obtain office or production space
21) __ Acquire furniture and equipment
22) __ Complete any needed build-out of space
23) __ Select a payroll processing company
24) __ Select an employee benefits company
25) __ Hire staff and complete training
26) __ Commence marketing
27) __ Order initial inventory and begin production
28) __ Conduct a grand opening

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- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

Hobby vs. Business

Hobby or Business?

If an individual, partnership, estate, trust, or an S corporation engages in an activity that is not conducted as a for-profit business, expenses (other than cost of goods sold) are not deductible. This rule does not apply to corporations, other than S corporations. If an activity is considered a for-profit business, deductions can exceed income, allowing the resulting loss to offset other income.

Determination

In determining whether an activity is a hobby or a business, all facts and circumstances are taken into account. No one factor can make the determination. The following list is not intended to be all inclusive.

1) ***The manner in which the taxpayer carries on the activity.*** Factors that may indicate a business include maintaining complete and accurate books and records, carrying on the activity substantially similar to other profitable activities of the same nature, and changing operating methods and techniques to improve profitability.
2) ***The expertise of the taxpayer or his or her advisors.*** Factors that may indicate a business include knowledge of the taxpayer, or consultation with those who are knowledgeable about a particular industry, then using that knowledge to try and make a profit.
3) ***The time and effort expended by the taxpayer in carrying on the activity.*** Factors that may indicate a business include spending a lot of time and effort in the activity, particularly if the activity does not have substantial personal or recreational aspects. Taking time away from another occupation may also indicate a profit motive. Spending little time will not be counted against the taxpayer if qualified employees are hired to carry on the activity.
4) ***The expectation that assets used in the activity may appreciate in value.*** Even if no profit is made from operations, if the value of land or other assets in the activity appreciate so that an overall profit is made from a sale, the activity may be considered a business.
5) ***The success of the taxpayer in carrying on other similar or dissimilar activities.*** If the taxpayer was successful in the past turning an unprofitable venture into a profitable venture, the current activity may be a business even if it has not yet made a profit.
6) ***The taxpayer's history of income or losses with respect to the activity.*** Early losses during start-up will not count against the taxpayer, but continued losses after the customary start-up stage that are not explainable may indicate a hobby. Losses sustained due to unforeseen circumstances, such as casualty or thefts beyond the taxpayer's control, will not count against the taxpayer. Any series of profitable years are strong evidence the activity is a business.
7) ***The amount of occasional profits, if any, which are earned.*** The amount of profits in relation to the amount of losses, and in relation to the taxpayer's investment in the activity, may indicate intent. An occasional small profit one year, mixed with large losses in other years or large taxpayer investments, may indicate the activity is a hobby. Substantial occasional profits mixed with frequent small losses or investment may indicate a business. An opportunity to earn substantial ultimate profits in a highly speculative venture also indicates a profit motive.

Hobby vs. Business

8) ***The financial status of the taxpayer.*** If the taxpayer does not have substantial income or capital from other sources, the taxpayer may have a profit motive. If the taxpayer has substantial income from other sources, and losses from the activity in question generate substantial tax benefits, the taxpayer may not have a profit motive.

9) ***Elements of personal pleasure or recreation.*** Where there are recreational or personal elements involved with the activity, a lack of profits may indicate a hobby. On the other hand, a lack of any appeal in the activity other than possible profits indicates a profit motive. It is not necessary that the sole purpose for engaging in an activity is to make a profit. The availability of other investments that might produce a higher rate of return will not count against the taxpayer. The fact that a taxpayer derives personal pleasure in the activity is not sufficient in itself to classify the activity as a hobby if other factors indicate the activity is a business.

Presumption of Profit

IRS rules state that if an activity is profitable in three of the last five tax years, including the current year, the presumption is it is carried on for profit, and the hobby loss limitations do not apply. If the activity consists primarily of breeding, training, showing, or racing horses, the IRS will presume it is carried on for profit if a profit is produced in at least two of the last seven tax years, including the current year.

Reporting Hobby Income and Expenses

Occasional profits from hobby activities are not subject to self-employment tax and are reported as Other Income on line 21, Form 1040.

Hobby Income

Gross income for the purposes of the hobby loss rules equals gross receipts minus the cost of goods sold deduction. Hobby income may include capital gain, rent, and other income.

Hobby Expenses

Under the Tax Cuts and Jobs Act, for tax years 2018–2025, expenses related to hobby income are not deductible as miscellaneous itemized deductions subject to the 2% AGI limit on Schedule A (Form 1040).

Activities Not Engaged in for Profit

IRS examiners consider the following in their analysis to determine whether or not an activity is engaged in for profit.

- Are there activities with large expenses and little or no income?
- Are losses offsetting other income on the tax return?
- Does the activity result in a large tax benefit to the taxpayer?
- Does the history of the activity show that it is generating any profit in any years?

Examples of possible hobby activities include:

- Airplane Charter
- Artists
- Auto Racing
- Boating
- Bowling
- Collecting
- Cooking
- Craft Sales
- Direct Sales
- Dog Breeding
- Entertainers
- Farming
- Fishing
- Fishkeeping
- Gambling
- Games
- Gardening
- Horse Breeding
- Horse Racing
- Jewelry Making
- Knitting
- Motocross Racing
- Music
- Outdoor Recreation
- Photography
- Rentals
- Stamp Collecting
- Woodworking
- Writing
- Yacht Charter

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2018

Limited Liability Companies (LLCs)

Limited Liability Companies (LLCs)

What is a Limited Liability Company?

A limited liability company (LLC) is a business entity organized in the United States under state law. Unlike a partnership, all of the members of an LLC have limited personal liability for its debts. An LLC may be classified for federal income tax purposes as a partnership, corporation, or an entity disregarded as separate from its owner.

This information applies to LLCs in general, and different rules may apply to special situations, including banks, insurance companies, or nonprofit organizations that are LLCs. Check your state's requirements.

LLCs	
Ownership	• Unlimited number of members. • Non U.S. citizens or residents allowed. • Can be owned by other corporations, partnerships, trusts, or LLCs.
Class of ownership interest	Different membership classes allowed.
Transfer of ownership	Member approval often required.
Formalities	Recommended: • Adopt operating agreement. • Issue membership shares. • Hold and document annual member meetings.
Existence	Some states require dissolution date. Events such as death or withdrawal of member can cause LLC to dissolve.
Income allocation	May decide to allocate income in any method agreed to by members.
Self-employment taxes	Members subject to SE tax on guaranteed payments and also distributive share of income.

Forming an LLC

Choose a business name. Your business name must be different from any existing LLC in your state, it must indicate that it is an LLC, and must not include words restricted by your state.

File the Articles of Organization. The articles of organization is a document that is filed with your Secretary of State that makes your LLC a legal entity and includes information such as your business name, address, names of members, and your resident agent. There is usually a filing fee.

Create an Operating Agreement. Most states do not require operating agreements, but it is highly recommended, especially for multi-member LLCs. The operating agreement structures your LLC's finances and organization, and provides rules and regulations for its operation. Sometimes tax treatment can be dictated by a written operating agreement. Default tax rules of multimember LLCs will split income and expenses evenly, unless otherwise noted in an operating agreement.

Hold and document annual member meetings. If the operating agreement requires an annual meeting, these meetings must be held and documented. Failure to adhere to provisions in the operating agreement and other formalities could result in loss of liability protection for your LLC.

Apply for an EIN. An employer identification number (EIN) is a nine-digit number assigned by the IRS used to identify the tax accounts of employers and certain others who have no employees. If you will hire employees or have an LLC with multiple members, you need to apply for an EIN. See IRS Form SS-4, *Application for Employer Identification Number,* or apply online at www.irs.gov.

Limited Liability Companies (LLCs)

Classification of an LLC

Default classification rules. An LLC with at least two members is classified as a partnership for federal income tax purposes. An LLC with only one member is treated as an entity disregarded as separate from its owner for income tax purposes (but as a separate entity for purposes of employment tax and certain excise taxes). See *Single Member LLCs—Disregarded Entities,* below.

Elected classification. If an LLC does not choose to be classified under the above default classifications, it can elect to be classified as an association taxable as a corporation or as an S corporation. After an LLC has determined its federal tax classification, it can later elect to change that classification. See IRS Form 8832, *Entity Classification Election.*

LLCs Classified as Partnerships

If an LLC has at least two members and is classified as a partnership, it generally is subject to the same filing and reporting requirements as partnerships. For certain purposes, members of an LLC are treated as limited partners in a limited partnership. For example, LLC members are treated as limited partners for purposes of material participation under the passive activity limitation rules.

Change in default classification. If the number of members in an LLC classified as a partnership is reduced to only one member, it becomes an entity disregarded as separate from its owner. However, if the LLC has made an election to be classified as a corporation and that elective classification is in effect at the time of the change in membership, the default classification as a disregarded entity will not apply. Other tax consequences of a change in membership, such as recognition of gain or loss, are determined by the transactions through which an interest in the LLC is acquired or disposed of.

Single Member LLCs—Disregarded Entities

If an LLC has only one member and is classified as an entity disregarded as separate from its owner, its income, deductions, gains, losses, and credits are reported on the owner's income tax return. For example, if the owner of the LLC is an individual, the LLC's income and expenses would be reported on the following schedules filed with the owner's Form 1040.

- Schedule C, *Profit or Loss from Business (Sole Proprietorship),*
- Schedule E, *Supplemental Income and Loss,* or
- Schedule F, *Profit or Loss From Farming.*

Employment tax and certain excise taxes. If the LLC pays wages to employees, employment taxes must be reported and paid in the name and EIN of the LLC rather than in the name and EIN of the single member owner. The single-member LLC is also required to use the LLC's name and EIN to register for certain excise taxes.

Self-employment tax. An individual owner of an LLC treated as a disregarded entity is not an employee of the LLC. The owner is subject to self-employment tax on the net earnings in the same manner as a sole proprietorship.

Taxpayer identification number. For all income tax purposes, a single-member LLC classified as a disregarded entity must use the owner's Social Security Number (SSN) or EIN. This includes all information returns and reporting related to income tax.

LLCs Classified as Corporations

An LLC with either a single member or more than one member can elect to be classified as a corporation rather than be classified as a partnership or disregarded entity under the default rules.

An LLC classified as a corporation is subject to the same filing and reporting requirements as a corporation. The entity may elect to be treated as an S corporation if it otherwise qualifies.

C corporation. If the entity is treated as a C corporation, it is taxed on its taxable income and distributions to members are includible in each member's gross income to the extent of the corporation's earnings and profits (double taxation).

S corporation. If the entity elects to be an S corporation, the corporation is generally not subject to an income tax. The income, deductions, gains, losses, and credits of the corporation pass through to the members.

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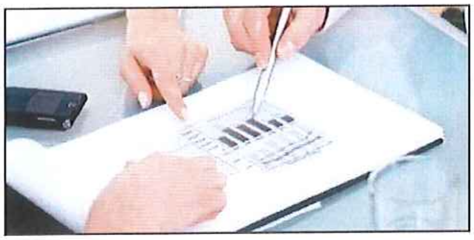

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Business Entity Pros and Cons

Business Entity Pros and Cons

Sole Proprietorship	
Pros	• No formal creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • No double taxation of profits.
Cons	• No liability protection. • Self-employment tax is assessed on entire profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners.
Good Fit	• Seasonal or part-time businesses. • Businesses with little liability. • Home-based businesses. • Businesses intended to operate for the owner's life only.

Single Member LLC	
Pros	• Simple creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • Liability protection for member, except for malpractice. • No double taxation of profits.
Cons	• Self-employment tax is assessed on entire profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners. • Laws regulating LLCs vary widely among states.
Good Fit	• Businesses with potential liability in operations. • Businesses intended to operate for the owner's life only.

Multimember LLC	
Pros	• Limited liability for all members, except for malpractice. • Unlimited number of members. • Separate entity from members, allowing for greater flexibility in operations. • Ownership is in the form of membership interest and can be transferred more easily than ownership in a single member LLC. • No double taxation of profits.
Cons	• Requires a separate tax return. • Laws regulating LLCs vary widely among states.
Good Fit	• Businesses requiring equity capital. • Businesses with potential liability in operations. • Businesses intended to exist beyond the lives of the members. • Businesses expecting changes in ownership over time.

General Partnership	
Pros	• Easy to create. • No limit on partner number or type. • Can be used to hold investments in other businesses and consolidate multiple lines of business. • Flexible allocation of profit, loss, and distributions. • Favorable tax treatment when liquidated. • No double taxation of profits.
Cons	• Requires a separate tax return. • Unlimited liability for all partners. • Difficult to dissolve or change ownership without substantial planning. • Requires tracking of basis for partners, both inside and outside the partnership. • Individual partner's share of income is subject to self-employment taxes.
Good Fit	• Two established businesses who wish to work as one. • Partners wishing to consolidate multiple entities into one entity.

Business Entity Pros and Cons

Limited Liability Partnership	
Pros	• Liability protection for limited partners. • Separate entity from partners. • Ownership can be transferred within the rules of the partnership agreement. • Limited partners' liability is limited to their investment in the business. • Limited partners pay self-employment tax on guaranteed payments only. • No double taxation of profits.
Cons	• Must have one general partner with unlimited liability. • Limited liability status for damages can be lost for a variety of administrative reasons. • Restrictions on partners based on entity type. • Requires a separate tax return. • Requires tracking of basis for partners, both inside and outside the partnership.
Good Fit	• Businesses with partners not actively involved in business. • Businesses with equity capital needs. • Businesses with exposure to liability.

C Corporation	
Pros	• No liability for non-active stockholders. • No restrictions on ownership. • Ownership can be transferred through the sale of stock. • Separate entity from stockholders. • Fringe benefits for owner-officers. • Can have ownership interest in any other business entity. • Perpetual existence. • Raising capital can be achieved by issuing stock.
Cons	• Double taxation of profits. • Complex and expensive to create and maintain. • Require regular board of directors' meetings and minutes. • Requires a separate tax return.
Good Fit	• Businesses with ownership in multiple other entities. • Businesses with significant exposure to liability. • Businesses intended to exist eternally.

S Corporation	
Pros	• Liability protection similar to that of C corporations. • No double taxation of profits. • Ownership is easily transferred through the sale of stock. • Separate entity from stockholders. • Self-employment tax is not assessed on the entire profit of the business. • Losses can offset shareholders' other taxable income.
Cons	• Complex and expensive to create and maintain. • Requires a separate tax return. • Requires regular board of directors' meetings and minutes. • Requires tracking of basis for stockholders. • Ownership is limited to specific types of entities. • Deductibility of fringe benefits for owner-employees is limited.
Good Fit	• Businesses with significant exposure to liability.

Business Formalities

A common problem with a closely-held business is failure to adhere to business formalities. Trouble can occur when business and personal funds are intermingled, the business is not adequately capitalized, or reasonable compensation for services is not paid.

For example, separation of funds can be a key in preserving the liability protection of the "corporate veil." Courts can pierce the corporate veil if they find the corporation is an "alter ego" of the shareholder, which is likely to occur if shareholders pay personal expenses from the corporation checkbook or vice versa.

Transactions such as capital contributions or loans between the business and the owners can also be recharacterized by the IRS, creating unexpected negative tax consequences.

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Business Entity Comparison Chart

Entity	Accounting and Recordkeeping	Fringe Benefits	Liability
Sole proprietor, single-member LLC, and husband/wife business • Schedule C, Form 1040, *Profit or Loss From Business* • Schedule F, Form 1040, *Profit or Loss From Farming* • Schedule SE, Form 1040, *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• Accounting is less involved than partnerships and corporations. Double-entry bookkeeping is not required as no balance sheet is needed when filing Schedule C or F. • Cannot file as a fiscal year business unless owner files Form 1040 under the fiscal year rules.	Excludable fringe benefits are generally not allowed for owner. ***Exceptions:*** Health insurance if spouse is an employee, and the owner is covered as a family member of the employee-spouse. The spouse is also eligible for dependent care assistance fringe benefits, de minimis fringe benefits, and working condition fringe benefits.	Owner is personally liable for all debts and lawsuits against the business. ***Exception:*** If organized as an LLC, liability is usually limited to owner's investment and his or her own malpractice or guarantees.
Partnership • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • IRC Subchapter K, §701 through §777	• Small partnerships are not required to provide a balance sheet and can use the same bookkeeping system as a sole proprietor. Larger partnerships must provide a balance sheet with the return, which requires double-entry bookkeeping. • A partnership must generally use the same tax year as its partners, but can use a fiscal year if there is a business purpose or an IRC section 444 election was made. • Complex books and records are needed when a partner exchanges property, other than cash, for a partnership interest or for special allocations and basis elections.	Partners are eligible for some excludable fringe benefits. Taxable benefits are reported as guaranteed payments or an adjustment to a partner's distributable share of profits.	A general partner is personally liable for all debts and lawsuits brought against the partnership. ***Exception:*** If the partner is a limited partner, or the business is organized as an LLC, liability is generally limited to the partner's investment, plus his or her own malpractice.
S corporation • Form 1120S, *U.S. Income Tax Return for an S Corporation* • IRC Subchapter S, §1361 through §1379	• Double-entry bookkeeping may be required depending on income and other factors affecting the need for a balance sheet on the return. • Must use a calendar year unless it establishes a business purpose for using a fiscal year, or it makes an IRC section 444 election.	Shareholder/employees are eligible for some excludable fringe benefits. Benefits added to taxable wages on W-2 of more than 2% shareholders include accident and health plans, up to $50,000 of group health insurance, and meals and lodging furnished for the employer's convenience.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice or guarantees.
C corporation • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • IRC Subchapter C, §301 through §385	• Double-entry bookkeeping is required as the tax return requires a balance sheet. • No restriction on use of a fiscal year. ***Exception:*** A personal service corporation (PSC) must use a calendar year unless it establishes a business purpose for using a fiscal year or makes an IRC section 444 election. • Required to use accrual method of accounting if average annual gross receipts exceed $5 million.	Shareholder/employees eligible for excludable fringe benefits, generally to the same extent as any other employee, with exceptions under the non-discrimination rules. Benefits can include health insurance and reimbursement, education, life insurance, etc.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice.

Business Entity Comparison Chart

Entity	Organization and Ownership	Taxation of Profits and Losses
Sole proprietor, single-member LLC, and husband/wife business • Schedule C, Form 1040, *Profit or Loss From Business* • Schedule F, Form 1040, *Profit or Loss From Farming* • Schedule SE, Form 1040, *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• One individual carrying on an unincorporated trade or business. • A qualified joint venture whose only members are a husband and wife may elect not to be taxed as a partnership and file as two sole proprietorships. An LLC may not make this election. • Easiest business to organize with minimal legal restrictions. • The entity does not exist apart from the owner. Business starts and ends based on engaging in and ending engagement in business. • The owner has complete freedom over business decisions and is entitled to 100% of the profits. The owner is limited by his or her own ability to raise capital and obtain financing. Outside investors cannot be part owners. • Transfer of ownership consists of selling the business assets. • A single-member LLC is taxed as a sole proprietorship unless the election is made to be taxed as a corporation.	• The owner is self-employed and pays self-employment (SE) tax on net profits. • Net profits are subject to income tax in the year earned and cannot be deferred by retaining profits. • Losses offset other income in year incurred, such as W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Activity subject to passive loss, at-risk loss, and hobby loss rules. • Eligible for the 20% pass-through entity deduction subject to taxable income limitations.
Partnership • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • IRC Subchapter K, §701 through §777	• Two or more owners conducting an unincorporated trade or business. • Easy to organize with minimal legal restrictions. • Multi-member LLCs are taxed as partnerships, unless the election to be taxed as a corporation is made. • No limitations on the number of partners or partner entities. • More flexibility than a corporation in dividing up profits, losses, ownership of capital, and making special allocations to partners. • Contributing property in exchange for a partnership interest is a tax-free event (except for the receipt of cash) and there is generally no tax when liquidating a partnership interest in exchange for property (unless the liquidation is in cash only). • Getting out of a partnership may be more complicated than starting one. A partnership agreement can restrict selling or transferring of a partnership interest. • A partnership can terminate if too much ownership is exchanged or liquidated in one year. • State law may limit an LLC's life.	• The partnership pays no income tax. Profits pass through to partners for individual payment of tax. • Tax to partners cannot be deferred by retaining business earnings. • Pass-through items retain the same character to the partner as they had to the partnership. • A general partner's distributive share of profits is subject to SE tax. Limited partners share of profits not subject to SE tax unless in the form of guaranteed payments. • Payment for partner services to the partnership is not W-2 income, but may be guaranteed payments, profits, or special allocations. • Losses flow through to partners and can be used to offset other income such as W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Activity subject to passive loss, at-risk loss, and hobby loss rules. • Eligible for the 20% pass-through entity deduction subject to taxable income limitations.
S corporation • Form 1120S, *U.S. Income Tax Return for an S Corporation* • IRC Subchapter S, §1361 through §1379	• A corporation that has elected to be taxed as an S corporation by filing Form 2553. • Ownership is through owning shares of stock. Limited to 100 shareholders. (A husband and wife, and their estates and all members of a family, as defined in IRC section 1361(c)(1)(B), and their estates can be treated as one shareholder for this test.) • Stock is limited to one class of stock with equal rights to distributions and liquidation proceeds. • Shareholders are limited to individuals, estates, certain trusts, and certain charities. Corporations and certain partnerships are ineligible to own stock. • Other ownership and organization issues are the same as a C corporation.	• An S corporation generally pays no tax. Profits flow through to the shareholders. • Pass-through items retain the same character to the shareholder as they had to the corporation. • Distributions are not subject to SE tax. • Shareholders who perform services are paid as employees and income is reported on a W-2. • Losses flow through to shareholders and may be used to offset other income, subject to passive, at-risk, and hobby loss exception rules. • Eligible for the 20% pass-through entity deduction subject to taxable income limitations.
C corporation • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • IRC Subchapter C, §301 through §385	• A legal association carrying on a trade or business organized under state law. • Ownership is through owning shares of stock, and there is no limit on number of shareholders, or type of taxpayer or entity. • Forming a corporation may require complex and expensive legal procedures. Corporations must hold board meetings, shareholder meetings, and keep corporate minutes. Corporations are subject to federal and state regulations. • The life of a corporation is perpetual. Transfers of ownership can be as easy as selling or inheriting stock. • Liquidating a corporation is usually a taxable event, and contributions in exchange for stock may be taxable. • Raising additional capital can be as easy as issuing new shares of stock.	• Shareholders who perform services are paid as W-2 employees subject to payroll taxes and reporting rules. Reasonable wages must be paid and not inflated to reduce corporate tax liability. • Net profits are subject to tax at the corporate rates. Profits distributed as dividends are taxed again on the shareholder's tax return. Tax to the shareholders can be deferred by retaining earnings for business purposes. • Losses do not pass through to shareholders. Business losses must be carried over to a year with profits. Capital losses must be carried over to a year with capital gains. At-risk limitations, hobby loss, and passive loss rules do not apply.

TAX YEAR
2018

Business Use of Home

Business Use of Home Expenses

Some expenses are deductible whether or not a taxpayer uses his or her home for business. Others are deductible only if the home is used for business.

Deductible Regardless*	Deductible Only If for Business**
• Real estate taxes. • Mortgage interest. • Casualty losses. • Qualified mortgage insurance premiums.	• Homeowner's insurance. • Rent. • Repairs and maintenance. • Security system. • Utilities and services. • Depreciation (deductible after applying deduction limitation to above expenses).

* Deductible as an itemized deduction.
** Deductible as a business expense pro-rated for the amount of the business use of the home

Direct Expenses

Expenses that benefit only the area exclusively used for business, such as painting or repairs in the home office, are direct expenses that are fully deductible.

Indirect Expenses

Expenses for keeping up and running the entire home, such as insurance, utilities, and general repairs, are indirect expenses that are deductible based on the percentage of the home used for business.

Unrelated Expenses

Expenses for the part of the home not used for business, such as lawn care or painting a room not used for business, are unrelated expenses that are not deductible.

Telephone

The basic local telephone service for the first telephone line is nondeductible even if it is used for business. Any additional charges for long distance or a second line into the home used for business are deductible. Any deductible telephone costs are not included as business use of home cost.

Depreciation

A qualified home office is considered nonresidential real property depreciable over 39 years. For home office depreciation, the basis in the home is the smaller of:

- The fair market value (FMV) of the home minus the FMV of land on the date the home was first used for business, or
- The home's cost plus permanent improvements minus casualty losses minus the cost of land on the date the home was first used for business.

Home Improvements

Permanent improvements prior to using the home for business are added to the basis of the home and depreciated as part of the adjusted basis of the home. The cost of improvements made after using the home for business that affect the area of the home used for business are depreciated separately.

Example: *Rita had a new roof put on her home in 2001. She first used her home for business in 2005. She also replaced her furnace in 2018. The cost of the new roof from 2001 is added to the basis of her home, and the business portion is depreciated starting in 2005. The business portion of the cost of the furnace is depreciated as a separate asset starting in 2018.*

Business Use of Home

Calculating Business Use of Home Deduction

Business Percentage

The business percentage equals the area of the part of the home used for business divided by the area of the whole house. Any reasonable method may be used to determine the business percentage.

The following are two common methods.

- Divide square footage of area used for business by total square footage of home.
- If all rooms are about the same size, divide the number of rooms used for business by total number of rooms in the home.

Part-Year Use

Do not include home expenses in the business use equation for any period during the year where the home was not used for business.

Day Care Facility

The business percentage of an area exclusively used for business in a day care facility is calculated under the business percentage method above. For the portion of the home regularly used, but not exclusively used for the day care business, multiply that portion by the business percentage of time.

Example: *Jane uses her 1,600 square foot basement for day care. The total area of her home is 3,200 square feet. Her day care uses the basement an average of 12 hours per day, five days a week, 50 weeks per year. The basement is used by her family at night and on weekends. The business percentage of her home is calculated as follows: 1,600 ÷ 3,200 = 50%. 12 × 5 × 50 = 3,000 day care hours per year. 24 × 365 = 8,760 total hours per year. 3,000 ÷ 8,760 = 34.25% day care time percentage. Any direct expenses, such as repainting the basement, are multiplied by 34.25% to determine the deductible business portion of the expense. Any indirect expenses, such as utilities, are multiplied by 17.13% (50% × 34.25% = 17.13%) to determine the deductible business portion of the expense.*

➲ ***Did You Know?*** In many cases, the basement and garage may be included in the total square footage of a day care provider's home when calculating the business use percentage. In addition to regularly used rooms, the business use area can include:

- Entryways, halls, food preparation areas, and bathrooms.
- Basement with laundry or tool rooms, storage or furnace area, etc.
- Garage where business car is parked or where household tools, trash cans, or stored day care items are kept.

Calculating Time Spent on Day Care

The provider should keep a log reflecting time spent conducting the day care business, including dates and hours each person was in the provider's care, and additional time spent organizing, preparing meals, and cleaning up.

Deduction Limitation

The business use of home deduction is limited to net income from the business.

Carryover of Unallowed Expenses

Deductions not allowed due to the net income limitation are carried over to the following year. They are added to current expenses from each category and subject to the deduction limit for that year for that category, whether or not the taxpayer lives in the same home during that year.

Simplified Option for Home Office Deduction

The simplified option for the home office deduction may be calculated as follows:

- A standard deduction is allowed of $5 per square foot of home used for business, limited to 300 square feet.
- Allowable home-related itemized deductions such as mortgage interest and real estate taxes are claimed in full on Schedule A, instead of apportioned between the business form and Schedule A.
- No home depreciation deduction is claimed and no later recapture of depreciation is required for the years the simplified method is used.

Note: Although recordkeeping is simplified, this option does not change the criteria for who may claim a home office deduction.

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- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

TAX YEAR
2018

Estimated Taxes

Estimated Taxes

The federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the year. There are two ways to pay as you go, either by employer withholding or estimated tax payments.

Employer withholding. If you are an employee, your employer generally withholds income tax from your pay. In addition, tax may be withheld from certain other income such as pensions, bonuses, commissions, and gambling winnings. If all of your income will be subject to income tax withholding, you probably do not need to pay estimated tax. Events during the year may change your marital status or exemptions, adjustments, deductions, or credits you expect to claim on your tax return. When this happens, you should complete a new Form W-4, *Employee's Withholding Allowance Certificate,* so that the appropriate amount of tax is withheld.

Estimated tax. Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rents, gains from the sale of assets, prizes and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough.

Estimated tax is used to pay not only income tax, but self-employment tax and alternative minimum tax as well. If you do not pay enough by the due date of each quarterly payment period you may be charged a penalty even if you are due a refund when you file your tax return.

Who Must Pay Estimated Tax

If you are filing as a sole proprietor, partner, S corporation shareholder, and/or a self-employed individual, you generally have to make estimated tax payments if you expect to owe tax of $1,000 or more when you file your return.

If you owed additional tax for the prior year (did not have enough withheld by employer), you may have to pay estimated tax for the current year.

General rule. In most cases, you must pay estimated tax for the current year if both of the following apply.

1) You expect to owe at least $1,000 in tax for the current year, after subtracting withholding and refundable credits, and
2) You expect your withholding and refundable credits to be less than the smaller of:
   a) 90% of the tax to be shown on your current year tax return, or
   b) 100% of the tax shown on your previous year's tax return, if your previous year's return covered all 12 months.

Note: The percentage amounts may be different if you are a farmer, fisherman, or higher-income taxpayer.

Who Does Not Have to Pay Estimated Tax

If you receive salaries and wages, you can avoid having to pay estimated tax by asking your employer to withhold more tax from your earnings. To do this, file a new Form W-4 with your employer. There is a special line on Form W-4 for you to enter the additional amount you want your employer to withhold.

You do not have to pay estimated tax for the current year if you meet all three of the following conditions.

- You had no tax liability for the prior year,
- You were a U.S. citizen or resident for the whole year, and
- Your prior tax year covered a 12 month period.

Estimated Taxes

You had no tax liability for the prior year if your total tax was zero or you did not have to file an income tax return.

When to Pay Estimated Taxes

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific payment due date. If you do not pay enough tax by the due date of each of the payment periods, you may be charged a penalty even if you are due a refund when you file your income tax return.

2018 Estimated Payment Dates for Individuals

Installment	*Tax Period Covered*	*Due Date*
First	January 1 to March 31, 2018	April 17, 2018
Second	April 1 to May 31, 2018	June 15, 2018
Third	June 1 to August 31, 2018	September 17, 2018
Fourth	September 1 to December 31, 2018	January 15, 2019

* Underpayment penalty for fourth installment does not apply if the 2018 return is filed and balance paid by January 31, 2019.
Note: It may be advantageous to pay the fourth period installment of estimated taxes for state by December 31, 2018, in order to deduct the amount as an itemized deduction for 2018.

You can use Form 1040-ES, *Estimated Tax for Individuals*, to file your quarterly estimated tax payments. Or, you can make all of your federal tax payments including federal tax deposits, installment agreement, and estimated tax payments using the Electronic Federal Tax Payment System (EFTPS). If it is easier to pay your estimated taxes weekly, bi-weekly, monthly, etc. you can, as long as you have paid enough in by the end of the quarter. Using EFTPS, you can access a history of your payments, so you know how much and when you made your estimated tax payments. See www.eftps.gov/eftps, for more information.

Underpayment of Estimated Tax

If you did not pay enough tax throughout the year, either through withholding or by making estimated tax payments, you may have to pay a penalty for underpayment of estimated tax. Generally, most taxpayers will avoid this penalty if they owe less than $1,000 in tax after subtracting their withholdings and credits, or if they paid at least 90% of the tax for the current year, or 100% of the tax shown on the return for the prior year, whichever is smaller.

The penalty may also be waived if:

1) The failure to make estimated payments was caused by a casualty, disaster, or other unusual circumstance and it would be inequitable to impose the penalty, or
2) You retired (after reaching age 62) or became disabled during the tax year for which estimated payments were required to be made or in the preceding tax year, and the underpayment was due to reasonable cause and not willful neglect.

Additional Medicare Tax and Net Investment Income Tax—Threshold Amounts

Filing Status	*Threshold Amount*
Single, Head of Household, Qualifying Widow(er)	$200,000
Married Filing Jointly	$250,000
Married Filing Separately	$125,000

Additional Medicare Tax. A 0.9% Additional Medicare Tax applies to Medicare wages, Railroad Retirement Tax Act compensation, and self-employment income over the threshold amount based on your filing status. You may need to include this amount when figuring your estimated tax.

Net Investment Income Tax. You may be subject to the Net Investment Income Tax (NIIT). NIIT is a 3.8% tax on the lesser of net investment income or the excess of your modified adjusted gross income (MAGI) over the threshold amount for your filing status. NIIT may need to be included when figuring your estimated tax.

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- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

Marketing Your Business

Marketing Your Business

In order to be successful in marketing, you'll need to follow a few simple steps.

1) Define your target market.
2) Identify the products and/or services that meet your customers' needs.
3) Define the offer for your product and/or services.
4) Advertise your product and/or services.

General Ideas

- Engage in at least one marketing activity every day.
- Determine a percentage of gross income allotted to spend annually on marketing.
- Set annual marketing goals. Review and adjust quarterly.
- Carry business cards with you at all times.

Marketing Communications

- Publish a newsletter for customers and prospects (it doesn't have to be fancy or expensive).
- Develop an online brochure of services.
- Create giveaways such as calendars or posters for your customers to keep your name in front of them.
- Print a slogan and/or one-sentence description of your business on letterhead, fax cover sheets and invoices.
- Create a signature file to be used for all your email messages. It should contain contact details, including your website address and key information about your company that will make the reader want to contact you.
- Include testimonials from customers in your literature.
- Remember to keep your message consistent with all communications.

Media Relations

- Write a column for the local newspaper, local business journal, or a trade publication.
- Publicize your 500th client of the year (or other notable milestone).
- Create an annual award and publicize it.
- Get public relations and media training.
- Create your own TV program on your industry or your specialty. Market the show to your local cable station or public broadcasting station as a regular program, or see if you can air your show on an open access cable channel.

Customer Service and Customer Relations

- Return phone calls promptly.
- Set up an email system to easily respond to customer inquiries.
- Get a memorable phone number, such as 1-800-WIDGETS.
- Obtain a memorable URL and email address and include them on all marketing materials.
- Take clients out to a ball game, show, or another special event—or just send them two tickets with a note.
- Send handwritten thank you notes.
- Send birthday cards and appropriate seasonal greetings.
- Create an area on your website specifically for your customers.

Marketing Your Business

- Redecorate your office or location where you meet with your clients.
- Distribute advertising specialty products such as pens, mouse pads, or mugs.
- Mail bumps—mail photos, samples or other innovative items to your prospect list. (A mail bump is anything that makes the envelope bulge and makes the recipient curious about what's inside!)
- Consider non-traditional tactics such as bus backs, billboards, and popular websites.
- Consider placing ads in your newspaper's classified section.
- Code your ads and keep records of results.

Marketing Performance

After implementing a marketing program, it is important to understand its impact on your business. Each program should have performance standards to compare with actual results. Researching industry norms and past performances will help to develop appropriate standards. Audit your company's marketing performance at least quarterly, if not monthly.

Marketing Tips

- The most important order you ever get from a customer is the second order.
- Understanding and adapting to consumer motivation and behavior is not an option. It is an absolute necessity for competitive survival.
- A well-designed catalog mailed to a qualified response list will probably bring a one percent response.
- Processing and fulfillment costs incurred from the time an order arrives until it is shipped should be kept below $10 an order.
- The two most common mistakes companies make in using the phone is failing to track results and tracking the wrong thing.
- Marketing activities should be designed to increase profits, not just sales.
- It costs five times as much to sell a new customer as an existing customer.
- Selling what your customers need, instead of what they want, can lead to failure.
- Don't think that product superiority, technology, innovation or company size will sell itself.
- Don't neglect or ignore your current customers while pursuing new ones.
- People don't buy products, they buy the benefits and solutions they believe the products provide.
- The average business never hears from 96% of its dissatisfied customers.
- Fifty percent of those customers who complain would do business with the company again if their complaints were handled satisfactorily.
- It is estimated that customers are twice as likely to talk about their bad experiences as their good ones.
- Marketing is everyone's business, regardless of title or position in the organization.
- Get to know your prime customers—the 20% of product users who account for 80% of the total consumption of that product class.

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Business Use of Home

Business Use of Home Expenses

Some expenses are deductible whether or not a taxpayer uses his or her home for business. Others are deductible only if the home is used for business.

Deductible Regardless*	Deductible Only If for Business**
• Real estate taxes. • Mortgage interest. • Casualty losses. • Qualified mortgage insurance premiums.	• Homeowner's insurance. • Rent. • Repairs and maintenance. • Security system. • Utilities and services. • Depreciation (deductible after applying deduction limitation to above expenses).

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Permanent improvements prior to using the home for business are added to the basis of the home and depreciated as part of the adjusted basis of the home. The cost of improvements made after using the home for business that affect the area of the home used for business are depreciated separately.

Example: *Rita had a new roof put on her home in 2001. She first used her home for business in 2005. She also replaced her furnace in 2018. The cost of the new roof from 2001 is added to the basis of her home, and the business portion is depreciated starting in 2005. The business portion of the cost of the furnace is depreciated as a separate asset starting in 2018.*

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Calculating Business Use of Home Deduction

Business Percentage

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- Divide square footage of area used for business by total square footage of home.
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Day Care Facility

The business percentage of an area exclusively used for business in a day care facility is calculated under the business percentage method above. For the portion of the home regularly used, but not exclusively used for the day care business, multiply that portion by the business percentage of time.

Example: *Jane uses her 1,600 square foot basement for day care. The total area of her home is 3,200 square feet. Her day care uses the basement an average of 12 hours per day, five days a week, 50 weeks per year. The basement is used by her family at night and on weekends. The business percentage of her home is calculated as follows: 1,600 ÷ 3,200 = 50%. 12 × 5 × 50 = 3,000 day care hours per year. 24 × 365 = 8,760 total hours per year. 3,000 ÷ 8,760 = 34.25% day care time percentage. Any direct expenses, such as repainting the basement, are multiplied by 34.25% to determine the deductible business portion of the expense. Any indirect expenses, such as utilities, are multiplied by 17.13% (50% × 34.25% = 17.13%) to determine the deductible business portion of the expense.*

➲ ***Did You Know?*** In many cases, the basement and garage may be included in the total square footage of a day care provider's home when calculating the business use percentage. In addition to regularly used rooms, the business use area can include:

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Calculating Time Spent on Day Care

The provider should keep a log reflecting time spent conducting the day care business, including dates and hours each person was in the provider's care, and additional time spent organizing, preparing meals, and cleaning up.

Deduction Limitation

The business use of home deduction is limited to net income from the business.

Carryover of Unallowed Expenses

Deductions not allowed due to the net income limitation are carried over to the following year. They are added to current expenses from each category and subject to the deduction limit for that year for that category, whether or not the taxpayer lives in the same home during that year.

Simplified Option for Home Office Deduction

The simplified option for the home office deduction may be calculated as follows:

- A standard deduction is allowed of $5 per square foot of home used for business, limited to 300 square feet.
- Allowable home-related itemized deductions such as mortgage interest and real estate taxes are claimed in full on Schedule A, instead of apportioned between the business form and Schedule A.
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Note: Although recordkeeping is simplified, this option does not change the criteria for who may claim a home office deduction.

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TAX YEAR 2018

Small Business Health Care Tax Credit

Small Business Health Care Tax Credit

Do You Qualify?

The three steps (next column) assist small employers (business or tax-exempt) that provide health insurance coverage to employees determine if they may qualify for the Small Business Health Care Tax Credit.

Employees

The credit is reduced if the employer had more than 10 full-time equivalent employees (FTEs) for the tax year. If the employer had more than 25 FTEs for the tax year, the credit is reduced to zero. Generally, all employees who perform services during the year are taken into account when determining FTEs.

Excluded Employees

Hours, wages, and premiums paid of excluded employees are not counted when figuring this credit. Excluded employees include the owner of a sole proprietorship, partner in a partnership, shareholder who owns more than 2% of an S corporation, shareholder who owns more than 5% of a C corporation, person who owns more than 5% of the capital or profits of any other business that is not a corporation, and family members or a member of the household who qualifies as a dependent of any person listed above.

Seasonal Employees

Seasonal employees who work 120 or fewer days during the tax year are not considered employees in determining FTEs and average annual wages. But, premiums paid on their behalf are counted. Seasonal workers include retail workers employed exclusively during the holiday seasons.

Do You Qualify?

1) Does the employer pay at least 50% of the employee insurance premiums at the single (employee-only) coverage rate?

If yes, continue to Step 2. ↓ If no, stop here. You do not qualify for the credit.

2) Determine the total number of employees (not counting owners or family members).

Full-time employees.................................... ________
(Enter number of employees that work at least 40 hours per week.)

plus

Full-time equivalent employees.................... ________
(Calculate the number of full-time equivalents by dividing total annual hours of part-time employees by 2,080.)

equals

Total employees... ________

If the total number of employees is less than 25, continue to Step 3. ↓ If no, stop here. You do not qualify for the credit.

3) Calculate the average annual wages of employees (not counting owners or family members).

Total annual wages (Medicare wages) paid to employees .... ________

divide by

Number of total employees from Step 2 .... ________

equals

Average wages... * ________

* If the result is less than $53,000, the employer may qualify for the Small Business Health Care Tax Credit.

Small Business Health Care Tax Credit

Full-Time Equivalent Employees (FTEs)

The employer's number of FTEs is determined by dividing the total hours of service for which the employer pays wages to employees during the year (but not more than 2,080 hours for any employee) by 2,080.

Average Annual Wages

The credit is reduced if the employer paid average annual wages of more than $26,500 for the tax year. If the employer paid average annual wages of $53,000 or more for the tax year, the credit is zero. Wages, for this purpose, mean wages subject to Social Security and Medicare tax withholding determined without considering any wage base limit. Average annual wages are total wages paid for the tax year divided by the number of FTEs.

Small Business Health Care Tax Credit Worksheet

Company Name: **Year Ended:**

Employee Name [1,2]	Hours Paid [3] During the Year	Wages Paid [3] (W-2, Box 5)	Enrolled in Company Health Insurance Plan? Yes/No	Type of Coverage (check one)		Annual Insurance Premium Amounts		
				Single	Other	Total Paid	Paid by Employee [4]	Paid by Employer

[1] Do not list any owner or owner's family members.

[2] Indicate any seasonal employee who worked 120 or fewer days during the tax year.

[3] Do not include hours worked or wages paid to seasonal employees. Do include premiums.

[4] Employee paid premiums include any premiums paid pursuant to a salary reduction plan under a IRC section 125 cafeteria plan.

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- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

Business Management Tips

Online Business Resources

www.sba.gov. The U.S. Small Business Administration (SBA) provides programs for businesses in the areas of technical assistance, training and counseling, financial assistance, assistance with government contracting, disaster assistance recovery, advocacy laws and regulations, civil rights compliance, and special interests, such as women, veterans, Native Americans, and young entrepreneurs. The website provides links to numerous information resources.

www.score.org. The Service Corps of Retired Executives (SCORE) is dedicated to helping small businesses get off the ground, grow and achieve their goals. SCORE provides volunteer mentors, free confidential business counseling, free business tools, and inexpensive or free business workshops.

Websites

www.archive.org	Internet Archive Wayback Machine
www.bizstats.com	Business/Industry Statistics
www.bls.gov	U.S. Bureau of Labor Statistics
www.entrepreneur.com	Entrepreneur Magazine
www.franchise.org	International Franchise Association

Business Plans

A business plan is a written document created to detail all aspects of a business on a comprehensive level. The process of writing a business plan requires significant research into each of the topics discussed. In some cases, the process of researching and writing a business plan will reveal potential problems or lead the writer to choose not to go into business.

A business plan helps to define short- and long-term goals for the business and the methods for measuring the level of success in reaching them. Many banks and investors require a written business plan before lending to or investing in a business. Also, by carefully examining each aspect of a business at its beginning, a business can be structured to create the maximum level of tax advantage for the owners.

Explore the website www.score.org for assistance with writing a business plan.

Start-Up Costs and Capitalization

Start-up costs. Start-up costs are incurred before the start of operations. Typical expenses include the costs of organization, professional consulting, capital equipment acquisition, and leasing a space.

Capital. Cash from the owners or investors is the most common source of capital when beginning a new entity. Business loans are also common and can be secured through private banks or the Small Business Administration (SBA).

SBA loans. The SBA is a federal agency which guarantees certain loans and lines of credit made by banks to small businesses. Loans and lines are available for working capital, asset purchase, and debt refinancing needs.

Use of Budgets

Annual budget. Development of an annual budget generally takes place late in the year prior to the year of the budget and is broken down by month. Financial statements from recently completed periods are used to develop estimates for the budget. Using the budget, costs can be reduced, resources properly allocated, and new goals for the year can be set.

Business Management Tips

Internal Control

Control procedures. Internal control procedures are designed to safeguard the assets of a business. Without them, dishonest employees or owners can misappropriate assets in the form of cash, property, or supplies with little effort.

Separation of duties. Duties which, if conducted by the same individual, would allow for simple concealment of theft should be kept separate. The following are examples of duties that should be performed by different people.

- Receiving, recording, and depositing customer payments.
- Sourcing, approving, ordering, and receiving supplies or merchandise.
- Inputting, approving for payment, and paying vendor bills and payroll.
- Balancing and inputting transactions into bank accounts.
- Counting cash and merchandise on hand at the beginning and end of the day.

Small businesses generally lack sufficient staff to properly separate all duties which should be separated. In this case, increased involvement of owners and management in daily operations of a business can assist in detecting misappropriation of assets.

Mandatory vacations. Many schemes to steal from a business require constant, manual intervention by the person perpetrating the scheme. By having and enforcing a mandatory vacation policy, the time a perpetrator spends away from work may allow a scheme to be uncovered in the course of daily operations. Mandatory vacations should be a minimum of two weeks, during which time the vacationing person has no access to a business or its records.

Environment of detection. If an employee or owner believes embezzlement will be discovered in the normal course of business, it is much less likely one would choose to embezzle. Creating an environment of detection is the process of alerting all employees and owners that systems are in place to detect embezzlement and theft, and that such acts will be prosecuted if perpetrated. This can be accomplished through training, one-on-one conversations, and the establishment of a hotline employees and owners can use to report suspected theft.

Background checks. Background checks during the hiring process allow a business to determine whether a prospective employee has any criminal history. Many background checks also include credit histories to uncover any financial conditions which may make an employee more likely to steal from a business.

Top 10 Reasons Businesses Fail

Failure rates. Data from the SBA indicates three in 10 new businesses fail within the first two years, and only five in 10 businesses survive five or more years.

Reasons for failure. The 10 most common reasons for failure are listed below.

1) ***Lack of experience.*** This can apply to a lack of experience in a specific business or in running a business in general.
2) ***Insufficient capital.*** Sufficient capital must be in place to support a business until cash flow from operations is adequate.
3) ***Poor location.***
4) ***Poor inventory management.*** Keeping too much inventory uses too much capital unnecessarily, while having too little inventory can lead to shortages and customer dissatisfaction.
5) ***Over-investment in fixed assets.***
6) ***Poor credit arrangements.*** Lacking access to sufficient, reasonably priced credit.
7) ***Personal use of business funds.*** Business funds should not be used for personal purposes.
8) ***Low sales.***
9) ***Competition.*** Not properly assessing competition can potentially leave a business in a position of needing to compete in a market where it cannot do so and survive.
10) ***Unexpected growth.*** Growth without sufficient planning for the consequences can lead a thriving business to failure.

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Business Financing—Don't Intermingle Funds

Business Financing—Don't Intermingle Funds

Intermingling Funds

A common problem with single-owner and other closely-held corporations is intermingling of funds. This occurs when a corporate shareholder uses his or her personal checking account for corporate deposits or payment of corporate expenses.

Separation of funds can be a key in preserving the liability protection of the corporate veil. Courts can pierce the corporate veil by finding that the corporation is an "alter ego" of the shareholder, essentially stating that the corporation is not separate and distinct from the individual as evidenced by the intermingling of finances.

Also, a shareholder who deposits personal funds or pays personal expenses from the corporate checking account is intermingling funds. For the same reasons as the reverse, courts can cite this as evidence that the corporation is not a separate and distinct entity from the individual.

Tax Problems Caused by Intermingling Funds

Unintended tax consequences can occur when personal and corporate funds are intermingled. When a shareholder provides funds to or on behalf of a corporation, there are several different types of tax treatment that may apply, depending on the circumstances. For example, when a shareholder provides funds to a corporation, it can be classified as one of the following transactions.

- Capital contribution.
- Loan to the corporation.
- Repayment of a loan from the corporation.
- Expense reimbursement.
- Purchase.

When a shareholder purchases an item for the corporation from his or her personal funds, that shareholder is considered to have provided funds, or made a contribution, to the corporation. Classification is determined by how the transaction is structured and the circumstances surrounding the transaction. Providing funds to corporations without careful planning can cause unintended tax consequences.

If an individual takes funds from a corporation checking account, the transaction can be classified as:

- Taxable dividend.
- Nontaxable distribution.
- Nontaxable expense reimbursement.
- Wages.
- Loan to the shareholder.
- Repayment of a loan from the shareholder.

Failure to carefully structure transactions when taking disbursements from a corporation can result in otherwise nontaxable transactions becoming taxable, in addition to opening the corporation up for a court to pierce the corporate veil.

Example: *Lucy owns a home and garden store. She recently incorporated in order to shield herself from liabilities of the business. Lucy meant to open a corporation checking account, but she never got around to it. Since she had been doing business with her suppliers for many years as a sole proprietor, she continued to purchase supplies and inventory on account and pay the invoices from her personal checking account. Unfortunately, Lucy had a particularly bad year, and she was successfully sued for $1 million by a customer injured by a Venus Flytrap purchased at Lucy's store. She also fell under audit by the IRS.*

Business Financing— Don't Intermingle Funds

Since Lucy's equity in the store was only one thousand dollars ($1,000), the plaintiff's attorney asked the court to pierce the corporate veil. The court agreed, stating that as evidenced by the intermingling of funds, the corporation did not operate as a separate legal entity and was a mere alter ego for Lucy. Lucy became personally liable for the damages caused by the carnivorous plant.

When Lucy made purchases for her business from personal funds, she had been writing off those amounts as expenses on her corporation tax return. The IRS determined that the amounts paid amounted to capital contributions, not payment of expenses, and adjusted her taxable income upward for the year under investigation. Lucy's accountant tried to cheer her up by noting that in some cases, expenses paid by a shareholder have been disallowed altogether and the deductions permanently lost.

Court Case: A taxpayer operated a tax preparation business as a sole proprietor. The taxpayer later incorporated but continued to have clients make checks out to him personally and treated funds received from the business as his own. No evidence of any employment agreement existed between the taxpayer and his corporation. The court ruled that the taxpayer operated his business as a sole proprietor and the income earned should be treated as earned not by the corporation but by the individual and be subject to self-employment tax. *(Reginald Jarrett, et al,* T.C. Summary 2008-94)

Personal use of corporate assets. A similar situation with intermingling funds occurs when personal assets are used by the corporation and vice versa. If corporate assets are used for personal purposes, the IRS can reclassify expenses reported on the corporation tax return as expenses attributable to the shareholder rather than the corporation. On the other hand, if a corporation uses personal assets owned by the shareholder, this could indicate lack of separation of the shareholder and corporation, opening up the possibility of having the corporate veil pierced.

Court Case: The taxpayer was engaged in several business activities, including real estate, entertainment services, and interior design. She incorporated her business in New York under the name Real Services, Inc. The taxpayer's books were not well-kept, and she frequently used the corporation checking account to intermingle funds. Business deposits were made into the account, but checks were written for items such as birthday presents for family members, tuition costs for the daughter of a friend, and contact lenses for her friend. The taxpayer was audited by the IRS and taxes were assessed on unreported income.

The taxpayer argued she was not individually liable for the taxes. Instead, her corporation, Real Services, Inc., should be liable because the corporation received the funds in question. The court decision determined the corporation was a sham and stated the corporation had the characteristics of an alter ego, including:

"The intermingling of corporate and personal funds, undercapitalization of the corporation, failure to observe corporate formalities, such as the maintenance of separate books and records, failure to pay dividends, insolvency at the time of a transaction, siphoning off funds by the dominant shareholder, and in the inactivity of other officers and directors." *(Zabetti Pappas,* T.C. Memo 2002-127)

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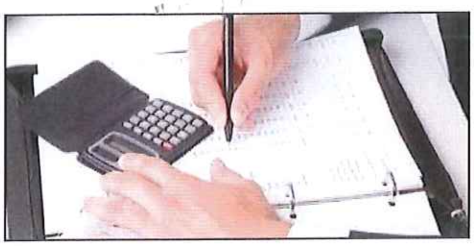


TAX YEAR
2018

Business Owners—Taking Money Out of a Business

Business Owners—Taking Money Out of a Business

When taking money out of a business, transactions must be carefully structured to avoid unwanted tax consequences or damage to the business entity. Business owners should follow the advice of a tax professional to make sure financial transactions are controlled and do not cause unanticipated taxation or other negative effects.

For example, a shareholder of a corporation can make a loan to the corporation, and subsequent repayments of principal are not taxable to the shareholder. This may seem straightforward. However, if the loan and repayments are not set up and processed properly, with specific documentation in place, the IRS can reclassify the funding as nondeductible capital contributions and classify the repayments as taxable dividends, resulting in unexpected taxation. A weak loan structure can also create a danger zone where a court can "pierce the corporate veil," resulting in personal liability for the business owner. These negative effects can occur in several different situations.

Classifications

When a business owner provides funds to the business, it can be classified as one of the following transactions.
- Capital contribution.
- Loan to the corporation.
- Repayment of a loan from the corporation.
- Expense reimbursement.
- Purchase.

On the other hand, when an individual takes funds from a business, the transaction can be classified as:
- Taxable dividend or distribution of profits.
- Nontaxable distribution.
- Nontaxable expense reimbursement.
- Taxable wages.
- Loan to the shareholder.
- Repayment of a loan from the shareholder.

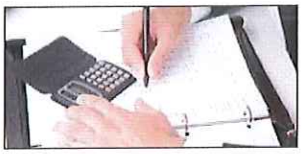
Failure to tightly control the nature of the transactions can have negative effects on the business and the business owner.

Intermingling Funds

One of the most dangerous financial mistakes a business owner can make is to intermingle funds, such as paying personal expenses from the business checking account, or paying business expenses from the owner's personal account. This can be done with the best of intentions with the business owner making adjustments in the books to separate the business and personal transactions, but the behavior can leave openings for the IRS or courts to question the integrity of the business entity or the transactions. Failure to maintain complete financial separation between a business and its owners is one of the major causes of tax and legal trouble for small businesses.

Sole Proprietorships

A sole proprietor is taxed on self-employment income without regard for activity in the business bank account. A sole proprietor should never pay himself or herself wages, dividends, or other distributions. A sole proprietor may take money out of the business bank account with no tax ramifications.



Business Owners—Taking Money Out of a Business

Taking Money Out

Wages

One way for a business owner to take money out of a corporation is through wages for services performed. Wages are appropriate only for C corporations and S corporations, not for sole proprietorships or partnerships. Owners are treated as employees, payroll taxes and income taxes are withheld, and the corporation issues Form W-2, *Wage and Tax Statement,* to the business owner after the beginning of the year.

"Reasonable Wages"

For C corporations and S corporations, there are incentives to skew wages one way or the other for purposes of tax savings. In a C corporation, wages are deductible by the corporation but dividends are not, creating incentive for a C corporation shareholder to inflate the wages for higher deductions. In an S corporation, wages are subject to payroll taxes but flow-through income is not, creating an incentive for artificially low wages. Both C corporations and S corporations are required by law to pay "reasonable wages," which approximate wages that would be paid for similar levels of services in unrelated companies.

Guaranteed Payments

Guaranteed payments to partners are the partnership counterpart to corporate wages. One major difference is with guaranteed payments, there is no withholding for payroll taxes or income tax. These amounts are computed and paid on the partner's individual Form 1040.

Dividends

Dividends are generally the means by which a C corporation distributes profits to shareholders. Amounts up to the C corporation's "earnings and profits" are taxable to the shareholder. Although flow-through income from S corporations or partnerships are often called "dividends," they are not treated as dividends under tax rules.

Flow-Through Income—S Corporations and Partnerships

Income from S corporations and partnerships flow through to the shareholder or partner's individual tax return. Flow-through income is reported without regard for whether or when the income is distributed to the shareholder or partner. Distributions of cash to an S corporation shareholder or partner are not taxable to the individual until the person's cost basis reaches zero.

One-Class-of-Stock Rule

An S corporation is allowed to have only one class of stock. If an S corporation does not make equal distributions to all shareholders, this rule may be violated and the S corporation status may be terminated. The one-class-of-stock rule must be adhered to whenever making distributions from an S corporation's bank account.

Loans

A corporation or partnership can receive loans from shareholders or partners, and on the other hand a corporation or partnership can make loans to shareholders or partners. There is generally no taxable event when a corporation or partnership repays a loan from a business owner, and no taxable event when a corporation or partnership makes a bona-fide loan to a shareholder or partner. However, failing to adhere to necessary formalities can put these transactions in danger, allowing the IRS to step in and reclassify the transactions, resulting in taxable income for the business owners.

Limited Liability Companies (LLCs)

Taxation of an LLC falls into either a default category, or the LLC makes an election on the manner of taxation. A single-owner LLC owned by an individual is considered a "disregarded entity" and is taxed as a sole proprietorship by default. If the LLC makes an election to be taxed as a corporation, either C corporation or the S corporation rules apply. An LLC owned by more than one individual is taxed as a partnership by default. As with a single-owner LLC, a multiple-owner LLC may make an election to be taxed as a corporation.

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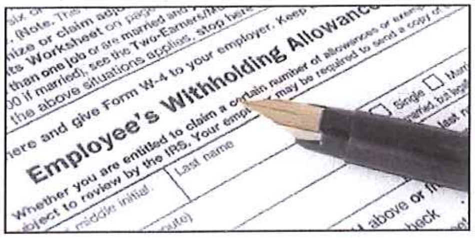

TAX YEAR
2018

Withholding — Filling Out Form W-4

2018 Federal Income Tax Withholding

The newly revised 2018 withholding tables are designed to work with Form W-4, *Employee's Withholding Allowance Certificate,* which you previously gave your employer.

To help determine your withholding you can also use the withholding calculator at www.irs.gov/W4App. Consider using this calculator if you have a more complicated tax situation, such as if you have a working spouse, more than one job, or a large amount of nonwage income.

Form W-4, *Employee's Withholding Allowance Certificate*

Starting a new job can be exciting, but it can also be stressful. One of the documents you're likely to see on your first day of work is IRS Form W-4, which tells your employer how much income tax to withhold from your paycheck so you don't owe a bundle when you file your tax return. The form has complicated instructions in small print, several worksheets, and can be intimidating at first glance. This handout provides some basic information about what Form W-4 is, how to fill it out properly, and what is done with the information when the form is handed in to the employer.

Purpose of Form W-4

Law requires every new employee to fill out Form W-4 so the employer can withhold the proper amount of federal income tax from the employee's pay.

Form W-4 is not filed with the IRS, but is kept in the employee file. A new Form W-4 may be filed with the employer at any time during the year should the employee's situation change. It is recommended that employees complete a new W-4 once a year.

The employer may also use the information from IRS Form W-4 to determine how much to withhold for state income tax. Note that withholding for Social Security and Medicare tax (FICA) is a set percentage and is not affected by Form W-4.

How Withholding is Computed

When preparing payroll, the employer refers to an IRS chart that states an amount to withhold based on whether the employee is single or married, how many personal allowances are indicated, and how much the employee earned during the pay period.

The amounts on the withholding chart are an attempt to withhold the proper amount so the employee will have paid the tax liability through withholding when he or she files a tax return for the year.

If tax liability on the return is more than the amount withheld, there will be a balance due. If the underpayment is substantial, penalties may apply.

If tax liability on the return is less than the amount withheld, the difference is refunded to the taxpayer. There is no penalty for having too much tax withheld. Keep in mind that big refunds are generally viewed as a bad tax planning strategy since they amount to giving an interest-free loan to the government and getting your own money back next year.

Single or Married

The employee checks a box on Form W-4 stating whether he or she is single or married. An employee who is single will have tax withheld at a higher rate than an employee who is married. Note that there is also an option to check a box indicating, "Married, but withhold at higher Single rate."

Withholding – Filling Out Form W-4

An employee may want a higher rate of withholding if he or she has a significant source of other taxable income (such as self-employment, interest, or dividend income), if he or she works more than one job, or is married and both spouses work.

Two earners or multiple jobs. If you have a working spouse or more than one job, the total number of allowances should be claimed on only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others.

Example: *Julie and Harold are married and both work at wage jobs. Julie's income is $90,000 and Harold's income is $40,000. The total number of allowances they claim together is two. Therefore, in order to have the correct amount of withholding, they each should check the box "Married, but withhold at the higher Single rate" and two (2) allowances should be claimed on Julie's Form W-4 and zero (0) allowances claimed on Harold's Form W-4.*

Personal Allowances

Personal allowances reported on Form W-4 take into consideration your filing status, amount of Child Tax Credit or Credit for Other Dependents you may be eligible for, deductions in excess of the standard deduction, adjustments to income, and additional income.

The higher the number of personal allowances claimed on Form W-4, the lower the amount of withholding will be. Complete the Personal Allowances Worksheet and Deductions, Adjustments, and Additional Income Worksheet in the instructions for Form W-4 to determine the proper number of personal allowances to claim.

Example #1: *Melissa earned $52,000 as an employee in 2018. She is single and uses the standard deduction on her tax return. Melissa's Form W-4 shows "Single – 1." Melissa's federal tax liability on Form 1040 is $4,745. Her federal withholding based on "Single – 1" is $5,653. Melissa is due a refund of $908 when she files her tax return.*

Example #2: *Assume the same facts as Example #1, except Melissa claimed "Single – 3" on Form W-4 so her take-home pay would be higher. Instead of having $5,653 withheld, at "Single – 3" she had only $4,112 withheld. Melissa has a balance due of $633 on her tax return.*

Danger Zones

Filling out Form W-4 is fairly straight-forward for a single taxpayer with one job claiming the standard deduction on his or her tax return. "Single-1" will cover the taxes and generally result in a small refund. Likewise with a married couple where only one spouse works, "Married – 2" will generally cover the tax bill. However, the withholding tables do not account for every situation. Many but not all of the following items can be taken into consideration on the worksheets on Form W-4. If there are significant additional sources of income, or other factors that create a more complicated tax situation, it is best to consult your tax advisor for assistance in what to claim for withholding.

Be especially careful filling out Form W-4 with:

- Both spouses working.
- Working more than one job.
- Additional non-wage income, especially self-employment income.
- High-income earners subject to alternative minimum tax, net investment income tax, or additional Medicare tax.
- Married filing separately filing status.

See IRS Publication 505, *Exemptions, Standard Deduction, and Filing Information,* for more information about withholding and filling out Form W-4.

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- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

Taxable Social Security Benefits

Taxable Social Security Benefits

Some taxpayers have to pay federal income taxes on their Social Security benefits. This usually happens only if they have other substantial income (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return) in addition to Social Security benefits.

Taxable Benefits

To determine the amount of Social Security or Railroad Retirement benefits that may be taxable, taxpayers must compare the base amount with the total of:
1) One-half of the benefits received, plus
2) All other income, including tax-exempt interest.

Other income is not reduced by any exclusions for:
- Interest from qualified U.S. Savings Bonds,
- Employer-provided adoption benefits,
- Foreign earned income or foreign housing, or
- Income earned by bona fide residents of American Samoa or Puerto Rico.

Taxable Social Security Base Amounts

Filing Status	*Base Amount*
Single, HOH, or QW	$25,000
MFS and lived apart from spouse all year	$25,000
MFJ	$32,000
MFS	$0

Worksheet to Determine if Benefits May Be Taxable

A) Amount of Social Security or Railroad Retirement Benefits .... A) ______
B) One-half of amount on line A .... B) ______
C) Taxable pensions, wages, interest, dividends, and other taxable income .... C) ______
D) Tax-exempt interest plus any exclusions from income .... D) ______
E) Add lines B, C, and D .... E) ______

If the amount on line E is less than or equal to the base amount, none of the benefits are taxable. If the amount on line E is more than the base amount, some of the benefits may be taxable.

Example #1: John and Betty, a married couple both age 68, are retired and receive the following income:

Source	*John*	*Betty*
Social Security	$7,500	$3,500
Pension	$16,000	$6,000
Interest	$250	$250

John and Betty file a joint tax return. Their income used to determine if Social Security benefits are taxable ($28,000) is less than the taxable Social Security base amount ($32,000) for joint filers. None of their Social Security benefits are taxable.

Worksheet to Determine if Benefits May Be Taxable

A) Amount of Social Security or Railroad Retirement Benefits .... A) $11,000
B) One-half of amount on line A .... B) $5,500
C) Taxable pensions, wages, interest, dividends, and other taxable income .... C) $22,500
D) Tax-exempt interest plus any exclusions from income .... D) $0
E) Add lines B, C, and D .... E) $28,000

Taxable Social Security Benefits

➲ ***Planning Tip:*** *If the only income received during the year was Social Security or Railroad Retirement benefits, the benefits are generally not taxable. Taxpayers should consider taking taxable IRA distributions and/or doing Roth conversions. Careful planning must be made to not take too large of a distribution so as to cause Social Security or Railroad Retirement benefits to be taxable.*

Example #2: *Assume the same facts as Example #1 however the combined interest income for John and Betty is $10,000 instead of $500. Their income used to determine if Social Security benefits are taxable ($37,500) is greater than the taxable Social Security base amount ($32,000) for joint filers. Therefore, some of their Social Security benefits are taxable.*

Worksheet to Determine if Benefits May Be Taxable

A)	Amount of Social Security or Railroad Retirement Benefits	A) $11,000
B)	One-half of amount on line A	B) $5,500
C)	Taxable pensions, wages, interest, dividends, and other taxable income	C) $32,000
D)	Tax-exempt interest plus any exclusions from income	D) $0
E)	Add lines B, C, and D	E) $37,500

How Much Is Taxable?

Generally, up to 50% of benefits will be taxable. However, up to 85% of benefits can be taxable if either of the following situations applies.

- The total of one-half of the benefits and all other income is more than $34,000 ($44,000 for Married Filing Jointly).
- The taxpayer is Married Filing Separately and lived with his or her spouse at any time during the year.

Who is taxed. Benefits are included in the taxable income (if taxable) for the person who has the legal right to receive the benefits.

Example: *Lisa receives Social Security benefits as a surviving spouse who is caring for two dependent children, Christopher, age 9, and Michelle, age 7. As dependents of their deceased father, Christopher and Michelle also receive Social Security benefits. The benefits for Christopher and Michelle are made payable to Lisa. When calculating the taxable portion (if any) of the benefits received, Lisa uses only the amount paid for her benefit. The amounts paid for Christopher and Michelle must be added to each child's other income to see whether any of those benefits are taxable to either of the children.*

Withholding. A taxpayer can choose to have federal income tax withheld from Social Security or Railroad Retirement benefits by completing Form W-4V, *Voluntary Withholding Statement.*

Investments That Help Reduce Taxable Social Security Benefits

Taxpayers may be able to reduce taxable Social Security benefits by reallocating investments that are generating income which is includable in the calculation used to determine taxable Social Security benefits to investments that do not generate includable income.

Tax Planning Strategies

U.S. Series EE and I bonds. Taxpayers who are earning taxable interest income from a bank CD that is causing a portion of Social Security benefits to be taxed, could switch the investment to U.S. savings bonds. Annual purchase limits apply.

Nonqualified annuities. Like interest accrued on U.S. savings bonds, earnings on a nonqualified annuity are deferred until the investment is cashed in. One advantage of choosing nonqualified annuities rather the U.S. savings bonds is there is no annual limit on the amount of principal that can be invested.

Real estate, gold, and other investments that produce capital gains. By switching investments from mutual funds and stocks that produce dividend income to investments that produce capital gains, the taxpayer may realize tax savings by reducing the amount of Social Security benefits subject to tax.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

TAX YEAR
2018

Recordkeeping for Tax Purposes

Recordkeeping for Tax Purposes

Which records should you keep? You should keep information that you and the IRS need to determine your correct tax. Everyone should keep the following records.

Copies of tax returns. Keep copies of your tax returns as part of your tax records.

- Your tax returns can help you prepare future returns and amended returns.
- After you die, copies of your tax returns and other records can be helpful to your survivors or the executor or administrator of your estate.

Proof of income and expenses. Listed below are examples of income and expense documents you should keep. The list is not all inclusive.

Income	• Form(s) W-2, 1099, and K-1 • Bank and brokerage statements • Business and hobby income records • Records relating to sale of business property
Expenses	• Sales slips, invoices, receipts • Cancelled checks or other proof of payment
Donations	• Details of cash and noncash contributions • Written communications from qualified charities
Your Home	• Closing statements, including any refinance documents • Purchase and sales invoices • Receipts for improvements • Insurance records
Investments	• Brokerage statements • Mutual fund statements • Form(s) 1099 and 2439 • Other basis documentation
IRAs	• Forms 1099-R, 5498, and 8606 for each year until all IRA funds have been distributed.

Records for Special Situations

Some items require specific records, in addition to the basic records of income and expenses.

- ***Alimony.*** If you pay or receive alimony, keep a copy of your written separation agreement or the divorce, separate maintenance, or support decree. If you pay alimony, you need to know your former spouse's Social Security Number.
- ***Business use of your home.*** Keep records that show which part of your home is used for business and the expenses related to that use. Child care providers should also keep track of hours open for business, as well as hours spent in preparation and clean up.
- ***Gambling.*** Keep an accurate diary of winnings and losses. Required information includes:
  - Date and type of gambling activity.
  - Gambling establishment name and address, and names of persons present with you.
  - Amount you won or lost.
- ***Tax credits.*** Each tax credit includes special record requirements. Examples include:
  - Provider's name, address, and taxpayer ID number for the Child and Dependent Care Credit.
  - Physician's certification for the Credit for the Elderly or the Disabled.
  - School records for the education credits.
- ***Vehicle records.*** If you use your own car for business, medical transportation, or qualifying volunteer work, keep a mileage log that includes the date, destination, and purpose of each trip. You also need to know how many miles you drove for other purposes, such as commuting and personal use. Your vehicle records should include purchase or lease papers and loan records. You may receive a larger deduction if you keep

Recordkeeping for Tax Purposes

records of gas purchases, maintenance costs, etc., in addition to mileage.

What is Proof of Payment?

The records you keep provide the documentation to support the deductions and expenses claimed on your tax return. You must always keep documentation of the reason for the payment. Other documents, such as statements and receipts, will help establish that the item is allowable on your tax return.

If You Pay With	Then the Statement Must Show
Cash	Amount, payee name, transaction date
Check	Check number, amount, payee's name, date the check was posted to your account
Debit or Credit Card	Amount charged, payee's name, transaction date
Electronic Funds Transfer	Amount transferred, payee's name, date, the transfer was posted to your account
Payroll Deduction	Amount, payee code, transaction date

- ***Account statements.*** Account statements from your financial institution are acceptable as proof if they provide the information shown above.
- ***Pay statements.*** You may have deductible expenses withheld from your wages, such as union dues, medical insurance premiums, and charitable contributions. Keep year-end or final pay statements to prove payment of these items.
- ***Mortgage interest.*** Form 1098, *Mortgage Interest Statement,* documents interest you paid. Be sure to verify that the amount is correct.

How Long Should You Keep Tax Records?

The IRS says you must keep your records for as long as they may be needed for the administration of any provision of the Internal Revenue Code, which means you must keep records of items shown on your return until the period of limitations for that return expires. The period of limitations is the time during which you can amend your return, claim a credit, or be assessed additional tax by the IRS. The chart below lists some general guidelines.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

If you	Then the period is
1) Owe additional tax, and conditions 2, 3, and 4, below, don't apply to you	3 years after the return is filed.*
2) Omit income that is more than 25% of gross income on your return	6 years after the return is filed.*
3) File a fraudulent return	Unlimited.
4) Do not file a return	Unlimited.
5) File a claim for credit or refund after filing* an original return	Later of 3 years, or 2 years after tax was paid.
6) File a claim for loss from worthless securities	7 years after the return is filed.*

* A return that is filed early is treated as being filed on the due date of the return.

Asset Records

Keep records of acquisition date and cost basis for each business or investment asset until the period of limitations expires for the year in which you dispose of the asset. For example, suppose you sold a piece of business equipment in 2015 and you meet condition (1) above. You must then keep records of that asset until at least April 15, 2019 (three years after the due date for your 2015 tax return).

Electronic Records

Paper records take up a lot of space, and they can fade or be damaged. Many people prefer to keep electronic records instead of paper records.

All requirements that apply to hard copy records apply to electronic records, including record retention periods.

If you scan or otherwise transfer your tax records to an electronic format, you must be able to store, preserve, retrieve, and reproduce the records in a legible, readable format.

Contact Us

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- Retirement.
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- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

TAX YEAR
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Mileage and Expense Log

Deductible Expenses

In order to be a deductible, business expenses for travel, lodging, and meals must be ordinary and necessary.

An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

Substantiation for Travel, Lodging, and Meals

Special rules apply for substantiation of expenses for travel, lodging, and meals. The taxpayer must maintain records that include:

- The amount of the expense.
- The time and place of travel.
- The business purpose of the expense.
- The business relationship between the taxpayer and persons entertained.

Note: For self-employed taxpayers, per diem rates for meals (standard meal allowance) may be used as a standard deduction in place of actual receipts. Actual receipts must be used for lodging.

Traveling exceptions. Documentary evidence is not needed if any of the following conditions apply.

- The expense, other than lodging, is less than $75.
- The taxpayer has a transportation expense for which a receipt is not readily available.

Travel and Lodging

Travel expenses include the ordinary and necessary expenses incurred by a taxpayer (generally for overnight stays) while on temporary travel away from his or her tax home for business purposes.

Tax home. Generally, your tax home is your regular place of business, regardless of where you maintain your family home. It includes the entire city or general area in which your business is located.

Deductible expenses. Deductible expenses include, but are not limited to:

- Air, train, bus, or car travel between the taxpayer's home and the business destination.
- Use of a car for business use while at the business destination.
- Transportation (including tips) between the airport or train station and a hotel, between the hotel and a business location, and between business locations or customers.
- Meals, lodging, dry cleaning, and laundry, including tips.

Meals

A deduction for meals is allowed (limited to 50%) if incurred while traveling on business or while entertaining a client or customer. The deduction for local meals is figured by using actual costs while the deduction for meals while out of town is figured by using actual costs or the standard meal allowance (per diem rate).

Entertainment. Effective January 1, 2018, entertainment expenses are no longer deductible.

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