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Business Lawyers Network

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Top 2015-2016 tax strategies that solo and small firm professionals need to know.

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Brad is both a Certified Public Accountant and a Registered Representative affiliated with Bay State Financial and a graduate of the Isenberg School of Management at the University of Massachusetts. He has over 25 years of practical experience in all areas of tax planning and tax return preparation for individual taxpayers and small businesses, with an emphasis on closely held family businesses. He also specializes in merger and acquisition work, business exit planning and general business consulting and accounting-related services along with expertise in IRS and State Income Tax Audits. Brad is a member of the American Institute of Certified Public Accountants and the Massachusetts Society of Certified Public Accountants. He has owned his own CPA firm, now located in West Concord MA, since 1991.

Prior expertise includes being an outside financial consultant to American Medical Response (AMR), Provant Inc. and Bridgestreet Accommodations, Inc. He assisted on initial price offerings and served as interim controller for the above public corporations.

Brad lives in Acton, MA and is married with three children and one Golden Doodle named Bailey. His hobbies include skiing and tennis.

Agenda

1. General information
2. Type of entity
3. Cash vs. Accrual basis
4. Section 179 & Bonus depreciation (buy vs. lease). How to maximize auto expenses! New IRS $2,500 expense deduction
5. Establish a retirement plan & get a $500 tax credit
6. How do I deduct business miles (Actual vs. Standard)
7. Business use of home?? (Regular vs. Simplified method)
8. What about paying my child?
9. Reporting issues for independent consultants
10. Tax Tips / Tax Tidbits to follow and Pitfalls to watch out for
11. What to look for in a CPA or professional tax preparer
12. Q & A

1. General information

Whenever a new or existing client meets with me to discuss forming a new business I always ask what their EXIT STRATEGY is.
The usual answer is “I have no idea”. Realistically the initial exit strategy today may be significantly different 10 or 20 years from now but it’s the initial exit strategy I use to offer initial tax advice to a client. The tax strategy can be adjusted as events change. It’s a lot easier to set up the entity correctly than trying to “fix a problem” years later. For example: If you own a commercial building that you use as your law office, and you’re thinking of selling that property, there are significant tax ramifications depending how that property is owned. Therefore, once I know the initial exit plan it often answers the question: What type of business should I form?

I thought I could walk through, as an example, what I would do when a new business client “Attorney Roger” comes to my office for advice on opening a new law office. I’ll also be sure to provide some specific tax saving strategies along with advice I might offer:

General information, cont'd

"Hi Brad! You were highly recommended to me by John who is also an attorney that I know very well. John told me you're great and can help me with some business and tax advice. I have lots of school loans and need all the tax deductions I can take advantage of!"

"Roger— thanks for coming in and congratulations on passing the bar exam! I understand it only took you three tries! I hear you're opening a new office?

Let's discuss some options and strategies that might work for you. I'll point out some areas that can help to save some money on taxes. I want to be certain you take advantage of any tax savings ideas and strategies that are available to you."

At this point I'd point out to the client that they are not only attorneys but also in the "business" of providing law.

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2. What type of entity should I form?

Options:

- Schedule C
- C Corp (PSC Co)
- S Corp
- LLC
- LLP

Do I need a separate tax ID number?
What is the best vehicle, from a tax standpoint?

3. Should I be on cash or accrual method?

- How do I report my income and expenses?
- What's the difference?
- How will I be taxed?
- Any extra taxes that I need to pay?
- How do I pay taxes?
- How do I record my expenses?
- What can I deduct?
- I usually recommend that small business use a software called Quick-Books.

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ATTENTION PLEASE!

You'll want to pay attention to the next 5 items that we discuss because these can definitely save you some money in taxes!

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4. Do I need to depreciate assets or can I write them off?

Generally computers, equipment, furniture and fixtures and cars should be capitalized and not expensed. These capitalized items are then systematically amortized by way of depreciation. However, there is a IRS Notice 2015-82, which was bill passed late in 2015, that simplifies record keeping requirements for small businesses by raising from $500 to $2,500 the safe harbor threshold for deducting certain capital items. This change goes into effect for 2016 BUT early adoption is allowed! All that is needed is to establish an accounting policy to acknowledge policy of early adoption of this allowed method.

4. continued…

This is a great change making it easier for small businesses to not have to depreciate assets but also get an immediate tax deduction!

Any capital item, greater than $2,500 (assuming Notice 2015-82 is adopted), would then be capitalized and depreciated using either:

- Section 179 Depreciation
- Bonus Depreciation
- Regular Depreciation

There is an example in the table on page 21.

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5. Can I have a retirement plan?

The general answer is yes! Not only can you deduct the retirement plan contribution, but the setup of the new plan may also be eligible for a $500 tax credit!

You need to offer this plan to any employee, or class of employees, that is eligible to participate.

See table in back on page 19 of this handout.

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6. How do I deduct business miles? How can I maximize my auto expenses?

There are two options:

1: The IRS mileage provides for a standard business use mileage rate of 57.5 cents per mile for 2015 and 54 cents per mile for 2016. This rate would simply be used to multiply any business related miles to arrive at an amount to be deducted for taxes.

2: Actual auto expenses (gas, oil, repairs, insurance etc.) plus auto depreciation can be used. These expenses must be applicable for business use only.

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6. continued…

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Regardless which method is used a written auto log is required—sorry!

There are different tax rules for depreciation of business autos:
One rule is for auto weighing **less than 6,000 pounds** and another for autos weighing **more than 6,000 pounds**.
There is an example of each situation in the table on page #22.

7. Can I deduct a business use of home?

As long as you use your home as the normal business location to conduct your business and meet with your clients the answer is yes. Regardless which of the following methods you choose to claim a home office deduction, I suggest you also take a picture of the office and keep it! A picture is worth a thousand words in the event of an audit.

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7. continued…

There are two options:

1: The IRS provides a Simplified method available at $5/foot up to a max square footage of 300 sq. feet or $1,500 max amount of deduction.
2: Actual business use of home, which includes depreciation. (See attached schedule on page 23).

General comment: the depreciation claimed (allowed or allowable) can impact your tax situation when you eventually sell the home.

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8. Can I pay my child if he/she works for me?

Yes, if the expense is deemed to be ordinary and necessary, the work can be substantiated, and the rate is reasonable. You could even pay your child for modeling when using their picture on your business brochure.

I always suggest some sort of a weekly timesheet be used. This is a great tax strategy for a number of reasons:

- It saves you taxes by taxing income at a lower tax rate
- It allows your child to have an IRA.

See attached handout on page 24.

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9. Any reporting issues for independent consultants

- 1099 issued to consultants
- Cash basis vs. accrual
- Issue 1099's by end of January to recipients and end of February to IRS.
- Please be certain that any true employees be paid via a W2 and not as a 1099 consultant

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10. Tax tips/tax tidbits to follow and pitfalls to watch out for!

One of the keys to tax planning is trying to **shift income to a lower tax bracket**. In the event of an IRS audit, unlike law, you are generally guilty unless you can prove otherwise. It will come down to *Form over Substance*: If you have the backup you win, if you don't you lose! You will need records and checks to back up expense deductions.

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10. continued…

No one likes to keep an **auto log**! Everyone always complains BUT if you get audited that will be the first item the agent will ask for. If you don't have a log, all of the auto expenses could be disallowed!

How long do I need to keep my records?

New IRS due dates for 2016 returns due in 2017 (see page 25)

Major area of concern is having no records and expense payments pierce the corporate veil.

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11. What to look for in a CPA or professional preparer

New tax regulations come out all the time and it's critical that tax preparers stay current!

Extender Bill wasn't passed until December 18, 2015 but was retroactive to January 1, 2015! There are very significant items in that bill.

Taxes are extremely complicated and I generally suggest that anyone "in business" use a CPA for guidance and tax preparation.

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11. continued…

I know most, if not all of you are attorneys, so if you decide to review IRS regulations and tax instructions to prepare your own tax returns, I suggest that you consider hiring a tax professional to review your taxes before you file them.

Be certain to choose a CPA (or tax preparer) that has expertise in an area that you or your business is involved in. For example: If you have stock option income (ISO's, NQ or Qualified options) make sure your preparer has expertise in that area!

Brad's Top 5 Tax Savings Strategies

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Comparison between 2015 and 2016 for "Small Businesses"

		2016	2015
1	Section 179 depreciation (non-autos)	(Note 1) $500,000 (New or Used Equip)	(Note 1) $500,000 (New or Used Equip)
	Bonus Depreciation	(Note 1) 50% (New Equipment Only)	(Note 1) 50% (New Equipment Only)
	Buy vs lease equipment	Buy: Can depreciate as follows: Year 1: 50% bonus plus sec 179 (up to $500K). Lease: Expense as paid (assumes operating lease).	Buy: Can depreciate as follows: Year 1: 50% bonus plus sec 179 (up to $500K). Lease: Expense as paid (assumes operating lease).
	Max amount allowed for auto< 6,000 lbs., 1st year	(Note 2) 3,160 + 8,000 (bonus) = 11,160	(Note 2) 3,160 & 8,000 (bonus) = 11,160
	Max amt for new auto > 6,000 lbs costing $67,000, 90% business use (see example attached)	50% bonus, section 179 & reg depreciation = $44,244 or 73% of business cost! Pre extender bill was $ 25,344!	50% bonus, section 179 & reg depreciation = $44,244 or 73% of business cost! Pre extender bill was $ 25,344!
2	Set Up a Pension Plan		
	Pension Plan Limits for 401K (Plan must be established prior to 12/31. ER funding due by due date of tax return)	EE: 17,500 ER: 34,500 Overall Total: 53,000 Over 50: extra 6,000	EE: 18,000 ER: 35,000 Overall Total: 53,000 Over 50: extra 6,000
	Pension Limits for non-401K Plans A SEP is ONLY plan that can be setup AFTER the end of calendar year! IRA Plan Limits	SIMPLE: 12,500 Over 50: Extra 3,000 SEP: 20% SE Inc to 53,000 Over 50: no extra catchup IRA: 5,500 Over 50: extra 1,000	SIMPLE: 12,500 Over 50: extra 3,000 SEP: 20% SE Inc to 53,000 Over 50: no extra catchup IRA: 5,500 Over 50: extra 1,000
3	Standard IRS Mileage Rate or Actual	54.0 cents per mile or % of actual expenses	57.5 cents per mile or % of actual expenses
4	Business Use of Home	Simplified method @$5/foot or Actual Expense Method	Simplified method @ $5/foot or Actual Expense Method
5	Pay Child for services	Great tax strategy	Great tax strategy

Note 1: Extender tax bill signed into law on December 18, 2015 making tax changes retroactive to January 1, 2015 and permanent until 2019.
Previous to extended tax bill being signed, section 179 depreciation was limited to $25,000 and bonus depreciation was repealed!
Note 2: Extender tax bill signed into law on December 18, 2015 making tax changes retroactive to January 1, 2015 and permanent until 2019.
Previous to extended tax bill being signed, bonus depreciation was repealed and not allowed!

12. Q & A

I've included a copy of my monthly electronic newsletter for this January. If you'd like to get included in my monthly distribution list just send me an email and I'll add you to the list.

Thank you!

IRS

For Small Businesses: IRS Raises Tangible Property Expensing Threshold to $2,500; Simplifies Filing and Recordkeeping

WASHINGTON —The Internal Revenue Service today simplified the paperwork and recordkeeping requirements for small businesses by raising from $500 to $2,500 the safe harbor threshold for deducting certain capital items.

The change affects businesses that do not maintain an applicable financial statement (audited financial statement). It applies to amounts spent to acquire, produce or improve tangible property that would normally qualify as a capital item.

The new $2,500 threshold applies to any such item substantiated by an invoice. As a result, small businesses will be able to immediately deduct many expenditures that would otherwise need to be spread over a period of years through annual depreciation deductions.

"We received many thoughtful comments from taxpayers, their representatives and the professional tax community, said IRS Commissioner John Koskinen. "This important step simplifies taxes for small businesses, easing the recordkeeping and paperwork burden on small business owners and their tax preparers."

Responding to a February comment request, the IRS received more than 150 letters from businesses and their representatives suggesting an increase in the threshold. Commenters noted that the existing $500 threshold was too low to effectively reduce administrative burden on small business. Moreover, the cost of many commonly expensed items such as tablet-style personal computers, smart phones, and machinery and equipment parts typically surpass the $500 threshold.

As before, businesses can still claim otherwise deductible repair and maintenance costs, even if they exceed the $2,500 threshold.

The new $2,500 threshold takes effect starting with tax year 2016. In addition, the IRS will provide audit protection to eligible businesses by not challenging use of the new $2,500 threshold in tax years prior to 2016.

For taxpayers with an applicable financial statement, the de minimis or small-dollar threshold remains $5,000.

Further details on this change can be found in Notice 2015-82, posted today on IRS.gov.

Depreciation Write-off For Car (post extender bill)
Purchased in 2015

		Total Cost	Business %	Business Amount	Actual 2015 Depreciation
Suburban Vehicle (Assumed new & weighs > 6,000 lbs)		$ 67,000	0.9	$ 60,300	
Business use is 90%					
Maximum amount of deduction for 2015					
Section 179 depreciation		$ 25,000	0.9	$ 22,500	$ 22,500
Subtotal		$ 42,000		$ 37,800	
Less:					
Bonus Depreciation		$ 21,000	0.9	$ 18,900	$ 18,900
Amount to depreciate		$ 21,000		$ 18,900	
Life/Rate		5 / 200%			
Actual depreciation	$ 4,200 but limited to $3,160	$ 3,160	0.9	$ 2,844	$ 2,844
Total projected depreciation					**$ 44,244**
% written off (after the extender tax bill was signed)					**73.37%**
Extra depreciation as a result of extender bill (44,244 - 25,344)					$ 18,900

Depreciation Write-off For Car (pre extender bill)
Purchased in 2015

		Total Cost	Business %	Business Amount	Actual 2015 Depreciation
Suburban Vehicle (Assumed new & weighs > 6,000 lbs)		$ 67,000	0.9	$ 60,300	
Business use is 90%					
Maximum amount of deduction for 2015					
Section 179 depreciation		$ 25,000	0.9	$ 22,500	$ 22,500
Subtotal		$ 42,000		$ 37,800	
Less:					
Bonus Depreciation		$ -	0.9	$ -	$ -
Amount to depreciate		$ 42,000		$ 37,800	
Life/Rate		5 / 200%			
Actual depreciation	$ 8,400 but limited to $3,160	$ 3,160	0.9	$ 2,844	$ 2,844
Total projected depreciation					**$ 25,344**
% written off (prior to the extender tax bill being signed)					**42.03%**

Business Use of Home Worksheet

Caution: Schedule C filers must use Form 8829, *Expenses for Business Use of Your Home,* or claim the deduction computed under the simplified method on Schedule C, line 30. Use this worksheet if Schedule F is filed or if the individual is an employee (result to Schedule A) or a partner (result to Schedule E). For daycare facilities not used exclusively for business, see Form 8829.

Part 1—Part of Home Used for Business:

1) Area of home used for business			1) ______
2) Total area of home			2) ______
3) Percentage of home used for business (divide line 1 by line 2 and show result as percentage)			3) ______%

Part 2—Allowable Deductions:

	(a) Direct Expenses	(b) Indirect Expenses	
4) Gross income from business			4) ______
5) Casualty loss	5) ______	______	
6) Deductible mortgage interest	6) ______	______	
7) Real estate taxes	7) ______	______	
8) Total of lines 5 through 7	8) ______	______	
9) Multiply column (b) of line 8 by line 3		9) ______	
10) Add column (a) of line 8 and line 9		10) ______	
11) Business expenses not related to business use of home		11) ______	
12) Add lines 10 and 11			12) ______
13) Deduction limit. Subtract line 12 from line 4 (if zero or less, enter -0-)			13) ______
14) Excess mortgage interest	14) ______	______	
15) Insurance	15) ______	______	
16) Rent	16) ______	______	
17) Repairs and maintenance	17) ______	______	
18) Utilities	18) ______	______	
19) Other expenses related to use of home	19) ______	______	
20) Add lines 14 through 19	20) ______	______	
21) Multiply column (b) of line 20 by line 3		21) ______	
22) Carryover of operating expenses from prior year		22) ______	
23) Add column (a) of line 20, line 21 and line 22			23) ______
24) Allowable operating expenses. Enter the *smaller* of line 13 or line 23			24) ______
25) Limit on excess casualty losses and depreciation. Subtract line 24 from line 13			25) ______
26) Excess casualty losses		26) ______	
27) Depreciation of home from line 39 below		27) ______	
28) Carryover of excess casualty losses and depreciation from prior year		28) ______	
29) Add lines 26 through 28			29) ______
30) Allowable excess casualty losses and depreciation. Enter the *smaller* of line 25 or line 29			30) ______
31) Add lines 10, 24 and 30			31) ______
32) Casualty losses included on lines 10 and 30			32) ______
33) Allowable expenses for business use of home. (Subtract line 32 from line 31.)			33) ______

Part 3—Depreciation of Home:

34) Smaller of adjusted basis or fair market value of home when first used for business	34) ______
35) Basis of land (or FMV, if FMV of home used on line 34)	35) ______
36) Depreciable basis of building (subtract line 35 from line 34)	36) ______
37) Business basis of building (multiply line 36 by line 3)	37) ______
38) MACRS depreciation percentage	38) ______
39) Depreciation allowable (multiply line 37 by line 38)	39) ______

Part 4—Carryover of Unallowed Expenses to Next Year:

40) Operating expenses. Subtract line 24 from line 23. If less than zero, enter -0-	40) ______
41) Excess casualty losses and depreciation. Subtract line 30 from line 29. If less than zero, enter -0-	41) ______

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Client's Children Hired for Their Business

If your client has chores their children can do in their business, they should consider hiring them. Generally, children will be in a lower tax rate bracket than your client. Thus, income can be shifted from the client's higher tax rate bracket to the children's lower tax rate brackets.

Also, if the children are under 18, your client as the employer, does not need to withhold or pay either Social Security tax or Federal unemployment tax on the children's wages. The tax treatment under the different Federal employment taxes for family members is:

Child Employed by Parent
Income Tax Withholding
Taxable
Social Security & Medicare
Exempt until age 18
Federal Unemployment
Exempt until age 21

There are four tests a person must meet to deduct the pay to children as a business expense. These are:

1. *Ordinary and Necessary* - The salary must be shown that it, like any other business expense, is an ordinary and necessary expense directly connected with the business.
2. *Reasonable* - The pay must prove to be reasonable at the time the services were contracted. Reasonable pay is the amount that would normally be paid for similar services under similar circumstances.
3. *Services Provided* - It must be proved that services were actually provided. Also, benefits from the services performed must be reasonably expected.
4. *Paid or Incurred* - The compensation must be paid or the expense incurred during the tax year.

Example: You are in the 28% tax rate bracket and you are subject to self-employment tax. If you have business filing, typing, cleaning, and other chores for which you hire your child, you can deduct your child's wages against your business income. The total you pay your 16-year-old child in 2014 is $11,200. Your approximate savings would be:

Your tax savings since you can deduct the wages:		
Federal tax *($11,200 x 28%)*	$3,136	
Self-employment tax *($11,200 x 15.3%)*	1,714	
Your tax saving		$4,850
Your child's tax assuming no other income:		
Wages	$11,200	
Standard deduction	(6,200)	
Taxable income	$5,000	
Federal tax	$503	
Social Security tax	0	
Your child's total tax		(503)
Total Federal tax savings to the family		$4,347

Additionally, your child is eligible to contribute to an individual retirement account (IRA). In the above example, if your child contributes $5,000 to a deductible IRA, your child pays no tax. The total tax savings to your family is $4,850 ($4,347 + 503). Thus, in 2014, your child can earn $11,200 ($6,200 amount of standard deduction plus $5,000 put into an IRA) without paying any Federal income tax.

Alternatively, your child could contribute to a Roth IRA. In this case, your child would pay $503 of Federal tax but all qualified distributions from the Roth IRA would be completely tax-free.

HIRE YOUR CHILDREN

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Original and Extended Tax Return Due Dates

Return Type	Due Dates Under Prior Law	New Law: Original and Extended Due Dates (Dates changed by law in bold)	Comments
Partnership (calendar year) Form 1065	April 15 Sept. 15	**March 15** Sept. 15	Under the new law, for fiscal year partnerships, returns will be due on the 15th day of the 3rd month after the year-end. A six-month extension is allowed from that date
S Corporation (calendar year) Form 1120S	March 15 Sept. 15	March 15 Sept. 15	No change
Trust and Estate Form 1041	April 15 Sept. 15	April 15 **Sept. 30**	
C Corporation (calendar year) Form 1120	March 15 Sept.15	Before Jan. 1, 2026: **April 15** Sept. 15 After Dec. 31, 2025: **April 15** **Oct. 15**	Starting with 2016 tax returns, all other C corps besides Dec. 31 and June 30 year-ends (including those with other fiscal year-ends) will be due on the 15th of the **4th month** after the year-end. A six-month extension is allowed from that date.
C Corporation Fiscal Year End (other than Dec. 31 or June 30)	15th day of 3rd month after year-end 15th day of 9th month after year-end	15th day of **4th month** after year-end 15th day of **10th month** after year-end	
C Corporation June 30 Fiscal Year Form 1120	Sept. 15 March 15	Before Jan. 1, 2026: Sept. 15 **April 15** After Dec. 31, 2025: **Oct. 15** **April 15**	Special rule for C Corporations with fiscal years ending on June 30 — the new due date rules will go into effect for returns with taxable years beginning after Dec. 31, 2025 (2027 Filing Season).
Individual Form 1040	April 15 Oct. 15	April 15 Oct. 15	No change
Exempt Organizations Forms 990	May 15 Aug. 15 Nov. 15	May 15 **Nov. 15**	New extension will be a single, automatic 6-month extension, eliminating the need to process the current first 90-day extension.
Employee Benefit Plans Form 5500	July 31 Oct.15	July 31 **Nov. 15**	
Foreign Trusts with a U.S. Owner Form 3520-A	March 15 Sept. 15	March 15 Sept.15	No change
FinCEN Report 114	June 30	**April 15** **Oct. 15**	Foreign Bank and Financial Accounts Report (FBAR)
Information Returns (i.e., W-2 and 1099s)	To IRS/SSA – Feb. 28 and March 31 if filed electronically	To IRS/SSA – Feb. 28 and March 31 if filed electronically	No change

Note: New due date rules will go into effect for the 2017 Tax Filing Season (Tax Year 2016), except for C Corps as noted above.

Extended Due Dates:

(These dates apply for taxable years beginning after Dec. 31, 2015 (2016 Filing Season)).

1. **Forms 1040, 1065 and 1120S** shall be a six-month period beginning on the due date for filing the return (without regard to any extensions).

2. **Form 1041** shall be a 5½-month period beginning on the due date for filing the return (without regard to any extensions).

3. **Form 1120** generally shall be a six-month period beginning on the due date for filing the return (without regard to any extensions). Note that Dec. 31 year-end C corporations before Jan. 1, 2026, shall have a five-month extension, and June 30 year-end C corporations before Jan 1, 2026, shall have a seven-month extension.

4. **Form 3520,** Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, for calendar year filers shall have due date of April 15, with maximum extension for a six-month period ending Oct. 15.

5. **Form 3520–A,** Annual Information Return of a Foreign Trust with a United States Owner, shall be the 15th day of the 3rd month after the close of the trust's taxable year, and the maximum extension shall be a six-month period beginning on such day.

6. **Form 5500** shall be an automatic 3½-month period beginning on the due date for filing the return (without regard to any extensions).

7. **Forms 990 (series)** returns of organizations exempt from income tax shall be an automatic six-month period beginning on the due date for filing the return (without regard to any extensions).

8. **Form 4720** returns of excise taxes shall be an automatic six-month period beginning on the due date for filing the return (without regard to any extensions).

9. **Form 5227** shall be an automatic six-month period beginning on the due date for filing the return (without regard to any extensions).

10. **Form 6069** returns of excise taxes shall be an automatic six-month period beginning on the due date for filing the return (without regard to any extensions).

11. **Form 8870** shall be an automatic six-month period beginning on the due date for filing the return (without regard to any extensions).

12. **FinCEN Form 114,** relating to Report of Foreign Bank and Financial Accounts, shall be April 15 with a maximum extension for a six-month period ending Oct.15, and with provision for an extension under rules similar to the rules of 26 C.F.R. 1.6081–5. For any taxpayer required to file such form for the first time, the Secretary of the Treasury may waive any penalty for failure to timely request or file an extension.

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