HEALEY & ASSOCIATES
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Chart your course

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Tax & Business letter

WINTER 2018

Avoid the shock: Review big tax changes ASAP

While it's clear the 2018 business tax changes will affect all businesses, the extent of the impact on your business may vary greatly. Now is the time to review your situation to see if there are any moves you can make to manage your tax obligation. Here are some of the top changes to consider:

- **C corporation tax rate cut to 21 percent**
  Tax rates for C corporations are slashed from 35 percent to 21 percent. This tax saving frees up additional capital you can use to invest in the company, employees and shareholders. It is important to project how this change will impact your taxes and cash flow this year.
- **New 20 percent deduction for pass-through entities**
  Businesses taxed as pass-through entities (like partnerships, S corporations and sole proprietorships) have a new deduction. Eligible businesses may deduct 20 percent of their qualified business income. If you are under the taxable income threshold of $157,500 ($315,000 for joint filers), you should be able to take full advantage of this new deduction. But beware, there are complex definitions and limitations to wade through, and other restrictions apply.

  As with C corporations, revise forecasts with your bottom line in mind. Do this by determining if you will be under the taxable income threshold. If you are, great! If not, some additional research and calculations may be necessary.
- **Expansion of bonus depreciation and Section 179 expensing**
  Bonus depreciation for first-year assets is now 100 percent, up from 50 percent of the cost of qualified property. To qualify, the property must be purchased and placed in service after Sept. 27, 2017. The property can be new or used. Likewise, the annual amount of qualified assets that can be expensed under Section 179 is now $1 million for 2018 and beyond.

  If your business is planning on purchasing qualified property, doing so before the end of the year can provide short-term tax savings. On the flip side, expenses taken this year are given up in future years. Before investing capital in new purchases, forecast your projected pre-tax earnings with and without these two special provisions to ensure you are making the right long-term tax decision.
- **Elimination of entertainment deductions**
  Deductions for entertainment, amusement or recreation are now eliminated. Meals are still deductible at 50 percent as long as business is discussed during the meal and the expense is not considered "lavish or extravagant." Scrutiny will be high on events that provide an element of both entertainment and food. In order to deduct the meals portion of such events, the costs for food must be clearly separated. Review your business meals processes to ensure that you are compliant with the new rules.
- **Repeal of the domestic production activities deduction (DPAD)**
  Originally passed in 2004 to level the playing field for U.S. manufacturers, DPAD is gone in lieu of broader tax cuts. The hope is that lower tax rates, accelerated depreciation and the new 20 percent pass-through deduction will offset the loss of DPAD. If your business has taken advantage of this deduction in the past, now is the time to forecast your revenue and expenses and evaluate the impact its removal will have on your bottom line.

Schedule a meeting as soon as possible to discuss your year-end tax strategy and ensure that you are making the best decisions for your business. ♦

IRS TAX NOTES

Fourth quarter: No change in interest rates

Overpayments are 5 percent for individuals and 4 percent for corporations. Corporate overpayments exceeding $10,000 have a 2.5-percent interest rate. The rate charged on underpayments is 5 percent. And large corporate underpayments are charged 7 percent.

Affected by a natural disaster? There's tax relief

If you suffered uninsured or unreimbursed losses as a result of Hurricane Florence or other federally declared natural disasters in 2018, you may be able to claim losses on your tax return.

Individuals and businesses in federally declared disaster areas can choose to claim losses on either the return for the year the loss occurred or the return for the prior year.

Refunds may be due to vets injured in combat

Certain veterans injured in combat may be due a credit or refund as a result of the Combat-Injured Veterans Tax Fairness Act of 2016, according to the IRS.

This affects vets who received one-time, lump-sum disability severance payments when they separated from military service after Jan. 17, 1991 and included those payments as income on their tax returns.

Vets should file an amended tax return, Form 1040X, to claim a credit or refund for overpayment related to their severance payments. Visit the Combat-injured Disabled Veterans page on the IRS website for more info. ♦

Thank you for giving us the opportunity to serve you this past year. Your trust and your business are appreciated, and your referrals are welcomed. We wish you a happy, healthy and prosperous 2019.

The accountable plan is a win-win tax move

While an accountable plan has always been a great way for a business to give employees a tax-free benefit that's also deductible, it's now more relevant than ever.

Employees can no longer deduct the excess expenses above 2 percent of their adjusted gross income. That's because itemized deductions for miscellaneous expenses, including unreimbursed business expenses have been suspended through 2025.

If you haven't already, you may want to consider establishing an accountable plan in 2019 to offer some financial relief to your workers for this lost tax benefit.

The basics of an accountable plan

An accountable plan is a set of rules a business uses for employee reimbursement. It's used to reimburse employees for travel expenses, but may also cover supplies, tools and home office expenses employees pay out of their own pockets.

Businesses create accountable plans for two reasons: to ensure reimbursements won't be treated as taxable income for employees and to prevent the need to pay payroll taxes on reimbursements. It's a win-win for both parties.

There are a lot of tax rules around accountable plans, but they're not unrealistic. Employees need to meet these three requirements in order for an accountable plan to qualify for the tax exemption:

- Deductible expenses must have been paid for or incurred while performing services as an employee.
- Expenses must be accounted for and reported to the employer within a reasonable time period.
- Any excess reimbursement or allowance must be returned to the employer within a reasonable time period.

If these requirements aren't met, reimbursements will be taxable to employees and employers.

Don't let excess payments trip you up

Employers should consider potential excess payment issues that may come up with accountable plans. Typically, an excess payment occurs when a business provides an advance for a business trip and an employee spends less than the advance amount. In this case, the employee will have to return the excess within a "reasonable" amount of time.

So what's reasonable for this purpose? It depends on the facts and circumstances. In any event, the IRS says that the following actions are treated as having taken place within a reasonable period of time. Employees need to:

- Receive an advance within 30 days of the time he or she has an expense.
- Adequately account for expenses within 60 days after they were paid or incurred.
- Return any excess reimbursement within 120 days after the expense was paid or incurred.
- Receive a periodic statement (at least quarterly) that asks to either return or adequately account for outstanding advances and he and she comply within 120 days of the statement.

Create an audit-proof accountable plan

Although you don't have to formally submit an accountable plan to the IRS, it's important to create a plan in writing in case the IRS ever challenges the tax benefits. Make sure that employees properly substantiate their expenses, and that records are filed and retained.

Does an accountable plan seem to make sense for your business? Call if you have questions or would like help establishing your plan. ♦

See and stop embezzlement now

It's safe to say the majority of business owners would be shocked to find out they had employees who were embezzling — and that it's been happening for longer than they thought. Nearly 30 percent of embezzlement schemes last longer than five years, according to a 2017 study by Hiscox small business insurance agency.

Luckily, you can halt embezzlement by learning more about the various methods thieves use to steal from their companies, and what you can do stop it.

Common methods of embezzlement

- **Handling cash.** In businesses such as bars and restaurants, an employee can simply fail to ring up a sale and pocket the cash. If a customer requests no receipt, an employee might record a no-sale transaction, or record a smaller amount of cash and pocket the difference.
- **Bogus vendors.** An employee who handles vendor work ends up billing the company using a very similar name as a recent vendor the company has done business with in the past.
- **Check kiting.** An employee writes a check and deposits it in their own account. They can then write a check against their new balance back to the employer's account. This type of theft is often used when a would-be thief needs funds and projects to pay it back before it is noticed.
- **Lapping.** A receivables clerk misapplies customer payments. In the confusion, a payment or two is cashed by the employee for their own benefit. For example, a payment from Customer A is deposited in the employee's account. When Customer B makes a payment, it is recorded as a payment by Customer A, and so on.
- **Fake refunds.** A refund is issued to a customer but the funds go directly to the employee in charge of issuing refunds (often the only office employee). Or the employee overpays an invoice or payroll tax deposits and pockets the refunds when received.

Tips to reduce the risk of embezzlement

The smaller your company, the more vulnerable you are to fraud, including those listed above. Here are some tips to reduce your risk of theft:

- **Separate the duties.** If one employee is responsible for enough different finance-handling functions, the company is ripe for the picking. As the owner, consider stepping into a couple of the cash-handling functions or outsource certain duties. For example, you can make it a rule that you always open and review the bank statements.
- **Randomize.** On a random schedule, review a few customer transactions from billing to collection, then to the deposit into the bank. Make this random check very public. This random audit may be all it takes to discourage those tempted to conduct mischief.
- **Control access.** Ensure only the employees who need access to sensitive financial and customer information get it. Unique IDs, activity logs and routine monitoring of employee access can help you spot unusual behavior.
- **Perform an "internal control" review.** That will include a look at who does what on a daily basis and which duties need to be assigned to different employees to help prevent employee theft. This may include assigning certain individuals to do random reviews of credit and account activity. ♦

CASH FLOW CORNER

Find cash when you need it

The No. 1 cause of business failure is poor cash flow management. Cash Flow Corner gives you tips to help you master this business fundamental.

It's not uncommon for small businesses to go through periods of extreme cash shortages. While there's typically no easy solution for funding problems, you may have more options than you think when it comes to finding cash for your business:

Extend terms with key vendor(s). You may have a great cash resource in your key vendors, especially if you've been a long-time customer. You may be able to extend your payment terms to help in times of need. By talking to vendors about this need upfront, you can often move 30-day terms to 90-day terms.

Hold and release inventory. Instead of paying for your inventory at one time, work with your supplier to produce inventory and release it to you over time. By paying for inventory when you receive it, you can more closely match your inventory spend with your sales receipts. You may be required to pay a small storage fee, but your large inventory commitment can often reduce your unit costs.

Lease vs. buy. If you're low on capital, leasing may be a good way to free up cash for other uses. Leasing can be especially helpful for businesses that rely on vehicles or equipment that must be upgraded frequently. Just make sure to consider the overall costs of leasing and the flexibility of the leasing terms.

Bring on a silent partner. Taking on a silent business partner can be an economical alternative to lines of credit — especially considering high interest rates, fees and strict repayment schedules. Typically, the chief role of a silent partner is to provide capital, and stay "silent" on other areas of the business, like management and daily operations. That said, a contractual negotiation should spell out the agreed upon silent partner role.

Create a fortress balance sheet. Truth be told, the best time to get cash is when you don't need it. That's because building a balance sheet with high levels of assets and few liabilities will ultimately get a bank to provide a line of credit with reasonable interest rates. So when times are good, work to improve your balance sheet and request a line of credit with a trusted lender. Then you'll have cash available when your business really needs it.

For assistance with financial concerns facing your business, give us a call. ♦

Is your business too dependent?

The last thing most business owners worry about is having too much of a good thing — whether it's proceeds from a top-selling product or good work from an outstanding employee. Over-reliance rarely appears as a problem until it's too late.

So is your business too dependent? Check to see if you relate to any of the examples of possible over-reliance, and create a backup plan.

1. Too much of your company's revenue comes from one client. If your customer base is too narrow, consider expanding your marketing. Ask your best customers what they like about dealing with you, and highlight those traits when soliciting new prospects.

2. You depend on one or two primary vendors. Talk to vendors about preparing contingency plans to deal with shortages or other supply problems. Develop a relationship with one or more backup suppliers. Be especially cautious if you must use one-of-a-kind products.

3. Very few products or services are keeping the business afloat. Changes in technology, regulation, competition or customer needs can render your best-selling product or service suddenly obsolete. Stay aware of trends that might affect your operation. Embrace innovation, and diversify your product line as much as possible.

4. You rely heavily on a few employees. Recognize and reward your indispensable performers through financial incentives or other benefits, like a chance to acquire ownership interests. And consider cross-training your employees into one another's jobs to minimize the impact of absences and losses.

5. You use credit too much. Borrowing to finance your operations can be a successful strategy, and credit can be a valuable tool. But constantly using credit to offset every cash flow fluctuation can create a dangerous debt buildup. Analyze your cash flow to find ways of smoothing out dips without borrowing. If you must borrow, try to repay the debt during flush periods. ♦

NOTE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.* ©MC

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

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Jan. 15, 2019

- Due date for the fourth installment of 2018 individual estimated tax.

Jan. 31

- Due date for employers to provide W-2 statements to employees, and also file Forms W-2 with the Social Security Administration.
- Due date for payers to provide most Forms 1099 to recipients and report Form 1099-MISC non-employee compensation in Box 7 to the IRS.
- Due date for providers to send Forms 1095 to recipients.
- Employers must file 2018 federal unemployment tax returns and pay any tax due.
- Due date to file 2018 fourth quarter Form 941 for Social Security, Medicare and withheld income tax.

Feb. 28

- Payers must file most Forms 1099s (except certain Forms 1099-MISC due Jan. 31) with the IRS.*
- Due date to file Forms 1095 with the IRS.*

March 1

- Farmers and fishermen who did not make 2018 estimated tax payments must file 2018 tax returns and pay taxes in full to avoid a penalty. ♦

*April 1 if filing electronically