Tax Planning Guide for Businesses

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Certified Public Accountants and Consultants

Contents

ARE YOU CONFIDENT YOU ARE DOING EVERYTHING TO MINIMIZE TAXES FOR YOUR BUSINESS?

If not, it may be time to review your current situation. Planning is the key to successfully and legally reducing tax liability. This Tax Planning Guide provides tips to help minimize your business tax liability, summarizes complex tax regulations, identifies common business deductions, and much more!

TAX PLANNING

The process of examining tax options to determine when, whether and how to conduct business transactions to reduce tax liability.

CORPORATE INCOME TAX

C Corporations subject to a flat 21%. Corporate AMT tax no longer applies in 2018 and forward.

CREATE A STRATEGY. GAIN VALUE BEYOND THE NEXT TAX RETURN.

THE MOST POPULAR BUSINESS TAX CREDITS

Tax credits are extremely valuable breaks for taxpayers. Credits lead to a greater reduction in tax than deductions because they are directly applied to your tax bill in a dollar-for-dollar manner.

RESEARCH & DEVELOPMENT (R&D) TAX CREDIT

The federal R&D tax credit was first introduced in 1981. The R&D tax credit is an incentive for businesses to invest in research and development activities to increase growth and competitiveness. Effective credits are typically 5-7% of annual qualified research expenditures.

Qualified research must meet the following criteria:

1. New or improved products, processes, or software
2. Technological in nature
3. Elimination of uncertainty
4. Process of experimentation

What expenses can be included to calculate the credit? R&D expenses include:

- Employee wages
- Cost of supplies
- Cost of testing
- Contract research expenses
- Costs associated with developing a patent

Taxpayers need to show documentation supporting the expenses. They must be associated with activity in science, technology and experimentation developing a new or improved business component. The federal credit may be carried forward for 20 years or have the potential to offset payroll tax.

> *"I AM PROUD TO BE PAYING TAXES IN THE UNITED STATES. THE ONLY THING IS I COULD BE JUST AS PROUD FOR HALF OF THE MONEY."*
>
> *- Arthur Godfrey*

WORK OPPORTUNITY TAX CREDIT (WOTC)

Hiring people from targeted categories and employing them for at least 120 hours may qualify your business for the WOTC. Eligible employers may claim the WOTC for all targeted group employee categories if the individual began or begins work for the employer after December 31, 2014 and before January 1, 2020. This credit is an incentive provided to employers who hire individuals in groups whose members historically have had difficulty obtaining employment. It is available for first-year wages paid or incurred for employees hired and who began work during certain years the credit was available.

Disadvantaged groups include:

- Qualified IV-A Recipient
- Qualified Veteran
- Ex-Felon
- Designated Community Resident
- Vocational Rehabilitation Referral
- Summer Youth Employee
- Supplemental Nutrition Assistance Program Recipient
- Supplemental Security Income Recipient
- Long-Term Family Assistance Recipient
- Qualified Long-Term Unemployment Recipient

If it is determined they qualify for the WOTC, the employee must complete IRS Form 8850 (Pre-Screening Notice and Certification Request for the Work Opportunity Credit) on or before their start date. This form MUST be postmarked within 28 days of the start date and sent to the state Department of Labor for Certification. This form is used to make a written request to the state workforce agency to certify an individual as a member of a targeted group.

Depending on which target group the individual belongs to, the maximum credit per new hire may range from $1,200 to $9,600.

TIP CREDIT

Businesses may be able to claim a credit for social security and Medicare taxes paid or incurred by an employer on certain employees' tips. This credit is part of the general business credit.

You may claim this credit if you meet both of the following conditions:

- You had employees who received tips from customers for providing, delivering, or serving food or beverages for consumption if tipping of employees for delivering or serving food or beverages is customary.
- During the tax year, you paid or incurred employer social security and Medicare taxes on those tips.

Generally, the credit equals the amount of employer social security and Medicare taxes (7.65%) paid or incurred by the employer on tips received by the employee.

ALTERNATIVE FUEL CREDIT

A tax incentive is available for alternative fuel that is sold for use or used as a fuel to operate a motor vehicle. It is a refund of federal excise taxes many transportation and manufacturing businesses utilize. The idea behind it is to encourage business owners to invest in other fuels to reduce the U.S. dependence on imported oil. The taxpayer is required to be registered with the IRS as an Alternative Fueler.

A tax credit in the amount of $0.50 per gallon is available for the following alternative fuels:

- Liquefied petroleum gas
- "P-Series" fuel
- Compressed natural gas
- Liquefied hydrogen
- Fischer-Tropsch process liquid fuel from coal
- Liquid fuel derived from biomass
- Liquefied natural gas
- Liquefied gas derived from biomass
- Compressed gas derived from biomass

MINNESOTA TAX LAW CONFORMITY

The Minnesota Legislature recently passed a tax bill conforming or partially conforming several Minnesota tax laws to changes made under prior Federal tax bills. However, complexities remain around Minnesota's treatment of the tax reform and tax planning has never been more important.
Contact your Smith Schafer professional today to discuss your specific situation.

THE MOST POPULAR BUSINESS TAX DEDUCTIONS

QUALIFIED BUSINESS INCOME DEDUCTION

Tax Reform included a new tax deduction for business owners. It is called the Qualified Business Income Deduction, also called a Section 199A deduction or QBI deduction. According to the IRS, "QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. Only items included in taxable income are counted."

This deduction, in certain situations, may provide up to 20% tax deduction on qualified business income for eligible partnerships, S corporations and sole proprietorships. For taxpayers with taxable income exceeding $321,400 for a married couple filing a joint return, or $160,700 for all other taxpayers, the deduction is subject to limitations. This applies to new or used expenditures.

These limitations include:

- Whether the business is classified as a service trade or business.
- Taxpayer's taxable income.
- The amount of W-2 Wages of the business.
- Unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business.

DEPRECIATION DEDUCTIONS

- **Section 179**

In 2019, businesses can deduct up to $1.02 million of cost of qualifying property placed in service during the given tax year. In addition, as a business owner, you may purchase up to $2.55 million in business property qualifying for the Section 179 deduction each year before the benefit is phased out.

Example: ABC Corp. spends $400,000 on equipment and off-the-shelf computer software equipment in 2019. The business can deduct $400,000 this year on those purchases. To qualify for this Section 179 tax treatment in 2019, the equipment or software must be purchased and placed into service by December 31.

- **Bonus Depreciation**

Tax Reform now allows businesses to fully expense certain capital expenditures instead of depreciating them over several years.

Examples of eligible expenses are:

- Office furniture
- Equipment
- Machinery
- Computers
- Software

These expenditures may be fully expensed starting with business assets placed in service after September 27, 2017. Bonus depreciation will begin phasing out for assets placed into service after December 31, 2022. This immediate tax benefit is likely to encourage more capital spending.

Passenger/Luxury vehicles are defined as four-wheeled, used primarily for street use and have gross vehicle weight (GVWR) of 6,000 pounds or less. Trucks and vans not qualifying as passenger or "luxury" automobiles are not subject to limitations on regular or bonus depreciation. Trucks and vans with GVWR over 6,000 pounds but not over 14,000 pounds are limited to $25,000 of Section 179 expense. The exception to this Section 179 expense rule for trucks and vans is there is no limitation if the vehicle has a bed length of 6 feet or more.

VEHICLE DEPRECIATION
PASSENGER/LUXURY AUTOMOBILES

	YEAR 1	YEAR 2	YEAR 3	YEAR 4 and thereafter
Bonus depreciation limits for passenger/luxury vehicles acquired and placed in service during 2019:	$18,100	$16,100	$9,700	$5,760
Regular depreciation limits for passenger/luxury vehicles acquired and placed in service during 2019	$10,100	$16,100	$9,700	$5,760

Note: Truck, SUV or Vehicles over 6,000 pounds are not subject to the Luxury Auto depreciation limits. The vehicle is eligible for 100% bonus depreciation.

MEALS & ENTERTAINMENT DEDUCTION

Under the new Tax Reform laws, business owners may deduct 50% of food and beverage related to operating a trade or business, with a couple conditions:

- The expense is not lavish or extravagant under the circumstances.
- The taxpayer is present when the food or beverages are furnished.

Expenses related to entertainment, amusement, or recreation no longer fall under the 50% deduction. The IRS will not allow the entertainment disallowance rule to be circumvented through inflation of food and beverage costs.

Example: If a business owner treats a current or potential business client, consultant, or other professional contact to a suite at a sporting event, such as a Vikings game, the food and beverage provided during this entertainment activity is 50% deductible. The cost of the food and beverage must be stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The tickets or suite is not deductible.

Exception to the Rule: Expenses related to business meetings for employees, stockholders, agents or directors are fully deductible. Therefore, entertainment expenses related to meetings, activities, or events for the benefit of employees are fully deductible. This may include events such as shareholder meetings, holiday parties and summer outings. As long as these events remain as COMPANY ONLY functions, these rules should apply.

BUSINESS STRATEGIES

Build and preserve your business value with tax-smart planning.

These strategies can help you engage in proactive planning and help grow your businesses.

QUALIFIED OPPORTUNITY ZONES

Tax Reform developed a new incentive for businesses called Qualified Opportunity Zones (QOZ). This program is designed to increase economic development and job creation in troubled communities by providing tax benefits to investors who invest eligible capital into these areas. Capital gains from investments in a Qualified Opportunity Fund (QOF) allow taxpayers to defer gains up to 15%. A QOF must hold at least 90% of its assets as QOZ stock, partnerships, or business property.

Minnesota Businesses: Governor Dayton nominated 128 census tracts for designation as a qualified opportunity zone. On May 18, 2018, the U.S. Department of Treasury certified and formally designated these census tracts as qualified Opportunity Zones.

MINNESOTA OPPORTUNITY ZONES

COST SEGREGATION STUDY

Cost segregation studies identify costs related to real property that can be reallocated to a short-life deprecation schedule. These studies are one of the most valuable tax saving strategies available for commercial real estate owners, leaseholders and others.

Cost segregation studies must be engineering-based, typically involving professional engineers to review all the costs associated with the building or building improvement along with a CPA to provide itemized details for tax purposes.

The study examines a wide range of building components, such as:

- Electrical installations
- Plumbing
- Mechanical components
- HVAC
- Finishes

It also involves a physical inspection of the property, analysis of architectural and engineering drawings and review of cost data, including the contractor's application of payments, material components, change orders, owner-incurred costs, and indirect disbursements.

As a result of a cost segregation study, a business owner can depreciate property over the shortest permissible period of time.

Example: *The study may identify electrical or plumbing costs related to the operation of machinery and equipment, which is generally depreciated over five years vs. 39 years for commercial property. This reallocation of cost increases cash flow by reducing the overall tax burden. The tax savings created by depreciating more assets as personal property usually more than make up the expenses paid to perform the study.*

In a typical **cost segregation study**, between 15% and 45% of a building's costs can be reclassified to shorter-life assets, depending on the type of facility. For a $1 million project, this can equal between $30,000 and $90,000 in increased cash flow. This allows further investment or even quicker repayment of the loan on the building.

BUSINESS STRATEGIES

RETIREMENT PLANS

Have you procrastinated in setting up a tax-advantaged retirement plan for your business? If so, you are paying income taxes that could easily be avoided and putting your retirement financial situation at risk. However, you can set things right by taking action. That way, you will be positioned for tax savings now and in the future.

Various plan options are available for businesses to establish depending on their size and makeup. Options include:

- SEP
- SIMPLE
- 401k
- Defined benefit cash balance plans

Example: You could implement a safe harbor 401(k) plan for your business. This type of plan requires the company to contribute to employees' savings accounts. These contributions by the business are completely tax deductible. In addition, a safe harbor 401(k) plan automatically passes annual compliance testing, which will allow you as an owner to maximize your contributions to the plan.

Smith Schafer can guide you through every facet of structuring and managing the right retirement plan for your business. We can also evaluate your current plan to identify additional opportunities. **Contact us today to start the conversation**.

WEALTH MANAGEMENT

The unknown path of investments, retirement and taxes can be overwhelming and unclear. Your finances are more complex when you are a business owner. We can help guide you through the entire planning process to ensure a smoother ride. In addition to our core financial and tax services, we provide wealth management services to our clients through our strategic partner, HK Financial Services. We connect tax planning, estate planning and wealth management to what is important to you. Interested in connecting with one of our financial advisors about our wealth management services?

REQUEST A CONSULTATION

SUCCESSION PLANNING

Planning is at the center of effective business management. Planning for your exit is often one of the hardest things a business owner must do. Contemplating the business you built or help to develop without you is complex, difficult and emotionally challenging. Key issues such as leadership selection, personal financial concerns, the impact succession will have on the business and preparing a detailed strategy are challenging parts of the process. However, when succession planning is executed properly, it allows for the orderly transition of management while protecting the exiting owner professionally, emotionally and financially.

In our experience, there are a number of mistakes often made in the planning process:

- Not creating a planning timeline
- No clear benchmarks
- Unable to transfer responsibility
- Secretive planning
- Retirement fear

Succession planning is an essential and complex process requiring careful planning for the various tax considerations. If you are a business owner, who plans to retire in the next 10 years, start planning NOW.

What should business owners do to prepare for business succession and how can they maximize the value of their business? Determine a realistic value of the business. This is accomplished by having a valuation performed on an as-is, on-going basis of the business. Incorporating this information into your overall financial, retirement and estate planning, will help you manage the wealth of your business. Smith Schafer offers business valuation and succession planning services designed to help businesses create and execute a successful transition strategy.

FRINGE BENEFIT PLANS

The right employee benefits allow you to maximize your tax savings, while also benefiting your business and employees.

Below are common tax-exempt benefits you could offer to your employees:

- Transportation benefits
- Dependent care assistance
- Educational assistance
- Health Benefits
- Long-term care insurance
- Disability insurance
- Group term life insurance

BUSINESS STRATEGIES

ACCOUNTING METHODS

Many growing businesses struggle to create well-tuned accounting processes, especially as systems need to change to support increased activity.

There are two principal options for accounting for revenue and expenses:

1. the cash method
2. the accrual method

Note: Businesses with average annual gross receipts of $25 million or less in the three previous years can choose either cash or accrual method of accounting. Businesses above average annual gross receipts of $25 million are required to report under the accrual method of accounting.

The **cash method** of accounting is exactly as it sounds – revenue is recorded when cash is received, and expenses are recorded when cash is spent. This is the simplest accounting method. However, it does not always give a complete and accurate picture of your business operations.

Under the **accrual method** of accounting, revenue is recognized when it is earned, regardless of when the cash is received and expenses are accrued even if not yet paid. The accrual method of accounting provides a more complete and accurate picture of your business operations and matches the expenses to the same period as the revenue.

TIP:

Accelerate or delay income and expense.

Taxpayers who use the cash method of accounting instead of the accrual method should consider delaying year-end billing, so payments are not received until the next tax year. The same goes for expenses; taxpayers should prepay items prior to the end of the tax year to increase expenses and offset taxable income or delay paying until the next tax year.

ACCOUNTING SOFTWARE SELECTIONS

Running your business goes smoother and profits stay higher with the right accounting and business management software. It allows users to store all the information, giving a clear picture of the business financial health. Most accounting softwares can easily manage bookkeeping and monitor costs and revenues to maximize profit margins.

Before committing to a new software package, you should asses the following:

- What are your business needs from its accounting software?
- What are the potential time and cost benefits a new accounting software could provide?
- Does your current accounting software meet those needs?

If, after the above assessment, changing accounting software is the best option, here are a few items to consider:

- Fully integrated vs. Basic accounting software
- Access & portability
- Knowledge required
- Cost

Changing your accounting software may be a time-consuming and costly process, but an ineffective accounting software is burdensome and impedes growth. Smith Schafer can help you choose the right financial management tools for your business and guide you through the implementation.

OUTSOURCING ACCOUNTING

Many growing businesses struggle to create a well-tuned accounting process, especially as certain systems and processes need to change to support increased activity. While invoicing, accounts payable and payroll often suffer first, improper or delayed accounting also stifles future growth by limiting the necessary data for strategic decisions. Business owners typically try to manage it themselves while balancing their many other duties or hire accounting staff to remedy the problem. However, this not only ties up additional resources, but it can be ineffective without the proper expertise and day-to-day guidance.

Outsourcing this part of your business helps you gain the confidence and tools you need to be successful. **Outsourced accounting provides you with:**

- A better understanding of your financial condition
- More free time to focus on your business and craft
- Expert guidance towards your financial goals

10 SIGNS YOUR BUSINESS IS READY TO OUTSOURCE ACCOUNTING

Business

2020 DUE DATES

Form W-2 & certain 1099-Misc (electronic or mail)	JANUARY 31
Form 1065 – Partnerships Form 1120-S – S Corporations	MARCH 16
Form 1040 – Individuals FinCEN 114 – FBAR (will be allowed to extend) Form 1041 – Trusts and Estates Form 1120 – C Corporations	APRIL 15
Form 990 series – Tax Exempt Organizations	MAY 15
Form 5500 series – Employee Benefit Plan	JULY 31
Form 1065 Extended Return Form 1120-S Extended Return	SEPTEMBER 15
Form 1041 Extended Return	SEPTEMBER 30
Form 1120 Extended Return Form 1040 Extended Return FinCEN 114 (Extended with Form 1040) Form 5500 series – Employee Benefit Plan Extended Return	OCTOBER 15
Form 990 series – Tax Exempt Organization Extended Return	NOVEMBER 16

FISCAL YEAR FILERS

Partnership and S Corporation tax returns will be due the 15th day of the third month after the end of their fiscal tax year.

C Corporation tax returns will be due the 15th day of the fourth month after the end of their fiscal tax year.

Employee Benefit Plan tax returns are due the last day of the seventh month after the plan year ends.

PROACTIVE TAX STRATEGIES.

A continuing education requirement keeps CPAs up-to-date about changing tax laws. And since tax reform continues to create comprehensive changes, proactive tax planning needs to be a part of your business strategy. Partner with an experienced team of CPAs to help you create saving opportunities both now and in the future.

We will work closely with you to evaluate your situation and recommend the best approach to lower the current year's tax liability, maximize savings from allowable deductions and take advantage of available tax credits so you can focus on growing your business. We have **over 45 years of experience** helping businesses, in numerous industries, effectively manage taxes.

Contact Us Today

TO LEARN TAX SAVING STRATEGIES THAT BEST FIT YOUR SITUATION.

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