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FEBRUARY 2017

NEW DEADLINE FOR PARTNERSHIP AND LLC INCOME TAX RETURNS MARCH 15, 2017

As many of you realize, the filing deadline for the tax returns of partnerships and limited liability companies (LLCs) (generally treated as partnerships under the federal tax rules) has been changed from April 15th to March 15th effective for 2016 calendar year returns. Those of you involved with LLCs and partnerships will want to be certain that the responsible member is aware of this new filing deadline as substantial penalties are assessed by the Internal Revenue Service for filings late by even one day.

Unlike most tax returns where the late filing penalty is based on the amount due, the partnership (or LLC) return penalty is based on the number of partners. The penalty is $195 for each month or part of a month (for a maximum of 12 months) multiplied by the total number of persons who were partners during any part of the tax year. For example, one day late on a 10-partner partnership results in a penalty of $1,950. One month and one day late doubles that penalty to $3,900. The penalty period is limited to 12 months resulting in a maximum penalty per partner of $2,340 or for a four person partnership, $9,360. For a 30-person partnership, the maximum penalty would be $70,200. Because even a small partnership or LLC can rack up a big penalty bill, all taxpayers will want to be certain that such returns are timely filed.

SUSTAINING THE CHARITABLE CONTRIBUTION TAX DEDUCTION (IT AIN'T EASY)

In the recent case of French v. Commissioner, the Tax Court again reminded taxpayers that for a charitable contribution deduction they must strictly comply with Section 170 of the Internal Revenue Code. This Section details the required contents of a timely written acknowledgment for charitable contributions of $250 or more. The acknowledgement must state whether or not the donee organization provided goods or services in exchange for a taxpayer's contributions. In this 2016 case, the taxpayer had a written acknowledgment that was obtained before the timely filing of the return, but the acknowledgement did not include the "magic words" stating that the taxpayer did not receive any goods or services in return for the charitable contribution. The deduction was disallowed.

(Continued on reverse)

All taxpayers with charitable contributions of $250 or more must obtain, prior to the filing of their returns, a receipt from the charitable organization for the amount of the contribution and containing a statement that the taxpayer received no goods or services (or, disclosing the value of goods and services received) in consideration for the contribution. In short, to obtain a charitable contribution deduction of $250 or more, the taxpayer must have the acknowledgement prior to timely filing the return and it must include the required statement – no magic words, no deduction.

SOMETIMES SIMPLE IS BETTER
FAILING GRADES FOR IVY LEAGUE ENDOWMENTS

Ivy League schools have long achieved academic excellence. However, according to a recent article in the Wall Street Journal citing data of Cambridge Associates and of Fact Set, they have failed to reach excellence in the investment of their endowments. The average endowment tracked by Cambridge Associates achieved an investment return of approximately five percent for the 10 years ended June 30, 2016. Harvard's return was slightly better at 5.7 percent on its $35.7 billion endowment. The return of the S&P 500 Index was approximately seven percent for the same 10-year period.

Harvard announced it was terminating about half of the 230 persons working for the endowment and outsourcing more of its money management. Had Harvard achieved the approximate seven percent return available by investing in an S&P 500 Index Fund for the 10 years ended June 30, 2016, its endowment would have totaled about 13 percent ($4.64 billion) more than the $35.7 billion reported by the Wall Street Journal.

The experience of these endowments demonstrates once again the difficulty or unlikelihood of outperforming the overall equity market over a long period of time – even when highly intelligent, educated people are using hedge funds, private equity funds, alternative investments, etc.

For taxable investors, the added burden of current taxation borne by actively managed equities ensures that over long periods of time passive index funds are almost certain to outperform even the best of money managers.

IRS TO USE COLLECTION AGENCIES

The Internal Revenue Service (IRS) recently announced in IR-2016-125 that it will use private collection agencies to collect unpaid taxes. The collection agencies will be able to identify themselves as contractors of the IRS. In light of the continual telephone scams where callers impersonate IRS agents and demand immediate payment, the IRS appears to be concerned that the private collectors might cause confusion and increase the chances of others successfully scamming vulnerable taxpayers. The IRS included in its announcement that the private collectors will not ask for payment on a prepaid debit card, that all payments would be by check payable to the U.S. Treasury and sent directly to the IRS, not to the private collection agency. The collection agencies will begin collection efforts this spring.

Tax & Business Alert

FEBRUARY 2017

CONSIDER SEPARATING REAL ESTATE ASSETS FROM YOUR BUSINESS

Many companies choose *not* to combine real estate and other assets into a single entity. Perhaps the business fears liability for injuries suffered on the property. Or legal liabilities encountered by the company could affect property ownership. But there are valid and potentially beneficial tax reasons for holding real estate in a separate entity as well.

AVOIDING COSTLY MISTAKES

Many businesses operate as C corporations so they can buy and hold real estate just as they do equipment, inventory and other assets. The expenses of owning the property are treated as ordinary expenses on the company's income statement. However, when the real estate is sold, any profit is subject to double taxation: first at the corporate level and then at the owner's individual level when a distribution is made. As a result, putting real estate in a C corporation can be a costly mistake.

If the real estate were held instead by the business owner(s) or in a pass-through entity, such as a limited liability company (LLC) or limited partnership, and then leased to the corporation, the profit upon a sale of the property would be taxed only once — at the individual level.

MAXIMIZING TAX BENEFITS

The most straightforward and seemingly least expensive way for a business owner to maximize the tax benefits is to buy the property outright. However, this could transfer liabilities related to the property directly to the owner, putting other assets — including the business — at risk. In essence, it would negate part of the rationale for organizing the business as a corporation in the first place.

So it's generally best to hold real estate in its own limited liability entity. The LLC is most often the vehicle of choice for this, but limited partnerships can accomplish the same ends if there are multiple owners. No matter which structure is used, though, make sure all entities are adequately insured.

THE BENEFITS OF SEPARATION FOR FAMILY BUSINESSES

Family businesses face many distinctive challenges. One is that several family members may participate in the ownership of the company. Under such circumstances, separating real estate ownership from the business creates more options to meet the needs of multiple owners.

Let's say that a family business is passing from one generation to the next. One child is very interested in owning and operating the business but doesn't have the means to finance the purchase of both the business and its real estate.

If the two are separated, it's possible for one sibling to take over the business while other siblings hold the real estate. In this case, everyone can benefit: The child who buys the business doesn't have to share control with the other siblings, yet they can still reap benefits as property owners.

TAILORING THE RIGHT STRATEGY

There are many complexities to a company owning real estate. And there's no one-size-fits-all solution to protecting yourself legally while minimizing your tax liability. But if you do nothing and treat real estate like any other business asset, you could be exposing your business to substantial risk. So please contact our firm for an assessment of your situation. We can help tailor a strategy that's right for you. ■

FACING THE TAX CHALLENGES OF SELF-EMPLOYMENT

Today's technology makes self-employment easier than ever. But if you work for yourself, you'll face some distinctive challenges when it comes to your taxes. Here are some important steps to take:

Learn your liability. Self-employed individuals are liable for self-employment tax, which means they must pay both the employ*ee* and employ*er* portions of FICA taxes. The good news is that you may deduct the employ*er* portion of these taxes. Plus, you might be able to make significantly larger retirement contributions than you would as an employee.

However, you'll likely be required to make quarterly estimated tax payments, because income taxes aren't withheld from your self-employment income as they are from wages. If you fail to fully make these payments, you could face an unexpectedly high tax bill and underpayment penalties.

Distinguish what's deductible. Under IRS rules, deductible business expenses for the self-employed must be "ordinary" and "necessary." Basically, these are costs that are commonly incurred by businesses similar to yours and readily justifiable as needed to run your operations.

The tax agency stipulates, "An expense does not have to be indispensable to be considered necessary." But pushing this grey area too far can trigger an audit. Common examples of deductible business expenses

for the self-employed include licenses, accounting fees, equipment, supplies, legal expenses and business-related software.

Don't forget your home office! You may deduct many direct expenses (such as business-only phone and data lines, as well as office supplies) and indirect expenses (such as real estate taxes and maintenance) associated with your home office. The tax break for indirect expenses is based on just how much of your home is used for business purposes, which you can generally determine by either measuring the square footage of your workspace as a percentage of the home's total area or using a fraction based on the number of rooms.

The IRS typically looks at two questions to determine whether a taxpayer qualifies for the home office deduction:

1. Is the specific area of the home that's used for business purposes used *only* for business purposes, not personal ones?
2. Is the space used regularly and continuously for business?

If you can answer in the affirmative to these questions, you'll likely qualify. But please contact our firm for specific assistance with the home office deduction or any other aspect of filing your taxes as a self-employed individual. ■

4 MYTHS ABOUT MANAGING YOUR DEBT

Debt is a reality for many Americans. Median household debt was estimated at $2,300 as of May 2016, according to consumer information provider ValuePenguin. And debt isn't limited to those earning lower incomes; households with a net worth of $500,000 and over had an estimated $8,139 in credit card debt, per the same source.

Underestimating or ignoring your obligations can delay or even prevent you from accomplishing many financial goals. Here are four myths about managing your debt.

1. MY CREDIT REPORT IS FINE, AND SO AM I

Many people glance at their credit reports, see a decent score and move on. But credit reports often contain inaccuracies that blur your true debt picture.

Review your report regularly and follow up with the issuing credit agency if there's an inaccuracy. For example, make sure your report doesn't reflect a lower credit limit than your actual one.

2. SHUT IT DOWN … SHUT IT DOWN NOW

Closing out credit cards may seem like elementary debt management. But eliminating them isn't necessarily the way to go. Instead, you should limit your number of open cards, pay them off or maintain low account balances, and avoid or renegotiate high interest rates.

The major credit-reporting agencies use a combination of metrics to establish your credit score, including credit history and debt utilization (ratio of debt to available credit). Closing out a card reduces your credit history, limiting the data by which you're evaluated, and increases your debt utilization, which hurts your credit score.

3. I HOLD THE GOLDEN TICKET

The easiest way to deal with debt may seem a broad, sweeping strike to pay it down. Unfortunately, gathering the funds to make that move may only worsen the overall situation.

For instance, home equity loans typically offer lower interest rates than credit cards and large available balances. Plus, the interest paid on a home equity debt may be tax deductible, while credit card debt generally isn't. But the greater obligation isn't really wiped out — only transferred. And the borrower's home is at risk.

Similarly, taking out a 401(k) loan offers easy, low-interest access to funds. But a significantly negative tax impact and marked reduction in one's retirement savings are downsides. Also, interest paid on such a 401(k) loan wouldn't be tax deductible.

4. BANKRUPTCY = FAILURE

Well, it certainly doesn't equal success. And a bankruptcy filing should undoubtedly form the last line of defense in any debt management plan. But, rather than considering it an outright failure, you might want to look at bankruptcy as a last-chance opportunity.

In many cases, a person's credit score can recover surprisingly quickly — sometimes as soon as three to five years. In addition, some tax liabilities that meet certain requirements may be discharged in bankruptcy.

ASK FOR HELP

Sound, timely advice can help you avoid getting in over your head when it comes to debt. Please contact our firm for a detailed assessment of your situation. ■

PHASEOUTS AND REDUCTIONS: A TAX-FILING REMINDER

As tax-filing season gets into full swing, there are many details to remember. One subject to keep in mind — especially if you've seen your income rise recently — is whether you'll be able to reap the full value of tax breaks that you've claimed previously.

What could change? If your adjusted gross income (AGI) exceeds the applicable threshold, your personal exemptions will begin to be phased out and your itemized deductions reduced. For 2016, the thresholds are $259,400 (single), $285,350 (head of household), $311,300 (joint filer) and $155,650 (married filing separately). These are up from the 2015 thresholds, which were $258,250 (single), $284,050 (head of household), $309,900 (joint filer) and $154,950 (married filing separately).

The personal exemption phaseout reduces exemptions by 2% for each $2,500 (or portion thereof) by which a taxpayer's AGI exceeds the applicable threshold (2% for each $1,250 for married taxpayers filing separately). Meanwhile, the itemized deduction limitation reduces

otherwise allowable deductions by 3% of the amount by which a taxpayer's AGI exceeds the applicable threshold (not to exceed 80% of otherwise allowable deductions). It doesn't apply, however, to deductions for medical expenses, investment interest, or casualty, theft or wagering losses.

If your AGI is close to the threshold, AGI-reduction strategies (such as making retirement plan and Health Savings Account contributions) may allow you to stay under it. If that's not possible, consider the reduced tax benefit of the affected deductions before implementing strategies to accelerate or defer deductible expenses. Please contact our firm for specific strategies tailored to your situation. ■

REVIEWING YOUR COMPANY'S INVENTORY OPTIONS FOR BEST RESULTS

Robust cash flow is a must for virtually every kind of business. Yet an improperly or inadequately managed inventory system can drag down your revenues. It's a good idea to regularly review your approach to inventory accounting.

RECONSIDER YOUR APPROACH

Generally, there are two primary inventory accounting methods for both tax accounting and financial accounting. They are:

1. Last in, first out (LIFO). If you tend to retain inventory items (such as repair parts or durable goods) for long periods, LIFO may be your best choice. It allows you to allocate the most recent (and, therefore, higher) costs first, ideally maximizing your cost of goods sold and minimizing your taxable income.

2. First in, first out (FIFO). This refers to selling the oldest stock first. Generally, FIFO works best with dated goods, perishable items and collectibles. In an inflationary market, this approach usually results in higher income as older purchases with lower costs are included in cost of sales. (In a deflationary market, the opposite generally holds true.)

Of the two, FIFO is used more often because it more genuinely reflects the typical normal flow of goods and is easier to account for than LIFO, which can be highly complex and deals with inventory costs (not the actual inventory) that may be many years old.

If you're dissatisfied with your company's method, you may be able to change it. But doing so is generally not simple. Should a business wish to change its inventory accounting method for tax purposes, it needs to request permission from the IRS. And if it wishes to change for financial accounting purposes, it needs a valid reason. This is why changes in accounting for inventory are not routine.

TEND TO YOUR GARDEN

As you review your inventory accounting, try to drill down and pinpoint as many discrepancies as possible. By identifying the source of accuracy problems, you can figure out the best solutions. After all, your inventory is like a garden. Left untended, it will grow out of control or die on the vine. Manage yours carefully, however, and it should bear profitable fruit. ■

TAX CALENDAR

January 17

- Individual taxpayers' final 2016 estimated tax payment is due.

January 31

- File 2016 Forms W-2 ("Wage and Tax Statement") with the SSA and provide copies to your employees.
- File 2016 Forms 1099-MISC ("Miscellaneous Income") reporting nonemployee compensation payments in box 7 with the IRS and provide copies to recipients.
- Most employers must file Form 941 ("Employer's Quarterly Federal Tax Return") to report Medicare, Social Security and income taxes withheld in the fourth quarter of 2016. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until February 10 to file the return. Employers who have an estimated annual employment tax liability of $1,000 or less may be eligible to file Form 944 ("Employer's Annual Federal Tax Return").
- File Form 940 ("Employer's Annual Federal Unemployment [FUTA] Tax Return") for 2016. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you deposited the tax for the year in full and on time, you have until February 10 to file the return.
- File Form 943 ("Employer's Annual Federal Tax Return for Agricultural Employees") to report Social Security, Medicare and withheld income taxes for 2016. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the year in full and on time, you have until February 10 to file the return.
- File Form 945 ("Annual Return of Withheld Federal Income Tax") for 2016 to report income tax withheld on all nonpayroll items, including backup withholding and withholding on accounts such as pensions, annuities and IRAs. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the year in full and on time, you have until February 10 to file the return.

February 28

- File 2016 Forms 1099-MISC with the IRS and provide copies to recipients. (Note that Forms 1099-MISC reporting nonemployee compensation in box 7 must be filed by Jan. 31, beginning with 2016 forms filed in 2017.)

March 15

- 2016 tax returns must be filed or extended for calendar-year partnerships and S corporations. If the return is not extended, this is also the last day to make 2016 contributions to pension and profit-sharing plans.

Continued from Page 2.

you receive an installment payment, you must report as income the interest and gain components.

Calculating taxable gain involves multiplying the amount of payments, excluding interest, received in the taxable year by the gross profit ratio for the sale. The gross profit ratio is equal to the gross profit (the selling price less your adjusted basis) divided by the total contract price (the selling price less any qualifying indebtedness — mortgages, debts and other liabilities assumed or taken by the buyer — that doesn't exceed your basis).

The selling price includes the money and the fair market value of any other property you received for the sale of the property, selling expenses paid by the buyer and existing debt encumbering the property (regardless of whether the buyer assumes personal liability for it).

You may be considered to have received a taxable payment even if the buyer doesn't pay you directly.

If the buyer assumes or pays any of your debts or expenses, it could be deemed a payment in the year of the sale. In many cases, though, the buyer's assumption of your debt is treated as a recovery of your basis, rather than a payment.

COMPLEX RULES

The rules of installment sales are complex. Please contact us to discuss this strategy further. ■