



SMT & Associates
Certified Public Accountants & Business Consultants • 815-788-5114

SMT & ASSOCIATES

YEAR-END 2011 BUSINESS GUIDE

For owners of:

S Corporations

C Corporations

Partnerships and LLCs

Sole Proprietorships

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FORMS YOU MAY NEED FOR YEAR-END

- Fringe Benefits / W-2 Planning Organizer
- 1099 worksheet
- Employer Provided Vehicle – Personal Use Information Schedule
- Engagement letter
- Client Organizer

All forms are available on our website at www.smt-associates.com/resources

How To Use This Guide

Some of the alerts you will see in this document to highlight certain issues:



Important deadline!



Land Mines. Areas to watch out for and issues the IRS is paying close attention to.



Caution areas that deserve extra attention

Dear Client:

As the year draws to a close, we want to help you prepare for year-end payroll, tax, and other informational return filing requirements. The following information highlights some areas you should consider in order to assist you planning for year-end.

The information in this document is very important to help ensure you are prepared for the upcoming filing deadlines. Please look over it carefully. If you have questions, please call as soon as possible so we can help you with any questions you might have.

If we prepare your W-2's and/or Forms 1099, or you need assistance in calculating the amounts for fringe benefit inclusion, please return the appropriate forms as soon as possible. If you use an outside payroll service, they will advise you of their cut-off dates for receiving this information for year-end processing.



IMPORTANT DEADLINES

DATE	DEADLINE
December 20, 2011	Fringe Benefits & W-2 Planning Questionnaire returned to us if we handle your payroll processing and year-end W-2's
January 16, 2012	Completed 1099 worksheets to our office to meet the IRS filing deadline of 1/31/12.
January 16, 2012	Last day to make estimated tax payments for 2011 (individuals and c-corporations with 12/31 year-end).
February 20, 2012	Corporate information and completed organizer to us in order to meet 3/15/2012 filing deadline (an automatic 6 month extension is available from the IRS)
March 15, 2012	Deadline for electing to be treated as an s-corporation for c-corps, partnerships and LLC's taxed as partnerships. First IRS deadline for corporate income tax returns (with 12/31 year-end) to be filed or extended.
March 19, 2012	Our deadline for individuals and sole proprietors to submit business and personal information to us in order to meet 4/17/12 filing deadline.
April 17, 2012	Deadline for personal and partnership income tax returns to be filed or extended.
September 15, 2012	Final IRS deadline for corporations and partnerships to file a federal income tax return. Note: Penalties for failing to file an S-corporation or partnership tax return have been increased to \$195 per shareholder, per month the return is filed late, up to a maximum of 12 months.
October 17, 2012	Final IRS deadline for individuals to file a 2011 personal income tax return. Failure to file penalties exist for returns filed after this date, in addition to late payment penalties and interest.

Closing the Books for Year-End

The year-end closing is a critical part of your annual accounting process. If you are handling your own bookkeeping, here are some things that can do to help ensure your books are accurate.

1. **Perform a bank reconciliation of all your bank accounts.** A bank reconciliation is a process that matches the deposits, checks and other debits you have recorded in your general ledger to what has cleared the bank. This process should be performed monthly as it will identify errors in your accounting records and possibly errors the bank has made.
2. **Reconcile your credit cards to your general ledger.** Same process as #1 above except it has to do with your credit cards. This will also ensure you are recording interest expense and haven't missed any deductions charged to your credit card.
3. **Update your inventory balance.** If you are in a business that maintains an inventory of raw materials, work in process, finished products, or goods held for re-sale, be sure to take a physical inventory at year-end, value the inventory at cost (not retail value), and update your general ledger to reflect the amount of inventory you actually have on-hand. You must also keep this list for your records in the event the IRS audits your books.
4. **Record all of your expenses.** If you maintain your books on a cash basis (you record an expense when you actually pay for it) this is nothing more than recording all your checks you wrote by the end of the year. A bank reconciliation (#1 above) will help ensure all expenses are captured in your accounting system. If you are an accrual basis taxpayer, be sure you record all amounts you owe your vendors as of the end of the year. This will ensure you are getting credit for all the expenses you are able to deduct. You should also set up a reliable system for recording your out-of-pocket expenses.
5. **Review your outstanding accounts receivable and accounts payable.** Be sure to periodically review the outstanding amounts to make sure items aren't duplicated or otherwise misstated.
6. **Review your fixed asset listing from the prior year.** Are there assets you may have sold? Are there assets you no longer have?
7. **Reconcile all loan balances to year-end loan statements.** Not only does this ensure all interest expense is properly accounted for, you could also discover loans that remain on the books but no longer exist because of forgiveness or oversight. Also, make sure all loans are actually recorded on the books. By not recording a loan, you may inadvertently cause yourself to miss an important depreciation deduction as a result of an unrecorded asset.
8. **Set a Closing Date (QuickBooks Users)** – Before you send us your QuickBooks data, set a closing date as of the end of the year. This will help prevent making changes to your data after we get it to prepare your tax return. By deleting or adding transactions or otherwise modifying the data in a prior year (including the one you are just closing) you can create extra work for which you may incur additional fees. Because adjustments end up flowing through various balance sheet accounts, changes to prior data will cause other items to be out of balance. When this happens we must identify the changes so we can decide whether you need to amend a prior year return or whether the adjustment belongs in a following year.

By following this list, you will create more accurate books and will save the expense by making the year-end tax return more efficient and effective.

Good Accounting Practices You Should Follow For Your Business

These are a couple of general good business practices to follow pertaining specifically to maintaining good accounting records:

1. **Do not run personal expenses through your business.** There are good legal reasons why most lawyers will recommend a corporation or partnership to not use their business accounts for personal expenses. If you don't know these reasons, you should consult your attorney. From the accounting side, this practice makes your bookkeeping more difficult and less accurate. In addition, if you get audited and the IRS sees significant personal expenses, it makes your books look more suspect to erroneous deductions and may result in increased IRS audit scrutiny and disallowed deductions.
2. **Maintain a separate checking account for your business.** We always will recommend that you setup a separate account for your business. If you don't and you use one or more personal accounts for your expenses, you run a high risk of not recording all expenses you are legitimately entitled to take.
3. **Maintain a separate credit card for your business.** For the same reasons as #1 and #2 above, we recommend this strongly. In addition, the IRS could deny an interest deduction for the credit card fees if you mix personal and business expenses on one card. They could argue the credit card is personal and disallow all interest charges.
4. **Use a program to track your finances such as QuickBooks.** For those clients for whom we handle the bookkeeping, we already use a professional bookkeeping program, so skip to #5. But for everyone else, you must keep your accounting records so that you can produce a detailed listing of individual transactions that make up a balance on your income statement. If the IRS or any governmental agency audits your books, this is the first thing they will request.
5. **Keep all your receipts for every transaction.** You need to properly document every deduction you take. Part of this documentation is a receipt for every deduction you take. Note that cancelled checks, credit card receipts or credit card statements alone will NOT suffice. In an IRS audit, you must provide proof of payment (cancelled check or amount on credit card statement), what specifically was purchased (this is the part that shows on the actual receipt – not the cancelled check or credit card statement), and the business reason for the purchase.

Please keep in mind the idea of “ordinary and necessary.” This phrase is important; we see many deductions disallowed on audit when the IRS deems the expense not to be ordinary and necessary. An expense is *ordinary* if it's customary or usual in the taxpayer's business. A *necessary* expense is one that's appropriate and helpful in developing and maintaining the taxpayer's business. It need not be essential or indispensable.

On the income side of your income statement, if you deposit any money into the business that is NOT income (such as a loan) you should keep documentation of the transaction such as a copy of the check and a loan agreement between the business and the lender. This will help show the IRS the deposit was not income. Under audit the IRS assumes all deposits are income unless you can prove otherwise.

These are only a few of the items we see that will help you prepare for year-end and help protect you in the event of an audit.

PAYROLL REPORTING ISSUES

There are several issues that must be addressed for year-end payroll reporting. Among the most common are health insurance premiums paid to s-corp shareholders or their families, personal use of company provided automobiles, and company-provided life insurance. Whether you process your own payroll, use an outside processor or we process your payroll, you must report these fringe benefits properly.

If any of these situations apply to you, please complete the attached Fringe Benefits/W-2 Planning Questionnaire.

Group Term Life Insurance

The value of company-provided group term life insurance in excess of \$50,000 must be included in the employee's income and is subject only to FICA and Medicare withholding. The value of includable compensation is calculated according to the following table:

UNIFORM PREMIUMS FOR \$1,000 OF
GROUP-TERM LIFE INSURANCE PROTECTION

5-year Age Bracket	Cost per \$1,000 for one month
Under 25.....	\$0.05
25 to 29.....	.06
30 to 34.....	.08
35 to 39.....	.09
40 to 44.....	.10
45 to 49.....	.15
50 to 54.....	.23
55 to 59.....	.43
60 to 64.....	.66
65 to 69.....	1.27
70 and above.....	2.06

For 2% shareholders, the entire amount of premiums paid must be included as income on the shareholder's W-2, subject to federal income tax withholding, but exempt from FICA, Medicare and FUTA.

Personal Use of Auto

When providing an employee (including shareholder/employees in corporations) the use of a company-provided vehicle, a value representing the personal portion of usage of the vehicle must be included in the employee's W-2 income. The value computed must be included in the employee's W-2 as wages and is taxable for federal income tax, FICA, Medicare and FUTA. Although FICA and Medicare withholding is required, federal withholding is not required if notice was provided to the employee of the Company's decision not to withhold by January 31st.

To provide us with the data needed to calculate the valuation, please complete one copy of the "Employer Provided Vehicle Personal Use Information Schedule" for each vehicle owned or leased by your company in



Make sure you keep a mileage log to document your business mileage and business purpose. If the IRS audits your records and you don't have this log, you will be denied all deductions related to your vehicle.

which personal use or commuting miles were driven. Please note, the usage period covered in the form is **November 1, 2010 to October 31, 2011.**

If more than one employee was assigned the same vehicle during that usage period, please complete a separate form for each employee who drove the vehicle. When completing item 6, be sure to show the entire period the employee was assigned the vehicle, e.g., February 15, 2011 to present, or November 1, 2010 to June 10, 2011. For items 7 through

14, enter the actual miles driven, e.g., 15,604, not 15,600.

If we process your payroll, we will include this amount as W-2 income before the end of the year. If you use a third-party to process your payroll, you should provide these amounts to your payroll provider within their timetable to be included in this year's W-2s.

We will contact you as soon as we have completed the computations to discuss the inclusion amount, if any, to be added to wages.

In order to gather this information as efficiently as possible, we ask that all pertinent items be completed fully prior to returning the form to our office. If you have any questions while completing the forms, please contact our office.

Be sure to return the completed forms to our office by December 20, 2011, by mail or fax.

Reasonable Compensation for S-corporation Shareholders

The IRS is increasingly auditing tax returns of s-corporations where the owners have taken less than a reasonable salary. If you are an owner of a profitable s-corporation and have not taken salary or have taken a very low salary that could be deemed as not reasonable, you are at risk of an IRS audit.

Health Insurance Premiums Paid to 2% Shareholders

The Internal Revenue Service requires health insurance premiums paid by Subchapter S corporations for employees owning more than 2% of the corporation and/or their family members ("2% shareholders"), to be treated as additional wages to the employee. These wages are subject to federal income tax withholding, but exempt from FICA, Medicare and FUTA. If health insurance premiums for 2% shareholders are not included on the shareholder's W-2, they cannot be deducted on the tax returns.

Reporting Payments Made To Vendors

One of the areas we see the most confusion concerning reporting compliance among businesses is that of reporting payments made to vendors for services performed for the company. This is also an area where business have the most difficulty in administering.

In summary, you are required to prepare a Form 1099 for any:

- ✓ Unincorporated business or individual,
- ✓ To which you have paid \$600 or more,
- ✓ For services (cleaning, repair, landscaping, marketing, etc) OR
- ✓ For services combined with providing materials (such as a repairman or building contractor), OR
- ✓ For rent

In general, you do not need to issue a 1099 to a corporation, unless payments were made to a

- ✓ Law firm
- ✓ Lawyer
- ✓ Health care provider

Examples of Situations where 1099 Reporting Is Required

- You paid rent to an individual or partnership for your business
- Your business paid over \$600 to an individual, sole proprietor, or partnership for services, including parts and materials, (such as cleaning, repairing, remodeling, website design, etc.)
- You paid over \$600 to an attorney or law firm for legal services (even if the law firm is incorporated).
- You paid over \$600 to an individual, sole proprietor, or partnership for services such as accounting, bookkeeping, or consulting.
- Your business paid over \$600 to any individual or business, even if incorporated, for medical or health services.

New for 2011! Because of new 1099-K reporting rules for payment made by credit card companies and banks, you should report on Form 1099-MISC only payments you made via cash or check. Payments made by credit or debit card should be excluded from your Form 1099-MISC because these payments will be reported on Form 1099-K by the credit card companies and banks.

So how do you know if the business is incorporated or not? This is one of the main purposes of the IRS issued document called a W-9 "Request for Taxpayer Number and Identification." You should obtain a W-9 from all of your vendors to determine whether they are operating as a sole proprietor, corporation, or partnership, and to obtain their federal Taxpayer Identification Number (TIN).

TIP! Obtain a W-9 from every vendor **before paying your vendor**. It is much easier to obtain this information up front. It also avoids the last minute scramble when gathering your information for the annual 1099 reporting exercise.

With this information you can determine whether this person should receive a 1099 at the end of the year. It also protects you in the event of an IRS audit. By performing your due diligence with a W-9, you protect yourself if you don't issue 1099 to a vendor that is not really incorporated. When you obtain a W-9 that states a certain vendor is incorporated, and it turns out the vendor is not (and you should have issued a 1099), you can turn to the W-9 as proof of your due diligence and avoid IRS penalties.

Penalties for failing to file Forms 1099 have risen to \$100 per payee statement not filed. This can quickly balloon to a large amount for a business with a large vendor base. Properly issuing 1099s to vendors meeting the reporting requirement also is helpful should your business get audited by the IRS. Failure to issue Forms 1099 can result in the IRS disallowing the expense claimed on your tax return.

If we are preparing your 1099s for you and we do not do your bookkeeping for you, we will need you to complete a "*1099 Worksheet*" to organize the data needed to prepare the forms in a timely manner.

Independent Contractors - How to Classify Workers

One of the steps we recommend to clients who use independent contractors and who therefore face a heightened risk of a costly IRS payroll tax or benefits audit, is a quick review of some of the key things the IRS tells its agents to look at in determining whether a worker is really an employee.



The primary inquiries fall into three categories. Who has financial control of the job? Who can exercise control over how the worker performs the specific task? And how do the parties themselves view the relationship? When reviewing the checklist, keep in mind that the IRS will make its decision based on the whole picture, not just a single factor.

Workers are more likely to be classified as independent contractors if they:

- Make a significant investment in business property (a home computer is not significant);
- Pay their own business expenses;
- Receive a flat fee that is not based on an hourly or similar rate;
- Are not prohibited from doing work for other companies;
- Can pay subcontractors to get the job done;
- Are not performing services as an integral part of your regular business;
- Have a contract with an enforceable liquidated damages provision;
- Can make a profit;
- Can suffer a loss.

Workers are more likely to be classified as employees if they:

- Are given specific instructions and on-going training in how to get the work done;
- Cannot work for others;
- Have expenses paid by your company;
- Are paid with a salary or hourly wage;
- Do not have a significant investment in their trade or business;
- Are an integral part of your regular business;
- Receive direct reimbursement for all, or almost all, expenses;

Less important is:

- Whether or not the work is performed on the business's premises;
- Whether the worker has flexibility in setting hours;
- Whether the relationship is temporary or short-term;
- Whether the work is full- or part-time;
- Whether the worker performs services for one or more businesses.

If you suspect from this list that there might be a problem, we would be happy to come in and do an audit of your hiring practices and suggest effective solutions if necessary.

Travel and Entertainment Expenses

The IRS has certain requirements for the substantiation of travel and entertainment expenses. In connection with the preparation of the tax return you must be able to produce under audit the information and documentation necessary to substantiate travel, entertainment, transportation and business gift expenses that are deducted in your tax return. **This documentation includes, but is not limited to, mileage logs, detailed receipts, and/or canceled checks.**

Below please find a chart adapted from [Internal Revenue Service Publication 463](#) that details how to substantiate these types of expenses:

If you have expenses for:	THEN you must keep records that show details of the following elements:			
	Amount	Time	Place or Description	Business Purpose and Business Relationship
Travel	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, daily meals for traveler, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation.)	<p><u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained.</p> <p><u>Relationship:</u> N/A</p>
Meals & Entertainment	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc may be totaled on a daily basis.	Date of entertainment or meal. (<i>Also see Business Purpose.</i>)	Name and address or location of place of entertainment or meal if not otherwise apparent. (<i>Also see Business Purpose.</i>)	<p><u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment and meals, the nature of the business discussion or activity. If the meal or entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and entertainment activity.</p> <p><u>Relationship:</u> Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.</p>
Gifts (Note there is a \$25 gift limit per year for each person to whom you provide a gift)	Cost of the gift	Date of the gift	Description of the gift	<p><u>Purpose:</u> Business purpose for the expense.</p> <p><u>Relationship:</u> N/A</p> <p>NOTE: Travel and transportation does not include commuting costs.</p>
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	<p><u>Purpose:</u> Business purpose for the expense.</p> <p><u>Relationship:</u> N/A</p> <p>NOTE: Travel and transportation does not include commuting costs.</p>

Note that meals are deductible only to the extent you are traveling “away from home” in pursuit of a trade or business. The away from home requirement is not black and white for the deductibility of meals, but there is a court case where meals were disallowed for a taxpayer who ate 30 miles away from his place of business. So clearly, meals eaten in the same or nearby community as your place of business are not deductible.

POSSIBLE PAYROLL TAX CREDITS

New Hire Retention Credit

The Hiring Incentives to Restore Employment Act (HIRE Act) provides a credit to employers that 1) hire certain previously unemployed workers after February 3, 2010, and before January 1, 2011, and 2) retain them for 52 consecutive weeks. Employers are eligible to claim the new hire retention credit in the tax year during which the 52-week period is met.

Qualified Employers: Businesses, tax-exempt organizations, public colleges and universities, and Indian tribal governments qualify for the credit. Household employers do not qualify.

Qualified Employees: Qualified employees must meet all of the following criteria for the employer to be eligible for the new hire credit:

1. The employee begins employment with the employer after February 3, 2010 and before January 1, 2011
2. The employee was unemployed or employed 40 hours or less during the 60-day period ending on the date such employment begins. The employee must certify they meet this requirement by signing an affidavit, Form W-11.
3. The employee is not related to the employer (child, sibling, parent, stepparent, niece/nephew, aunt/uncle, in-law, etc).

Amount of the credit: The credit is equal to the lesser of 6.2% if the employee's wages during the 52-week consecutive period, or \$1,000.

Be sure to complete a *HIRE Act Data Worksheet* for each employee who qualifies and return to our office.

Work Opportunity Tax Credit

The work opportunity credit (WOC) is available on an elective basis for a portion of first year wages paid to employees beginning work on or before December 31, 2011 who belong to a "targeted group" Members of a targeted group are defined as qualified (1) IV-A recipients, (2) veterans, (3) ex-felons, (4) long-term family assistance recipients, (5) vocational rehabilitation referrals, (6) summer youth employees, (7) nutrition assistance recipients, (8) social security income recipients, (9) designated community residents, (10) unemployed veterans, and (11) disconnected youth.

These individuals must be certified, either in advance or immediately after employment, by designated local agencies as outlined by the IRS. The IRS has developed Form 8850 (Pre-screening Notice and Certification Request for the Work Opportunity Credit) to assist employers in this certification process.

The credit is 40% of qualified first-year wages for certified workers who work at least 400 hours, and 25% for certified workers who work at least 120, but less than 400 hours. Qualified first-year wages are limited to \$6,000 for any one employee (\$12,000 for qualified veterans). For qualified summer youth employees, the credit equals 40% of wages paid during any 90 day period between May 1 and September 15 up to a maximum of \$3,000 per employee.

No wages shall be taken into account if paid to a related employee. In addition, wages paid to an individual who was previously employed by the employer prior to certification do not qualify.

Wages do not include amounts paid under a federally funded on-the-job training program. Work supplementation payments under Section 482(e) of the Social Security Act reduce qualified wages. Also wages paid to employees in strike replacement positions will not qualify. More than half of the wages must be paid for services performed in a trade or business of the employer.

Small Business Health Care Tax Credit

This relatively new credit introduced in 2010 helps small businesses and small tax-exempt organizations afford the cost of covering their employees and is specifically targeted for those with low- and moderate-income workers. The credit is designed to encourage small employers to offer health insurance coverage for the first time or maintain coverage they already have. In general, the credit is available to small employers that pay at least half the cost of single coverage for their employees.

This is a small selection of some of the more popular issues facing small businesses. If you have any questions about these or other topics, we encourage you to speak with us for additional information or clarification.

SMT & ASSOCIATES, INC.