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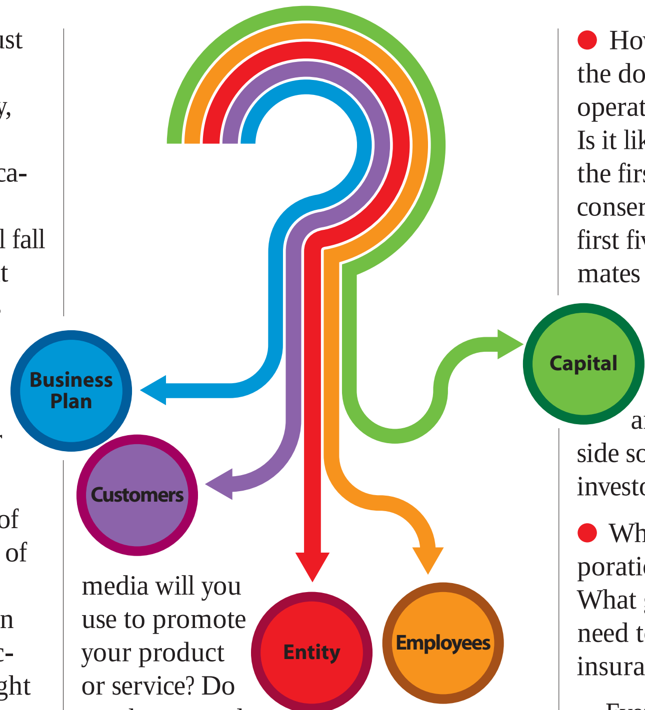
Tax & Business letter
SUMMER 2014

Questions to ask before you start a business



There are several questions you must answer before you even consider starting a new business. Unfortunately, some would-be-entrepreneurs spend more time planning their summer vacation than they do the start of a new business. Most of these businesses will fall into the three out of five start-ups that fail in the first five years. The statistics vary from industry to industry, but about 25% of new business start-ups close down in the first year of operation. Another 25% will fail in the four years that follow.

How can you increase the chances of a business's survival? Here are a series of questions you should answer before launching a new business. Nothing can guarantee a new business will be a success, but being well armed with the right information can certainly help.

- The first question to be answered in your written business plan is what products and/or services you intend to provide. Are these products currently being offered in your local market? What is the price being charged for competing products? How do you propose to capture enough of the local market to make a profit?
- Who is your ideal customer, and what media will you use to promote your product or service? Do you have an adequate population of potential customers to provide the sales you need to make a profit?
- What will make your business stand out? What is unique about your product or service? Will you compete on price, location, product variety, or customer service?
- What size building do you need, and how many employees will it take to serve customers properly?
- How much money will it take to open the doors, and how much is needed for operating capital until you turn a profit? Is it likely that you will make a profit in the first year or two? Be sure to prepare conservative cash flow projections for the first five years showing your best estimates of sales and projected expenses.
- What is the source of funds from day one until you turn a profit? How much will you invest and how much is needed from outside sources such as banks or private investors?
- What legal entity will you use: a corporation, sole proprietorship, LLC, etc.? What government forms and licenses need to be filed? Do you have adequate insurance of the right type?

Every business person can benefit from the services of at least four other business advisors. You should engage the services of an accountant, an attorney, a banker, and an insurance agent before you launch the business. These advisors work with a variety of businesses and business solutions every day and can help improve your chances of succeeding in your new venture. It is imperative that you involve them early in the planning process. ◆

IRS TAX NOTES

IRA rollover rules change

A recent Tax Court decision will soon limit the number of IRA rollovers a taxpayer can do in a year.

Generally, distributions from traditional IRAs are subject to income tax unless the funds are rolled over (redeposited) to an IRA within 60 days. Taxpayers have been allowed to do one rollover per year per IRA.

The Tax Court recently ruled that the once a year limit should apply on an aggregate basis to all IRAs owned by the taxpayer, not on an IRA by IRA basis.

The change goes into effect January 1, 2015, meaning that the aggregate rule won't apply for rollovers done during the remainder of 2014. Also, note that trustee-to-trustee transfers can be done as often as the taxpayer likes, with no tax consequences.

Don't overlook FBAR filing requirement

If you hold foreign bank or financial accounts and the total value of your account exceeds $10,000 at any time during the calendar year, you may be required to file a Treasury Department report known as the FBAR. It's easy to overlook this requirement because it's separate from your federal income tax filing, with a different deadline and strict rules.

FBAR refers to "Form 114, Report of Foreign Bank and Financial Accounts." That form is new this year, replacing the prior Form 90-22.1.

Your 2013 Form 114 must be filed electronically with the Treasury Department no later than June 30, 2014. No filing extension is available. Contact us if you need details or filing assistance. ◆

C or S Corporation: *How does your entity choice affect your taxes?*

Changes to the federal income tax code can prompt you to review the legal structure of your business. Last year's increase in the top tax rate for individuals is one such change, since corporate rates remain the same. At the most basic level, businesses are taxed as either stand-alone or pass-through entities, and a significant difference between corporate and individual tax rates is reason for a new assessment.

If you're debating between operating as a C corporation or an S corporation, here are three tax aspects to consider.

- **Income taxes.** A difference you're probably aware of between the two types of corporations is the way earnings are taxed. C corporations are stand-alone entities and pay federal income tax at the corporate level, based on business earnings. If the corporation has a loss, the loss offsets business income in past or future years.

S corporation earnings and losses are passed through to you, as a shareholder. Earnings are taxed on your individual income tax return at your personal tax rate. This is true even if you receive no cash from the business. Losses can offset other income, assuming you participate in corporate business on a regular and substantial basis.

- **Ownership.** Tax rules limit the number and type of shareholders who can own an interest in your S corporation. For example, an S corporation can have no more than 100 shareholders, and they must all be U.S. citizens or residents. In addition, your S corporation can issue only one class of stock, meaning all shareholders have the same liquidation and distribution rights. When you form a C corporation, foreign owners can hold stock in your business. You can also issue stock with different ownership privileges, such as preferred stock, which grants priority in receiving corporate dividends.

- **Dividends and distributions.** In general, when corporate income is distributed to you as a shareholder, the distribution is a dividend. Whether your corporation is formed as a C corporation or an S corporation, the business gets no deduction.

However, as a C corporation shareholder, you're required to include income distributions on your personal tax return. In effect, distributions are taxed twice, once on the corporate return and once on your return.

When you own stock in an S corporation, distributions can be considered a return of the money you invested in the business. The distinction means you may not owe income tax, assuming you have basis in the corporation.

Many tax and nontax reasons will affect your choice of the best type of structure for your business. Please call our office for a complete evaluation. ◆

Prepare for the Medicare surtax in your 2014 planning

The new 3.8% Medicare surtax on net investment income (NII) appears to be here to stay. If this tax caught you by surprise when you filed your 2013 tax return, you should be better prepared this year.

Here's how the tax works. If your investment income exceeds certain thresholds, you may owe a 3.8% Medicare tax on the excess. The taxable amount would be the lesser of (a) your net investment income (NII), or (b) the excess of your "modified adjusted gross income" (MAGI) above $200,000 for singles, $250,000 for spouses filing jointly, or $125,000 for spouses filing separately. MAGI is adjusted gross income increased by certain deductions and exclusions.

Net investment income includes items from most taxable income sources, such as interest, dividends, capital gains, passive activity income, and the like. However, certain other items – including income from an active trade or business, tax-exempt interest and distributions from qualified plans and IRAs – are specifically exempt.

Note that items exempted from the definition of NII could still cause problems because of the way the surtax is calculated. For instance, if you're over age 70½ and you take a required minimum distribution (RMD) from your IRA, the payout increases your MAGI. This could push you over the threshold for the 3.8% surtax or add to the amount you already owe.

What can you do now to reduce your exposure to the surtax? Consider these five potential strategies.

1. Include municipal bonds ("munis") in your investment portfolio. Income from munis doesn't count as NII or increase your MAGI for this purpose.
2. Time income to stay below the threshold. For example, you might delay the sale of securities until next year or sell real estate property on the installment sale basis to reduce current capital gains.
3. Avoid the passive activity rules. By meeting the tax law test for "material participation," you might be able to turn a passive activity into a regular business activity. But be aware that special rules affect rental real estate activities.
4. Convert traditional IRA funds into a Roth. Because qualified Roth distributions are generally tax-free, this may avoid future problems. Calculate the optimal amount to convert for your personal situation.
5. Maximize deductible contributions to traditional IRAs, 401(k) plans, or similar sheltered investments. Earnings in these accounts are not included in NII, and the contributions will reduce your MAGI.

At the very least, you can't simply ignore the surtax and hope it will go away. Develop a tax plan for 2014 that takes the relevant factors into account. ◆

Make time for taxes before saying "I do"

Getting married can affect your tax bill. For starters, your tax filing status will change. You will have the choice of filing a joint return with your spouse or filing a separate return as a married person.

Filing a joint return usually gives you the bigger tax savings. Both spouses' income and deductions for the entire year will be combined onto one return. Any deductions that are subject to limitations will be determined based on the combined income of both spouses.

In some cases, filing a separate return may save you taxes. A spouse who has high medical expenses or miscellaneous itemized deductions and low income, for example, might be better off filing a separate return. However, you may not claim certain credits and deductions if you file separate returns. Generally, only if you file a joint return can you claim the child and dependent care credit, the earned income credit, or education credits. Filing separate returns could affect the taxability of your social security benefits and the deductibility of rental losses.

The additional tax that some married couples once paid (the "marriage penalty") has been reduced for some, but the penalty still hits many two-income couples. Once you marry, you should review your federal income tax withholding at work. Fill out a new Form W-4 and indicate that you are married.

Several other limitations may come into play once you get married. For example, your IRA contribution may not be deductible if your spouse is covered by a retirement plan at work and your income exceeds certain limits.

Newlyweds can be faced with a surprise tax bill on April 15 unless they do advance planning. For details or planning guidance, give us a call. ◆

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With over 125 years combined experience as certified public accountants, we have the credentials and expertise to assist individuals and growing businesses in complex accounting and tax matters. We serve a variety of clients, with specializations in aviation, oil and gas, architecture, engineering, construction, and technology. Among our services are the following:

- Tax planning, projection, and preparation
- Business valuations
- Litigation consulting
- Compiled and reviewed financial statements.
- Outsource Accounting
- Family Office Services
- Accounting Software Consulting and custom QuickBooks add-ons.

Review your credit policies

There are many ways to make your business more profitable, and sound credit policies are high on the list. The current slowdown in the economy is a good reason to reexamine your company's policies. Keep the following items in mind as you review your policies.

▶ Don't be so eager to sign on new customers that you neglect to check out their credit history. Take the time to check references, and obtain a credit report to see how they've handled other financial transactions.

▶ Establish collection policies and follow up promptly on delinquent accounts. The more overdue accounts become, the more likely they are to become uncollectable. That cuts into your profits.

▶ Calculate what it costs to carry credit for your customers. For example, if your business generates $1,000 per day in credit sales, and it takes you an average of 60 days to collect, your cost of providing credit to your customers is $6,000 per year. This example assumes you can borrow money at 10% interest. By speeding up the average collection to 30 days, you cut your carrying costs by half.

▶ To speed collections, invoice customers when you ship the goods; don't wait until the end of the month. Make sure your invoice clearly shows your payment terms, including penalties for late payment and the discount, if any, for prompt payment.

▶ Be aware of the payment cycles for your industry. For example, if contractors typically pay their bills by the 10th of the month, make sure your invoices arrive in plenty of time for them to process your payment.

Call us if you'd like to review your credit policies. ◆

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.*

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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Tax CALENDAR

SUMMER 2014

June 16 – Second quarter 2014 individual estimated tax is due.

June 16 – Second quarter 2014 estimated tax is due for calendar-year corporations.

June 30 – Report on foreign financial assets and accounts (FBAR) must be received by the Treasury Department.

July 31 – 2013 retirement and employee benefit plan returns are due for calendar-year plans.

September 15 – Third quarter 2014 individual estimated tax is due.

September 15 – Third quarter 2014 estimated tax is due for calendar-year corporations.

September 15 – Deadline for filing 2013 calendar-year tax returns for corporations with extensions of the March 17 deadline.

September 15 – Deadline for filing 2013 partnership returns with extensions of the April 15 deadline. ◆