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THE VOS VOICE

"BECAUSE ACCOUNTING MATTERS AND WE KNOW IT"

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INSIDE THIS ISSUE

FUNDAMENTAL TAX TRUTHS FOR C-CORPORATIONS

The flat 21% federal income tax rate for C-Corporations under the Tax Cuts and Jobs Act (TCJA) has been great news for these entities and their owners. But some fundamental tax truths for C-Corporations largely remain the same:

C-Corporations Are Subject To Double Taxation. Double taxation occurs when corporate income is taxed once at the corporate level and again at the shareholder level as dividends are paid out. The cost of double taxation, however, is now generally less because of the 21% corporate rate.

And double taxation isn't a problem when a C-Corporation needs to retain all its earnings to finance growth and capital investments. Because all the earnings stay "inside" the corporation, no dividends are paid to shareholders, and, therefore, there's no double taxation.

Double taxation also isn't an issue when a C-Corporation's taxable income levels are low. This can often be achieved by paying reasonable salaries and bonuses to shareholder-employees and providing them with tax-favored fringe benefits (deductible by the corporation and tax-free to the recipient shareholder-employees).

C-Corporation Status Isn't Generally Advisable For Ventures With Appreciating Assets Or Certain Depreciable Assets. If assets such as real estate are eventually sold for substantial gains, it may be impossible to extract the profits from the corporation without being subject to double taxation. In contrast, if appreciating assets are held by a pass-through entity (such as an S-Corporation, partnership or limited liability company treated as a partnership for tax purposes), gains on such sales will be taxed only once, at the owner level.

But assets held by a C-Corporation don't necessarily have to appreciate in value for double taxation to occur. Depreciation lowers the tax basis of the property, so a taxable gain results whenever the sale price exceeds the depreciated basis. In effect, appreciation can be caused by depreciation when depreciable assets hold their value.

To avoid this double-taxation issue, you might consider using a pass-through entity to lease to your C-Corporation appreciating assets or depreciable assets that will hold their value.

C-Corporation Status Isn't Generally Advisable For Ventures That Will Incur Ongoing Tax Losses. When a venture is set up as a C-Corporation, losses aren't passed through to the owners (the shareholders) like they would be in a pass-through entity. Instead, they create corporate net operating losses (NOLs) that can be carried over to future tax years and then used to offset any corporate taxable income.

This was already a potential downside of C-Corporations, because it can take many years for a start-up to be profitable. Now, under the TCJA, NOLs that arise in tax years beginning after 2017 can't offset more than 80% of taxable income in the NOL carryover year. So it may take even longer to fully absorb tax losses.

Do you have questions about C-Corporation tax issues post-TCJA? Contact us.

> *"You Don't Have to See the Whole Staircase, Just Take the First Step."*
>
> *--Martin Luther King*

AUDITING CASHLESS TRANSACTIONS

Like most businesses, you've probably experienced a significant increase in the number of customers who prefer to make cashless payments. You may be wondering: *How does the acceptance of these types of transactions affect the auditing of your financial statements?*

Cashless transactions require the exchange of digital information to facilitate payments. Instead of focusing on the collection and recording of physical cash, your auditors will spend significant time analyzing your company's electronic sales records. This requires four specific procedures.

1. Identifying accepted payment methods

Auditors will ask for a list of the types of payments your company accepts and the process maps for each payment vehicle. Examples of cashless payment methods include:

- Credit and debit cards
- Mobile wallets (such as Venmo)
- Digital currencies (such as Bitcoin)
- Automated Clearing House (ACH) payments
- Wire transfers
- Payments via intermediaries (such as PayPal)

Be prepared to provide documents detailing how the receipt of cashless payments works and how the funds end up in your company's bank account.

2. Evaluating roles and responsibilities

Your auditors will request a list of employees involved in the receipt, recording, reporting and analysis of cashless transactions. They will also want to see how your company manages and monitors employee access to every technology platform connected to cashless payments.

Evaluating who handles each aspect of the cashless payment cycle helps auditors confirm whether you have the appropriate level of security and segregation of duties to prevent fraud and misstatement.

3. Testing the reconciliation process

Auditors will review prior sales reconciliations to test their accuracy and ensure appropriate recognition of revenue. This may be especially challenging as companies implement the new accounting rules on revenue recognition for long-term contracts. Auditors also will test accounting entries related to such accounts as inventory, deferred revenue and accounts receivable.

4. Analyzing trends

Cashless transactions create an electronic audit trail. Therefore, there's ample data for auditors to analyze. To uncover anomalies, auditors may, for example, analyze sales by payment vehicle, over different time periods and according to each employee's sales activity.

If your company has experienced payment fraud, it's important to share that information with your audit team. Also, tell them about steps you took to remediate the problem and recover losses.

Preparing For a Cashless Future

Before we arrive to conduct fieldwork, let's discuss the types of cashless payments you now accept — or plan to accept in the future. Depending on the number of cashless methods, we'll amend our audit program to review them in detail.

> *"Don't Be Afraid to Give Up the Good to Go for the Great."*
>
> *-- John D. Rockefeller*

WHEN ARE LLC MEMBERS SUBJECT TO SELF-EMPLOYMENT TAX?

Limited liability company (LLC) members commonly claim that their distributive shares of LLC income — after deducting compensation for services in the form of guaranteed payments — aren't subject to self-employment (SE) tax. But the IRS has been cracking down on LLC members it claims have underreported SE income, with some success in court.

SE TAX BACKGROUND

Self-employment income is subject to a 12.4% Social Security tax (up to the wage base) and a 2.9% Medicare tax. Generally,

Please see *When are LLC Members Subject to Self-Employment Tax* on page 3

When are LLC Members Subject to Self-Employment Tax from page 2

if you're a member of a partnership — including an LLC taxed as a partnership — that conducts a trade or business, you're considered self-employed.

General partners pay SE tax on all their business income from the partnership, whether it's distributed or not. Limited partners, however, are subject to SE tax only on any guaranteed payments for services they provide to the partnership. The rationale is that limited partners, who have no management authority, are more akin to passive investors.

(Note, however, that "service partners" in service partnerships, such as law firms, medical practices, and architecture and engineering firms, generally may not claim limited partner status regardless of their level of participation.)

LLC UNCERTAINTY

Over the years, many LLC members have taken the position that they're equivalent to limited partners and, therefore, exempt from SE tax (except on guaranteed payments for services). But there's a big difference between limited partners and LLC members. Both enjoy limited personal liability, but, unlike limited partners, LLC members can actively participate in management without jeopardizing their liability protection.

Arguably, LLC members who are active in management or perform substantial services related to the LLC's business are subject to SE tax, while those who more closely resemble passive investors should be treated like limited partners. The IRS issued proposed regulations to that effect in 1997, but hasn't finalized them — although it follows them as a matter of internal policy.

Some LLC members have argued that the IRS's failure to finalize the regulations supports the claim that their distributive shares aren't subject to SE tax. But the IRS routinely rejects this argument and has successfully litigated its position. The courts generally have imposed SE tax on LLC members unless, like traditional limited partners, they lack management authority and don't provide significant services to the business.

REVIEW YOUR SITUATION

The law in this area remains uncertain, particularly with regard to capital-intensive businesses. But given the IRS's aggressiveness in collecting SE taxes from LLCs, LLC members should assess whether the IRS might claim that they've underpaid SE taxes.

Those who wish to avoid or reduce these taxes in the future may have some options, including converting to an S corporation or limited partnership, or restructuring their ownership interests. When evaluating these strategies, there are issues to consider beyond taxes. Contact us to discuss your specific situation.

"Because Accounting Matters"

BEWARE THE IDES OF MARCH – IF YOU OWN A PASS-THRU ENTITY Shakespeare's words don't apply just to Julius Caesar; they also apply to calendar-year partnerships, S corporations and limited liability companies (LLCs) treated as partnerships or S corporations for tax purposes. Why? The Ides of March, more commonly known as March 15, is the federal income tax filing deadline for these "pass-through" entities.

Not-so-ancient history

Until the 2016 tax year, the filing deadline for partnerships was the same as that for individual taxpayers: April 15 (or shortly thereafter if April 15 fell on a weekend or holiday). One of the primary reasons for moving up the partnership filing deadline was to make it easier for owners to file their personal returns by the April filing deadline. After all, partnership (and S corporation) income passes through to the owners. The earlier date allows owners to use the information contained in the pass-through entity forms to file their personal returns.

For partnerships with fiscal year ends, tax returns are now due the 15th day of the third month after the close of the tax year. The same deadline applies to fiscal-year S corporations. Under prior law, returns for fiscal-year partnerships were due the 15th day of the fourth month after the close of the fiscal tax year.

Avoiding a tragedy

If you haven't filed your calendar-year partnership or S corporation return yet and are worried about having sufficient time to complete it, you can avoid the tragedy of a late return by filing for an extension. Under the current law, the maximum extension for calendar-year partnerships is six months (until September 16, 2019, for

Please see *Beware The Ides of March-If You Own A Pass-Thru Entity* on page 4

Beware The Ides of March-If You Own A Pass-Thru Entity **from page 3**

2018 returns). This is up from five months under the old law. So the extension deadline is the same — only the length of the extension has changed. The extension deadline for calendar-year S corporations also is September 16, 2019, for 2018 returns.

Whether you'll be filing a partnership or an S corporation return, you must file for the extension by March 15 if it's a calendar-year entity.

Extending the drama

Filing for an extension can be tax-smart if you're missing critical documents or you face unexpected life events that prevent you from devoting sufficient time to your return right now.

But to avoid potential interest and penalties, you still must (with a few exceptions) pay any tax due by the unextended deadline. There probably won't be any tax liability from the partnership or S corporation return. But, if filing for an extension for the entity return causes you to also have to file an extension for your personal return, it could cause you to owe interest and penalties in relation to your personal return.

We can help you file your tax returns on a timely basis or determine whether filing for an extension is appropriate. Contact us today.

I R S Corner

INTERNAL REVENUE SERVICE REMINDS TAXPAYERS WHO OWE OF THE PAYMENT OPTIONS

The IRS anticipates that most taxpayers will be affected by major tax law changes. While most will get a tax refund, others may find that they owe taxes, many of whom may qualify for a waiver of the estimated tax penalty that normally applies. See Form 2210, Underpayment of Estimated Tax by Individuals, Estates and Trusts, and its instructions for details.

"The IRS understands there were many changes that affected people last year, and the new penalty waiver will help taxpayers who inadvertently had too little tax withheld," said IRS Commissioner Chuck Rettig. "We encourage people to check their withholding again this year to make sure they have the right amount of tax withheld for 2019."

The IRS urges people with a filing requirement and a balance due to file by the April 15 deadline even if they cannot pay in full. Taxpayers in this situation should pay what they can and consider a payment plan for the remaining balance.

Taxpayers who owe taxes can choose among the following payment options:

- IRS Direct Pay allows payment directly from a checking or savings account. This service is free.
- Electronic Federal Tax Payment System, or EFTPS. Pay by phone or online. This service is free.
- Debit or credit card payment. This service is free, but the processing company may charge a fee. Fees vary by company.
- Check or money order made payable to the United States Treasury (or U.S. Treasury) either in person or through the mail.
- Cash payments at some IRS offices or at a participating PayNearMe location. Some restrictions apply. Taxpayers should not send cash through the mail.

Taxpayers who are unable to pay their taxes in full should act quickly. Several payment options are available including:

- Online Payment Agreement — Individuals who owe $50,000 or less in combined income tax, penalties and interest and businesses that owe $25,000 or less in payroll tax and have filed all tax returns may qualify for an Online Payment Agreement. Most taxpayers qualify for this option, and an agreement can usually be set up in a matter of minutes. Online applications to establish tax payment plans, like online payment agreements and installment agreements, are available Monday – Friday, 6 a.m. to 12:30 a.m.; Saturday, 6 a.m. to 10 p.m.; Sunday, 6 p.m. to midnight. All times are Eastern time.
- Installment Agreement — Installment agreements paid by direct deposit from a bank account or a payroll deduction will help taxpayers avoid default on their agreements. It also reduces the burden of mailing payments and saves postage costs. Even taxpayers who don't qualify for a payment agreement may still pay by installment. Certain fees apply.
- Delaying Collection — If the IRS determines a taxpayer is unable to pay, it may delay collection until the taxpayer's financial condition improves.
- Offer in Compromise — Certain taxpayers qualify to settle their tax bill for less than the amount they owe by submitting an offer in compromise. To help determine eligibility, use the Offer in Compromise Pre-Qualifier tool.

In addition, taxpayers can consider other options for payment, including getting a loan to pay the amount due. In many cases, loan costs may be lower than the combination of interest and penalties the IRS must charge under federal law.