THE VOS VOICE

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"BECAUSE ACCOUNTING MATTERS AND WE KNOW IT"

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THINKING ABOUT CONVERTING FROM A C CORPORATION TO AN S CORPORATION?

The right entity choice can make a difference in the tax bill you owe for your business. Although S corporations can provide substantial tax advantages over C corporations in some circumstances, there are plenty of potentially expensive tax problems that you should assess before making the decision to convert from a C corporation to an S corporation.

Here's a quick rundown of four issues to consider:

LIFO inventories. C corporations that use last-in, first-out (LIFO) inventories must pay tax on the benefits they derived by using LIFO if they convert to S corporations. The tax can be spread over four years. This cost must be weighed against the potential tax gains from converting to S status.

Built-in gains tax. Although S corporations generally aren't subject to tax, those that were formerly C corporations are taxed on built-in gains (such as appreciated property) that the C corporation has when the S election becomes effective, if those gains are recognized within five years after the conversion. This is generally unfavorable, although there are situations where the S election still can produce a better tax result despite the built-in gains tax.

Passive income. S corporations that were formerly C corporations are subject to a special tax. That tax kicks in if their passive investment income (including dividends, interest, rents, royalties, and stock sale gains) exceeds 25% of their gross receipts, and the S corporation has accumulated earnings and profits carried over from its C corporation years. If that tax is owed for three consecutive years, the corporation's election to be an S corporation terminates. You can avoid the tax by distributing the accumulated earnings and profits, which would be taxable to shareholders. Or you might want to avoid the tax by limiting the amount of passive income.

Unused losses. If your C corporation has unused net operating losses, they can't be used to offset its income as an S corporation and can't be passed through to shareholders. If the losses can't be carried back to an earlier C corporation year, it will be necessary to weigh the cost of giving up the losses against the tax savings expected to be generated by the switch to S status.

Additional Factors

These are only some of the factors to consider when a business switches from C to S status. For example, shareholder-employees of S corporations can't get all of the tax-free fringe benefits that are available with a C corporation. And there may be issues for shareholders who have outstanding loans from their qualified plans. These factors have to be taken into account in order to understand the implications of converting from C to S status.

Contact us. We can explain how these factors will affect your company's situation and come up with strategies to minimize taxes.

INSIDE THIS ISSUE

*"Growth is Never by Mere Chance;
It is the Result of Forces
Working Together."*

--James Cash Penney

SMALL BUSINESSES STAY CLEAR OF A SEVERE PAYROLL TAX PENALTY

One of the most laborious tasks for small businesses is managing payroll. However, it's critical that you not only withhold the right amount of taxes from employees' paychecks but also that you pay them over to the federal government on time.

If you willfully fail to do so, you could personally be hit with the Trust Fund Recovery Penalty, also known as the 100% penalty. The penalty applies to the Social Security and income taxes required to be withheld by a business from its employees' wages. Since the taxes are considered property of the government, the employer holds them in "trust" on the government's behalf until they are paid over.

The reason the penalty is sometimes called the "100% penalty" is because the person liable for the taxes (called the "responsible person") can be personally penalized 100% of the taxes due. Accordingly, the amounts the IRS seeks when the penalty is applied are usually substantial, and the IRS is aggressive in enforcing it.

Responsible Persons

The penalty can be imposed on any person "responsible" for the collection and payment of the taxes. This has been broadly defined to include a corporation's officers, directors, and shareholders under a duty to collect and pay the tax, as well as a partnership's partners or any employee of the business under such a duty. Even voluntary board members of tax-exempt organizations, who are generally exempt from responsibility, can be subject to this penalty under certain circumstances. Responsibility has even been extended in some cases to professional advisors.

According to the IRS, being a responsible person is a matter of status, duty and authority. Anyone with the power to see that the taxes are paid may be responsible. There is often more than one responsible person in a business, but each is at risk for the entire penalty. Although taxpayers held liable may sue other responsible persons for their contributions, this is an action they must take entirely on their own after they pay the penalty. It is not part of the IRS collection process.

The net can be broadly cast. You may not be directly involved with the withholding process in your business. However, let us say you learn of a failure to pay over withheld taxes and you have the power to have them paid. Instead, you make payments to creditors and others. You have now become a responsible person.

How the IRS defines "willfulness"

For actions to be willful, they do not have to include an overt intent to evade taxes. Simply bowing to business pressures and paying bills or obtaining supplies instead of paying over withheld taxes due to the government is willful behavior for these purposes. Moreover, just because you delegate responsibilities to someone else does not necessarily mean you are off the hook.

In addition, the corporate veil will not shield corporate owners from the 100% penalty. The liability protections that owners of corporations — and limited liability companies — typically have do not apply to payroll tax debts.

If the IRS assesses the penalty, it can file a lien or take levy or seizure action against the personal assets of a responsible person.

Avoiding The Penalty

You should never allow any failure to withhold taxes from employees, and no "borrowing" from withheld amounts should ever be allowed in your business — regardless of the circumstances. All funds withheld must be paid over on time.

If you are not already using a payroll service, consider hiring one. This can relieve you of the burden of withholding and paying the proper amounts, as well as handling the recordkeeping. Contact us for more information.

REASONS WHY CASH IS KING

In financial reporting, investors and business owners tend to focus on four key metrics: 1) revenue, 2) net income, 3) total assets and 4) net worth. However, when it comes to gauging short-term financial performance and creditworthiness, the trump card is *cash flow*.

Please see *Reasons Why Cash is King* on page 3

Reasons Why Cash is King **from page 2**

If a business does not have enough cash on hand to pay payroll, rent and other bills, it can spell disaster — no matter how profitable the company is or how fast it's growing. That is why you can't afford to cast aside the statement of cash flows and the important insight it can provide.

Monitoring Cash

The statement of cash flows reveals clues about a company's ability to manage cash. It shows changes in balance sheet items from one accounting period to the next. Special attention should be given to significant balance changes.

For example, if accounts receivable were $1 million in 2018 and $2 million in 2019, the change would be reported as a cash *outflow* of $1 million. That is because more money was tied up in receivables in 2019 than in 2018. An increase in receivables is common for growing businesses, because receivables generally grow in proportion to revenue. Nevertheless, a mounting receivables balance also might signal cash management inefficiencies. Additional financial information — such as an aging schedule — might reveal significant write-offs.

Continually reporting negative cash flows from operations can also signal danger. There is a limit to how much money a company can get from selling off its assets, issuing new stock or taking on more debt. A red flag should go up when operating cash outflows consistently outpace operating inflows. It can signal weaknesses, such as out-of-control growth, poor inventory management, mounting costs and weak customer demand.

Categorizing Cash Flows

The statement of cash flows typically consists of three sections:

1. **Cash flows from operations**. This section converts accrual net income to cash provided or used by operations. All income-related items flow through this part of the cash flow statement, such as net income; gains (or losses) on asset sales; depreciation and amortization; and net changes in accounts receivable, inventory, prepaid assets, accrued expenses and payables.

2. **Cash flows from investing activities**. If a company buys or sells property, equipment or marketable securities, the transaction shows up here. This section could reveal whether a company is divesting assets for emergency funds or whether it is reinvesting in future operations.

3. **Cash flows from financing activities**. This shows transactions with investors and lenders. Examples include Treasury stock purchases, additional capital contributions, debt issuances and payoffs, and dividend payments.

Below these three categories is the schedule of noncash investing and financing transactions. This portion of the cash flow statement summarizes significant transactions in which cash did not directly change hands: for example, like-kind exchanges or assets purchased directly with loan proceeds.

Keep A Watchful Eye

Effective cash management can be the difference between staying afloat and filing for bankruptcy — especially in an unpredictable economy. Contact us to help identify potential problems and find solutions to shore up inefficiencies and shortfalls.

ACCELERATE DEPRECIATION DEDUCTIONS WITH A COST SEGREGATION STUDY

Is your business depreciating over a 30-year period the entire cost of constructing the building that houses your operation? If so, you should consider a cost segregation study. It may allow you to accelerate depreciation deductions on certain items, thereby reducing taxes and boosting cash flow. In addition, under current law, the potential benefits of a cost segregation study are now even greater than they were a few years ago due to enhancements to certain depreciation-related tax breaks.

Depreciation Basics

Business buildings generally have a 39-year depreciation period (27.5 years for residential rental properties). Most times, you depreciate a building's structural components, including walls, windows, HVAC systems, elevators, plumbing and wiring, along with the building. Personal property — such as equipment, machinery, furniture and fixtures — is eligible for accelerated depreciation, usually over five or seven years. In addition, land improvements, such as fences, outdoor lighting and parking lots, are depreciable over 15 years.

Often, businesses allocate all or most of their buildings' acquisition or construction costs to real property, overlooking opportunities to allocate costs to shorter-lived personal property or land improvements. In some cases — computers or furniture, for example — the distinction between real and personal property is obvious. Nevertheless, the line between the two is frequently less clear. Items that appear to be "part

Please see *Accelerate Depreciation Deductions With a Cost Segregation Study* on page 4

Accelerate Depreciation Deductions with a Cost Segregation Study
From page 3

of a building" may in fact be personal property, like removable wall and floor coverings, removable partitions, awnings and canopies, window treatments, signs and decorative lighting.

In addition, certain items that otherwise would be treated as real property may qualify as personal property if they serve more of a business function than a structural purpose. This includes reinforced flooring to support heavy manufacturing equipment, electrical or plumbing installations required to operate specialized equipment, or dedicated cooling systems for data processing rooms.

Identifying And Substantiating Costs

A cost segregation study combines accounting and engineering techniques to identify building costs that are properly allocable to tangible personal property rather than real property. Although the relative costs and benefits of a cost segregation study depend on your particular facts and circumstances, it can be a valuable investment.

Speedier Depreciation Tax Breaks

The Tax Cuts and Jobs Act (TCJA) enhances certain depreciation-related tax breaks, which may also enhance the benefits of a cost segregation study. Among other things, the act permanently increased limits on Section 179 expensing, which allows you to immediately deduct the entire cost of qualifying equipment or other fixed assets up to specified thresholds.

The TCJA also expanded 15-year-property treatment to apply to qualified improvement property. Previously this break was limited to qualified leasehold-improvement, retail-improvement and restaurant property. Moreover, it temporarily increased first-year bonus depreciation to 100% (from 50%).

Making Favorable Depreciation Changes

Fortunately, it is not too late to get the benefit of speedier depreciation for items that were incorrectly assumed to be part of your building for depreciation purposes. You do not have to amend your past returns (or meet a deadline for claiming tax refunds) to claim the depreciation that you could have already claimed. Instead, you can claim that depreciation by following procedures, in connection with the next tax return that you file, that will result in "automatic" IRS consent to a change in your accounting for depreciation.

Cost segregation studies can yield substantial benefits, but they are not right for every business. We must judge whether a study will result in overall tax savings greater than the costs of the study itself. To find out whether this would be worthwhile for you, contact us.

"Because Accounting Matters"

~ *I R S Corner*

IRS URGES TAXPAYERS TO AVOID TAX TIME SURPRISES ON YOUR 2019 TAX RETURNS

When it comes to planning for next year's tax return filing, the IRS urges taxpayers to wait no longer. To avoid tax-time surprises on their 2019 federal tax returns, taxpayers should start by using the IRS withholding estimator and adjust withholding or estimated payments if necessary. This is important for those who received a smaller refund or higher tax bill than expected for 2018 or had a key life event (such as marriage, divorce, a home purchase or entering college). Taxpayers, especially those with investment or self-employment (or gig economy) income, need to monitor their tax situations and begin gathering documents. Contact us for more information or visit http://www.irs.gov

IRS PROVIDES GUIDANCE REGARDING TAX TREATMENT FOR FAMILY MEMBERS WORKING FOR THE FAMILY BUSINESS

Do you own a business and employ family members? If so, special tax treatment may apply. For example, if one spouse employs the other, the employed spouse's wages aren't subject to federal unemployment tax. The same is true for the wages of a parent employed by a child. In addition, the wages of children under 18 employed by their parents aren't subject to Social Security and Medicare taxes, if certain conditions apply. Also, spouses who run a business together and share in the profit or losses may elect special tax treatment. We can help you claim all the tax breaks involved in a family business. Contact us for more information or visit http://www.irs.gov

NEW IRS REPORTING REQUIREMENTS FOR LIFE INSURANCE CONTRACT TRANSACTIONS

New reporting requirements are taking effect for life insurance contract transactions. The IRS and U.S. Treasury Dept. issued final regulations that, among other things, will help people who sell life insurance contracts properly report any gain from that sale. The new requirements are applicable to each person who makes a payment of reportable death benefits (using IRS Form 1099-R). The regulations also cover how to calculate the amount of death benefits excluded from gross income. They generally apply to reportable policy sales and benefit payments after Dec. 31, 2018. The requirements were authorized under the Tax Cuts and Jobs Act in 2018. Contact us for more information or visit http://www.irs.gov