

2016 SMALL BUSINESS YEAR-END LETTER



Does your business operate at a loss? Be aware of the hobby loss rules.

Incorrect deduction of hobby losses amounts to billions in lost tax revenue a year. With Congress and the IRS hot on reducing revenue losses, be aware that your business could be reclassified as a hobby.

The IRS can consider your activity to be a hobby and **not a business** if you do not have a profit in 3 out of 5 years. Hobby income is claimed in full on form 1040, and offsetting expenses to the extent of income are claimed as itemized deductions, limited by 2% of gross income.

If a loss scenario applies to your business, **it is important to show that you are trying to make a profit**. The following strategies might be helpful.

- Keep a set of business books.
- Use a separate bank account for business.
- Keep a log of activity.
- Use a separate credit card for business expenses.
- Advertise

Did you pay for self-employed health insurance?

A self-employed taxpayer can deduct 100% of the amount paid during 2016 for medical insurance for him/herself, spouse, and dependents as an adjustment to income. Deductible payments for health insurance also include Medicare premiums.

No deduction is allowed for any month that the taxpayer is eligible to participate in a subsidized health plan maintained by an employer of either the taxpayer or the taxpayer's spouse.

The deduction is limited to net income from self-employment.

MADE IN THE USA: Is your business involved in domestic production?

If it is, you may qualify for a deduction. To qualify as a domestic producer, you must have income from one of the following:

- Construction performed in the U.S. Both new construction and substantial improvement qualify.
- Architecture or engineering involved with U.S. construction.
- Manufacture, development, production or growth of tangible personal property (not retail food and beverage establishments), software, sound recordings, films, electricity, natural gas, or potable water.

The deduction is equal to 9% of the lesser of

- Your taxable income,
- Sales less cost of goods sold, -or-
- ½ of your gross payroll.

This deduction could save you substantial tax dollars if your business qualifies. If your business only partly qualifies, you need to separate the qualifying activities (construction, manufacturing...) from the non-qualifying, (repairs, services...).

Note: You need **both** a profit and employees to qualify.

Have employees?

- If you are planning to give your employees a holiday gift, make sure it is de minimis and not in cash, otherwise, it must be included in wages.
- If you purchased health insurance for your employees, you might qualify for a 2016 tax credit.
- This year the IRS wants your W2 filings by Jan 31st. In prior years you had until March 31st (if you e-filed). The same deadline applies to 1099-misc filings for independent contractors.

Beware of misclassifying employees as independent contractors. The IRS has a form for misclassified employees to report you, in addition, they are actively pursuing businesses that do not comply with their rules.

Looking for more write-offs?

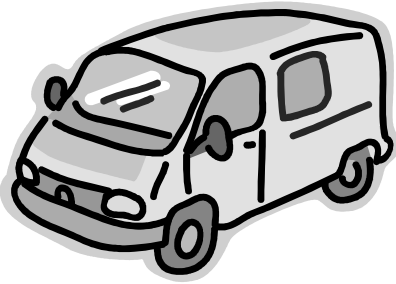
The IRS has made it easier to write-off items that last longer than one year. Now you can elect to expense items costing less than \$2500 (last year the limit was \$500). As always, save your receipts because you will need to prove that each item was less than \$2500.

There are other generous provisions if you bought a new truck (6000+ lbs gross vehicle weight) for your business. Legislation passed in December 2015 permanently extended the \$25,000 expensing and 50% bonus depreciation of such vehicles.

Q: What group of taxpayers is most likely to be audited?

A: Self-employed taxpayers. In its continuing effort to close the tax gap, in spite of budget cuts, the IRS is continuing its audit program. IRS auditors are now trained to be Quick-Books experts.

This letter is designed to inform you of the 2016 tax rules affecting small business and to help you prepare your year-end records to conform to IRS compliance requirements.



Do you use your vehicle for business?

Proper documentation of business miles can make quite a difference in your bottom line profit. The following rules apply to mileage expenses:

Business Mileage Guide Methods:

Business transportation expenses can be calculated for tax purposes in one of the following two ways. In both cases, a record must be kept of business miles, commuting miles, personal miles, and total miles.

Standard mileage rate: This method can be used if you do not use your car for hire or operate a fleet. The rate for 2016 is 54¢ for each business mile driven.

Actual expense method: This method must be used if you are unable to use the standard mileage rate. It is to your advantage to use this method if your vehicle is costly to run or is over 6000 pounds. Records of all vehicle expenses must be maintained and applied to the business mileage percentage. These expenses include gas, oil, lube, repairs, tires, batteries, insurance, supplies, washes and waxes. The business use percentage of lease payments or depreciation is also calculated.

Deductible Mileage:

You can use the following three scenarios to determine how many miles you can deduct. Keep in mind that **commuting is not deductible**.

If you have an office or regular place of business outside your home, you may not deduct commuting miles to and from work or to your first and from your last stop home, but you may deduct mileage to a temporary work place and mileage to and from different locations for work during the day.

If you have an office in your home that qualifies for a home office deduction (see below for qualifications) all of your business-related mileage is deductible.

If you work out of your home, but do not qualify for the home office deduction, the distance between home and your first stop and the distance between your last stop and home are nondeductible commuting miles. You should plan to have your first and last stops close to home to maximize the mileage deduction. A trip to the bank, post office or a nearby supplier can help increase deductible business miles.

The proof is in documentation.

Do you work at home?

You may qualify for the home office deduction if you use a portion of your home as your principal place of business, to store inventory, or to conduct substantial management or administrative activities. There can be no other fixed location where these activities could be done.

The office space still needs to be **used regularly and exclusively for business**, however. Which means you can not have any other usage of the area whatsoever. Using your office for personal or investment reasons eliminates the deduction as far as the IRS is concerned, so be careful to keep your office space and computer usage exclusively business.

Having a deductible home office means you can deduct all of your local business travel as described earlier, and you will not have to keep a log of computer usage because your computer will be used exclusively for business.

If you qualify for the deduction, you will need some additional information:

- Measure your exclusive business space and total area of your home. The resulting business percentage is then applied to the total of your household expenses.
- Gather the following information to calculate the deduction: Mortgage interest, taxes, insurance, association fees, general repairs, maintenance, utilities, garbage pickup, security, and rent paid.

You must also depreciate your home, so you will have to bring an accounting of the total investment in your property.

Beginning in 2013: The IRS has provided a new simplified home office calculation, if you choose. Instead of calculating all of the above information, \$5 per square foot may be deducted (maximum \$1,500). The IRS estimates that the new calculation will save taxpayers 1.6 million hours per year.

Did you start your business in 2016?

All of the costs you incurred before the business began are considered to be "start-up costs". You can choose to deduct up to \$5,000 of these costs in the first year. The remainder must be written off over a 15 year period. Remember to separate these costs from the rest of your expenses when you compile your records.

Don't forget the 1099s.

If you paid any person \$600 or more to perform services for your business, you need to give them a 1099-Misc. by the end of January. Failure to do so will result in loss of the deduction if you are audited and a penalty if filed late.

1099-K:

If your business does internet sales or accepts credit card payments, you may be issued a Form 1099-K. These 1099s will be issued to persons or businesses who generate \$20,000 or 200 or more sales. To avoid an audit, please include all 1099-Ks with your tax information.

You can use the organizer on the next two pages to help you prepare for your tax appointment. Keep in mind the IRS compliance requirements and focus on documentation.



BUSINESS EXPENSES (continued)

<p>ADVERTISING/PROMOTION: Ads, business cards, greeting cards, etc.</p> <p>*COMMISSIONS & FEES PAID: Contract labor</p> <p>EMPLOYEE BENEFITS: Health insurance, company party, mileage reimbursements, etc.</p> <p>INSURANCE: Worker's comp, business liability (do not include auto/truck/health)</p> <p>INTEREST: Mortgage (on business bldg.): Paid to financial institution Paid to individual</p> <p>OTHER INTEREST: (do not include auto or truck) List life insurance loans separately Business only credit card</p> <p>*LEGAL & PROFESSIONAL: Attorney fees for business, accounting fees, bonds, permits, etc.</p> <p>OFFICE EXPENSE: Postage, stationery, office supplies, bank charges, pens, etc.</p> <p>PENSION/PROFIT SHARING: Employees only</p> <p>*RENT/LEASE: Machinery and equipment Other business property</p> <p>*REPAIRS & MAINTENANCE: Building, equipment, etc. (do not include auto or truck)</p> <p>SUPPLIES: Misc. (not included elsewhere) Small tools</p> <p>TAXES: Personal property Licenses (not auto/truck) Real estate of business building & land Sales tax (if included in gross sales) Payroll (your share Soc.Sec./Medicare)</p> <p>TRAVEL (number of nights away): City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___</p>	<p>EXPENSES (AWAY FROM HOME OVERNIGHT): Lodging Meals & tips (keep total separate from other costs) Convention fees Cruise ship convention/seminar Airplane or train fares Auto rental, taxis or bus fares Other (incidentals, laundry, etc.)</p> <p>MEALS & ENTERTAINMENT: Sales lunches Gifts (limited to \$25 per individual or couple) Tickets Tickets to qualified charitable events</p> <p>UTILITIES & TELEPHONE: Electricity (business) Natural gas/heating fuel (business) Garbage, water, sewer (business) Telephone (bus. line, second line, other options) Business long distance (from home telephone) Faxes, paging svcs, cellular svcs</p> <p>WAGES: (bring your copy of W-2s/941s if they have been filed) Wages to spouse (subject to Soc.Sec. and Medicare tax) Children under 18 (not subject to Soc.Sec. and Medicare tax) Other</p> <p>OTHER EXPENSES (not listed elsewhere): Bank charges Courier services Dues & publications Education Fuel for equipment (not auto/truck) Laundry & cleaning Printing & copying Show Fees Shipping</p>
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EQUIPMENT PURCHASED

Item Purchased	Date Purchased	Business Use %	Cost (including sales tax)	Item Traded	Additional Cash Paid	Traded with Related Property	Other Information

*1099s: Amounts of \$600.00 or more paid to individuals (not corporations) for rent, interest, or services rendered to you in your business, require information returns to be filed by payer.

Due date of return is January 31. Nonfiling penalty can be \$150 per recipient. If recipient does not furnish you with his/her Social Security Number, you are required to withhold tax on the payment(s).

Name	Address	Social Security #	Amount	Purpose of Payment