tax report

JANUARY 2016

king + company
CERTIFIED PUBLIC ACCOUNTANTS
3400 Dutchmans Lane
Louisville, KY 40205
(502) 459-5000

Tax Concerns for the Self-employed

If you're in business for yourself, you know how challenging it can be to run your business and keep on top of your tax situation. Here's a refresher on the tax rules you need to be aware of if you're a self-employed sole proprietor or are thinking of becoming one.

Income Taxes

As you probably know, sole proprietors do not file a separate federal income-tax return for the business. Instead, they summarize their business income and expenses on Schedule C of their personal income-tax returns.

Be sure to keep complete records of your income and expenses. Deducting all your ordinary and necessary business expenses will help minimize your tax liability. If you have losses, these are generally deductible against your other income, subject to special rules relating to hobby losses, passive activity losses, and activities for which you were not "at risk."

Self-employment (SE) Taxes

Any self-employed person who has net earnings of at least $400 from the business is subject to SE taxes on those earnings. SE taxes generally track the Social Security and Medicare taxes paid by employees and their employers and are partially tax deductible.

For 2016, the SE tax rates are:

- Social Security — 12.4% of the first $118,500 of net SE earnings
- Medicare — 2.9% on all net SE earnings, plus an additional 0.9% on earnings in excess of $250,000 for joint returns, $125,000 for married taxpayers filing separately, and $200,000 in all other cases

Quarterly Estimated Tax Payments

Your net SE income will be taxable whether or not you withdraw cash from your business account. Moreover, you may be subject to penalties if you fail to make appropriate quarterly estimated tax payments.

Home Office Deduction

If you work out of your home, you may be able to deduct a portion of the costs incurred to maintain your home. You also may be able to deduct commuting expenses incurred to travel from your home office to another work location.

Health Insurance Costs

When tax law requirements are met, you may deduct your health insurance premiums as a trade or business expense, including premiums paid for your spouse, dependents, and children under the age of 27.

Retirement Plan

If you don't already have a tax-favored retirement plan, you may want to consider establishing one. Contributions to the plan would be tax deductible, within certain tax law limits. Types of retirement plans available to sole proprietors include solo 401(k) and simplified employee pension (SEP) plans. ■

Filing as Head of Household

Filing as a head-of-household taxpayer may be more advantageous than filing as a single taxpayer. Why? Generally, it results in a lower income-tax liability.

To qualify, you generally must:

- Be unmarried at the end of the tax year (certain married taxpayers living apart may qualify),
- Not be a surviving spouse who qualifies for joint return rates,*
- Not be a nonresident alien at any time during the tax year, and
- Maintain a household that, for more than half the tax year, is the residence of at least one *qualifying child* or *dependent relative* or is the residence of your dependent parent(s), whether or not you reside there.

A qualifying child must meet all the requirements of being a dependent, with the exception that the custodial parent may have released the dependency exemption to another person.

* Generally, a widow or widower with a dependent child may qualify for joint return rates for two years following the year his or her spouse died.

short takes

Increase in Per Diem Rates for Business Travel

The IRS has increased the "high-low" per diem rates for business travel, meal, and incidental expenses incurred in the continental United States. These rates apply when an employer chooses to provide a per diem allowance to traveling employees instead of reimbursing them for actual expenses. The per diem allowance will not count as taxable income if it does not exceed the IRS's published rates and the employee complies with substantiation requirements. Under the new IRS notice, the "high" rate (to be used for identified "high-cost" areas) is $275 (up from $259), and the rate for all other areas is $185 (up from $172).

New Basis Reporting Rules for Estates

A new law requires executors filing federal estate-tax returns to report the value of estate assets to both the IRS and the beneficiary. Generally, the date-of-death value of an estate asset is used in determining its income-tax "basis" for future sales. The new law — intended to increase consistency in basis reporting — generally requires that the beneficiary must use the reported value in calculating basis for future transactions.

Making a Move

If you make a job-related move, you may be able to deduct certain expenses on your income-tax return. The deduction is taken "above the line," so it is available whether you itemize or claim the standard deduction. Here are the basic rules.

Two-prong Test

To qualify for the deduction, you must satisfy both the *distance* and *time* tests.

Distance. The distance between your new job location and your former residence must be at least 50 miles longer than the distance from your old residence to your old job location. And generally, your new commute cannot be longer than the distance from your old residence to the new job.

Time. If you work solely as an employee, you must work full-time in the general location of your new principal workplace for at least 39 weeks during the first 12 months following your move. If you are self-employed, you must perform services full-time in the general location of your new principal workplace for at least 78 weeks during the 24-month period after the move (with a minimum of 39 work weeks occurring during the first 12 months).

What's Deductible?

Assuming you meet the requirements, these relocation expenses are potentially deductible:

- **Moving household goods and personal effects.** This category includes amounts paid for packing, crating, transporting, storing, and insuring your belongings.
- **Travel.** The cost of a single trip for you and members of your household to your new residence (though you may travel separately). The costs of lodging are also deductible (subject to restrictions).

If your employer reimburses you for your expenses or pays them directly, you may only deduct amounts that are included in your income. ■

A Student Loan Tax Break

If you are paying interest on one or more student loans, you may be able to deduct up to $2,500 of the interest annually. The deduction is "above the line," so you don't need to itemize to claim it.

General Rules

To qualify, the debt must have been incurred by you, your spouse, or your dependent (as of the time the debt was incurred) for the sole purpose of paying tuition, room and board, and related expenses for post-high-school education. Certain post-graduate and vocational programs also qualify. The student must be a degree candidate carrying at least half the normal full-time course load.

The person claiming the deduction must be legally obligated to make the interest payments and not be another taxpayer's dependent. Married couples must file jointly to claim the deduction. For 2016, the deduction is phased out if a couple's adjusted gross income is between $130,000 and $160,000 ($65,000 and $80,000 for single filers).

Home Equity Loans

Taxpayers who choose to use a home equity loan for higher education expenses also may be able to deduct the interest on their loans. Generally, interest on a home equity loan may qualify for an *itemized* deduction if the underlying debt doesn't exceed $100,000 ($50,000 for a married taxpayer filing separately) and all mortgages on the home do not exceed the home's fair market value. ■

Worker Classification: Pay Attention

It isn't easy deciding whether a worker should be treated as an employee or an independent contractor. But the IRS looks at the distinction closely.

Tax Obligations

For an employee, a business generally must withhold income and FICA (Social Security and Medicare) taxes from the employee's pay and remit those taxes to the government. Additionally, the employer must pay FICA taxes for the employee (currently 7.65% of earnings up to $118,500 and 1.45% of earnings exceeding that amount). The business must also pay unemployment taxes for the worker. In contrast, for an independent contractor, a business is not required to withhold income or FICA taxes. The contractor is fully liable for his or her own self-employment taxes, and FICA and federal unemployment taxes do not apply.

Employees Versus Independent Contractors

To determine whether a worker is an independent contractor or employee, the IRS examines factors in three categories:

- Behavioral control — the extent to which the business controls how the work is done, whether through instructions, training, or otherwise.

- Financial control — the extent to which the worker has the ability to control the economic aspects of the job. Factors considered include the worker's investment and whether he or she may realize a profit or loss.

- Type of relationship — whether the worker's services are essential to the business, the expected length of the relationship, and whether the business provides the worker with employee-type benefits, such as insurance, vacation pay or sick pay, etc.

In certain cases where a taxpayer has a reasonable basis for treating an individual as a non-employee (such as a prior IRS ruling), non-employee treatment may be allowed regardless of the three-prong test.

If the proper classification is unclear, the business or the worker may obtain an official IRS determination by filing Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.

Year-end Statements

Generally, if a business has made payments of $600 or more to an independent contractor, it must file an information return (Form 1099-MISC) with the IRS and send a corresponding statement to the independent contractor.

Consequences of Misclassification

Where the employer misclassifies the employee as an independent contractor, the IRS may impose penalties for failure to deduct and withhold the employee's income and/or FICA taxes. Penalties may be doubled if the employer also failed to file a Form 1099-MISC, though the lower penalty will apply if the failure was due to reasonable cause and not willful neglect.

Correcting Mistakes

Employers with misclassified workers may be able to correct their mistakes through the IRS's Voluntary Classification Settlement Program (VCSP). For employers that meet the program's eligibility requirements, the VCSP provides the following benefits:

- Workers improperly classified as independent contractors are treated as employees going forward.

- The employer pays 10% of the most recent tax year's employment-tax liability for the identified workers, determined under reduced rates (but no interest or penalties).

- The government agrees not to raise the issue of the workers' classification for prior years in an employment-tax audit.

Please contact us if we can help you sort through the IRS rules and fulfill your tax reporting obligations. ■

Calendar of Filing Dates

JANUARY

15 **Individuals:** Pay last installment of 2015 estimated tax with Form 1040-ES. Or file 2015 income-tax return and make full payment of any balance due by February 1.

FEBRUARY

1 **Employers:** Distribute copies of Form W-2 for 2015 to employees.

1 **Businesses:** Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2015. See us for more details.

1 **Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

1 **Employers:** File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2015.

10 **Employers:** Deferred due date of Forms 940 and 941, if timely deposits were made.

16 **Businesses:** Distribute Forms 1099-B, 1099-S, and certain Forms 1099-MISC to recipients of specified payments made in 2015. See us for more details.

29 **Businesses:** File 2015 Forms 1099 with the IRS. Electronic filers have until March 31 to file.

29 **Employers:** Paper filers must file 2015 Forms W-2 (together with transmittal Form W-3) with the Social Security Administration. Electronic filers have until March 31 to file.

MARCH

15 **Corporations:** Calendar-year corporations file their 2015 tax returns (Form 1120) and pay any taxes due. S corporations file Form 1120S. For an automatic filing extension, file Form 7004 and deposit the estimated tax due.

Deducting Job-related Education Expenses

Are you planning on taking a job-related class? If you are, you may be able to deduct your education expenses.

Basic Rules

Education expenses are deductible if the education:

- Maintains or improves skills required in your business or employment, or
- Meets the express requirements of either your employer or the law as a condition of retaining your salary, status, or employment.

But the rules can be tricky to apply. Educational costs will not be deductible if they are incurred to *enter* a field (as opposed to staying in one) or if they qualify you for a *new* trade or business. Therefore, an aspiring doctor may not deduct the costs of medical school, but he or she could potentially deduct the cost of courses necessary to maintain his or her medical skills.

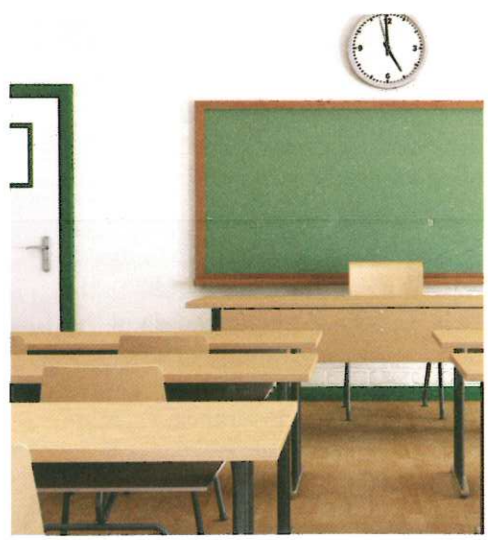
In a recent case, an attorney who was admitted to practice law in Germany sought to deduct law school expenses he had incurred to enable him to practice in New York. The taxpayer argued that the expenses allowed him to maintain his general skills as a lawyer. The Tax Court disagreed, however, reasoning that the education qualified him to satisfy the New York entrance requirements and therefore enter a new trade or business.

Itemized Deduction

Education expenses must be claimed as a miscellaneous itemized deduction. They are deductible only to the extent that they — along with your other miscellaneous expenses — exceed 2% of your adjusted gross income.

Other Alternatives

Instead of taking this deduction, you may want to see if you're eligible to claim a tax credit for a portion of



qualified tuition and related expenses. The American Opportunity credit is limited to undergraduate courses, but the Lifetime Learning credit may be claimed for most post-high-school education at eligible education institutions. ■