20 tax tips for small businesses

Give this list to all your SMB clients

BY DONALD WILLIAMSON AND DAVID KAUTTER

The Internal Revenue Service sent letters to thousands of small-business owners recently, questioning whether they underpaid their taxes last year.

Titled "Notification of Possible Income Underreporting," the letters were mailed to small employers this summer requesting that they review and confirm that they accurately reported their income on their 2012 tax returns.

In response to this action by the IRS, American University professors Donald Williamson and David Kautter have created a list of "Tax Best Practices for Small Businesses," a checklist designed to help small business entrepreneurs stay up to date on all tax-related issues, and away from the scrutiny of the IRS.

Here's what they recommend small-business owners should do:

1. Keep good records about who is an "employee" and who is an "independent contractor."

2. Keep track of places where they may have a "physical presence" (even unknowingly), to properly comply with state rules governing sales tax collection.

3. Invest in good tax software accounting systems — those that track their records and regularly provide updates to new IRS rules.

4. Hire a tax accountant who has experience in their type of business, whether it's a coffee shop or a construction business.

5. Keep good records on how much they paid for, and the date they placed in service, all business equipment, business vehicles, and so on.

6. Don't consider using funds that they have withheld for employee payroll taxes (or any taxes, for that matter) as a short-term loan to tide them over during a shortfall in their working capital.

7. One of the biggest traps for small-business taxpayers is estimated taxes — paying them on time, calculating them correctly, and knowing the safe harbors that can protect them against underpayments.

Miscalculating any of these steps can be a major headache, so small-business owners should speak with someone, most likely a tax accountant or enrolled agent, who knows the rules cold.

8. If the owner's spouse, child, mother-in-law, or other close relative works in their business, they should make sure that the relative abides by the same employment rules as their unrelated employees.

> When someone pays them in cash, it doesn't mean that payment is nontaxable.

9. Select a "tax year" for their business that reflects the natural ebb and flow of their business' receipts and disbursements. This way, they won't get caught in a cash crunch when tax time comes.

10. They (or their accountant) should retain all relevant tax records for at least three years, and if their records relate to property and depreciation, they should keep them until the property is disposed of, plus an additional three years.

11. Keep detailed records on how they use their personal or business-owned vehicle for business versus personal purposes.

12. Hire a reputable third-party administrator (such as Fidelity or Vanguard) to manage their 401(k) plan and other tax-favored employee benefits.

13. Make sure that they (and their tax accountant) are familiar with the tax rules, including the favorable tax credits and deductions that are unique to their business.

14. If it becomes necessary for their small business to open a foreign bank account in order to pay vendors or others in another country, make sure that they (and their tax accountant) are vigilant in following the new rules on foreign bank accounts enacted in the Foreign Account Tax Compliance Act, or FATCA.

15. If their hope is that their business will continue after they die, under the leadership of another family member or designated heir, they should take steps to protect the business against a forced sale in order to pay inheritance taxes.

16. Don't become foolishly emboldened by thinking that the IRS will have to "prove" that they have done something that doesn't comport with the tax law. The burden of proof is always on them, not the IRS.

17. Become familiar with the tax rules surrounding starting, running, selling and shutting down a business. Determine whether they should operate as a partnership, an S corporation, an LLC, or a sole proprietorship. Their tax accountant should be closely familiar with these rules.

18. Have a one-on-one conversation with their accountant about the Affordable Care Act.

19. If they can't pay the taxes they owe to the IRS, or another tax agency, they should contact their accountant right away. This situation won't get better by ignoring it.

20. When someone pays them in cash, it doesn't mean that the payment is nontaxable. The IRS has state-of-the-art statistical technology and models based on spending habits and bank accounts to build a case against alleged tax cheats. AT

Donald Williamson is a CPA, attorney and professor who has served as director of the Master of Science in Taxation degree program at American University's Kogod School of Business for more than 25 years. David Kautter is a CPA and attorney, and serves as executive-in-residence in the Department of Accounting and Taxation at the Kogod School of Business.