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YEAR-END BUSINESS GUIDE

For owners of:

S Corporations

C Corporations

Partnerships and LLCs

Sole Proprietorships

TABLE OF CONTENTS

How To Use This Guide

Some of the alerts you will see in this document to highlight certain issues:

Important deadline!

Land Mines. Areas to watch out for and issues the IRS is paying close attention to.

Caution areas that deserve extra attention

Dear Client:

As the year draws to a close, we want to help you prepare for year-end payroll, tax, and other informational return filing requirements. The following information highlights some areas you should consider in order to assist you planning for year-end.

The information in this document is very important to help ensure you are prepared for the upcoming filing deadlines. Please look over it carefully. If you have questions, please call as soon as possible so we can help you with any questions you might have.

If we prepare your W-2's and/or Forms 1099, or you need assistance in calculating the amounts for fringe benefit inclusion, please return the appropriate forms as soon as possible. If you use an outside payroll service, they will advise you of their cut-off dates for receiving this information for year-end processing.

One of the important documents in this attachment is the Business Tax Organizer. Please review this and completely fill this out prior to submitting your data. We will not be able to begin preparing your year-end tax return without this document.

What's New?

1. In our business organizer and throughout this year-end guide, we are providing links to forms on our website for your convenience.

2. In November 2009, the IRS significantly increased the penalties for filing an S corporation or partnership tax return late. The penalties for late filing have been increased to $195 per shareholder per month as long as the return remains unfiled, up to a maximum of 12 months. Therefore, an S-corporation with a single shareholder could be penalized up to $2,340 for filing their S-corporation income tax return late!

3. The IRS has continued to announce new requirements for tax preparers and is subjecting the tax preparation industry to increased scrutiny and regulation. Penalties for failure to comply with these stricter regulations have increased as well. As a result, we may be requesting your signature on more forms and documents and requesting more details on your tax information than in the past. We hope you understand that we do this only to abide by these regulations which are meant to protect you from unscrupulous tax preparers, to protect your privacy and to protect you from identity theft.

4. We now have a great process available for our clients to electronically submit your QuickBooks data files, and any other files, through a secure portal. If you do not already have a portal setup, please ask our staff.

Closing the Books for Year-End

The year-end closing is a critical part of your annual accounting process. If you are handling your own bookkeeping, here are some things that you can do to help ensure your books are accurate.

1. **Perform a bank reconciliation of all your bank accounts.** A bank reconciliation is a process that matches the deposits, checks and other debits you have recorded in your general ledger to what has cleared the bank. This process should be performed monthly as it will identify errors in your accounting records and possibly errors the bank has made.
2. **Reconcile your credit cards to your general ledger.** Same process as #1 above except it has to do with your credit cards. This will also ensure you are recording interest expense and haven't missed any deductions charged to your credit card.
3. **Update your inventory balance.** If you are in a business that maintains an inventory of raw materials, work in process, finished products, or goods held for re-sale, be sure to take a physical inventory at year-end, value the inventory <u>at cost</u> (not retail value), and update your general ledger to reflect the amount of inventory you actually have on-hand. You must also keep this list for your records in the event the IRS audits your books.
4. **Record all of your expenses.** If you maintain your books on a cash basis (you record an expense when you actually pay for it) this is nothing more than recording all your checks you wrote by the end of the year. A bank reconciliation (#1 above) will help ensure all expenses are captured in your accounting system. If you are an accrual basis taxpayer, be sure you record all amounts you owe your vendors as of the end of the year. This will ensure you are getting credit for all the expenses you are able to deduct. You should also set up a reliable system for recording your out-of-pocket expenses.
5. **Review your outstanding accounts receivable and accounts payable.** Be sure to periodically review the outstanding amounts to make sure items aren't duplicated or otherwise misstated.
6. **Review your fixed asset listing from the prior year.** Are there assets you may have sold? Are there assets you no longer have?
7. **Reconcile all loan balances to year-end loan statements.** Not only does this ensure all interest expense is properly accounted for, you could also discover loans that remain on the books but no longer exist because of forgiveness or oversight. Also, make sure all loans are actually recorded on the books. By not recording a loan, you may inadvertently cause yourself to miss an important depreciation deduction as a result of an unrecorded asset.
8. **Set a Closing Date (QuickBooks Users) –** Before you send us your QuickBooks data, set a closing date as of the end of the year. This will help prevent making changes to your data after we get it to prepare your tax return. By deleting or adding transactions or otherwise modifying the data in a prior year (including the one you are just closing) you can create extra work for which you may incur additional fees. Because adjustments end up flowing through various balance sheet accounts, changes to prior data will cause other items to be out of balance. When this happens we must identify the changes so we can decide whether you need to amend a prior year return or whether the adjustment belongs in a following year.

Good Accounting Practices You Should Follow For Your Business

These are a couple of general good business practices to follow pertaining specifically to maintaining good accounting records:

1. **Do not run personal expenses through your business.** There are good legal reasons why most lawyers will recommend a corporation or partnership to not use their business accounts for personal expenses. If you don't know these reasons, you should consult your attorney. From the accounting side, this practice makes your bookkeeping more difficult and less accurate. In addition, if you get audited and the IRS sees significant personal expenses, it makes your books look more suspect to erroneous deductions and may result in increased IRS audit scrutiny and disallowed deductions.
2. **Maintain a separate checking account for your business.** We always will recommend that you setup a separate account for your business. If you don't and you use one or more personal accounts for your expenses, you run a high risk of not recording all expenses you are legitimately entitled to take.
3. **Maintain a separate credit card for your business.** For the same reasons as #1 and #2 above, we recommend this strongly. In addition, the IRS could deny an interest deduction for the credit card fees if you mix personal and business expenses on one card. They could argue the credit card is personal and disallow all interest charges.
4. **Use a program to track your finances such as QuickBooks.** For those clients for whom we handle the bookkeeping, we already use a professional bookkeeping program, so skip to #5. But for everyone else, you must keep your accounting records so that you can produce a detailed listing of individual transactions that make up a balance on your income statement. If the IRS or any governmental agency audits your books, this is the first thing they will request.
5. **Keep all your receipts for every transaction.** You need to properly document every deduction you take. Part of this documentation is a receipt for every deduction you take. Note that cancelled checks, credit card receipts or credit card statements alone will NOT suffice. In an IRS audit, you must provide proof of payment (cancelled check or amount on credit card statement), what specifically was purchased (this is the part that shows on the actual receipt – not the cancelled check or credit card statement), and the business reason for the purchase.

   Please keep in mind the idea of "ordinary and necessary." This phrase is important; we see many deductions disallowed on audit when the IRS deems the expense not to be ordinary and necessary. An expense is *ordinary* if it's customary or usual in the taxpayer's business. A *necessary* expense is one that's appropriate and helpful in developing and maintaining the taxpayer's business. It need not be essential or indispensable.

   On the income side of your income statement, if you deposit any money into the business that is NOT income (such as a loan) you should keep documentation of the transaction such as a copy of the check and a loan agreement between the business and the lender. This will help show the IRS the deposit was not income. Under audit the IRS assumes all deposits are income unless you can prove otherwise.

   These are only a few of the items we see that will help you prepare for year-end and help protect you in the event of an audit.

PAYROLL ISSUES

There are several issues that must be addressed for year-end payroll reporting. Among the most common are health insurance premiums paid to s-corp shareholders or their families, personal use of company provided automobiles, and company-provided life insurance. Whether you process your own payroll, use an outside processor or we process your payroll, you must report these fringe benefits properly.

If any of these situations apply to you, please complete the attached Fringe Benefits/W-2 Planning Questionnaire.

Health Insurance Premiums Paid to 2% Shareholders

The Internal Revenue Service requires health insurance premiums paid by Subchapter S corporations for employees owning more than 2% of the corporation and/or their family members ("2% shareholders"), to be treated as additional wages to the employee. These wages are subject to federal income tax withholding, but exempt from FICA, Medicare and FUTA.

Reasonable Compensation for S-corporation Shareholders

The IRS is increasingly auditing tax returns of s-corporations where the owners have taken less than a reasonable salary. If you are an owner of a profitable s-corporation and have not taken salary or have taken a very low salary that could be deemed as not reasonable, you are at risk of an IRS audit.

Group Term Life Insurance

The value of company-provided group term life insurance in excess of $50,000 must be included in the employee's income and is subject only to FICA and Medicare withholding. The value of includable compensation is calculated according to the following table:

UNIFORM PREMIUMS FOR $1,000 OF
GROUP-TERM LIFE INSURANCE PROTECTION

5-year Age Bracket	Cost per $1,000 **for one month**
Under 25	$0.05
25 to 29	.06
30 to 34	.08
35 to 39	.09
40 to 44	.10
45 to 49	.15
50 to 54	.23
55 to 59	.43
60 to 64	.66
65 to 69	1.27
70 and above	2.06

For 2% shareholders, the entire amount of premiums paid must be included as income on the shareholder's W-2, subject to federal income tax withholding, but exempt from FICA, Medicare and FUTA.

Personal Use of Auto

When providing an employee (including shareholder/employees in corporations) the use of a company-provided vehicle, a value representing the personal portion of usage of the vehicle must be included in the employee's W-2 income. The value computed must be included in the employee's W-2 as wages and is taxable for federal income tax, FICA, Medicare and FUTA. Although FICA and Medicare withholding is required, federal withholding is not required if notice was provided to the employee of the Company's decision not to withhold by January 31st.

To provide us with the data needed to calculate the valuation, please complete one copy of the "Employer Provided Vehicle Personal Use Information Schedule" for each vehicle owned or leased by your company in which personal use or commuting miles were driven. Please note, the usage period covered in the form is **November 1 to October 31.**.

If more than one employee was assigned the same vehicle during that usage period, please complete a separate form for each employee who drove the vehicle. When completing item 6, be sure to show the entire period the employee was assigned the vehicle, e.g., February 15, 2009 to present, or November 1, 2009 to June 10, 2009. For items 7 through 14, enter the actual miles driven, e.g., 15,604, not 15,600.

If we process your payroll, we will include this amount as W-2 income before the end of the year. If you use a third-party to process your payroll, you should provide these amounts to your payroll provider within their timetable to be included in this year's W-2s.

We will contact you as soon as we have completed the computations to discuss the inclusion amount, if any, to be added to wages.

In order to gather this information as efficiently as possible, we ask that all pertinent items be completed fully prior to returning the form to our office. If you have any questions while completing the forms, please contact our office.

VERIFICATION OF EMPLOYEE SOCIAL SECURITY NUMBERS – NEW REQUIREMENTS

New regulations from the Department of Homeland Security have tightened up your obligations regarding the verification of employee social security numbers. Allegations by third parties that an employee may not be authorized to work here **must** now be investigated by the employer. A no-match letter from Social Security is an example of such a third party allegation.

If you receive a social security number no-match letter after September 14, 2007, you will have only 93 days to correct the situation. If the no-match issue can not be resolved in this time period, you **must** terminate the employee. Otherwise you may be subject to fines and/or **imprisonment** for knowingly continuing to employ an unauthorized person.

For your own protection, we strongly advise you to adhere to the following steps.

WHAT YOU SHOULD DO:

Institute, and post, your company policy regarding the hiring, and termination of employees with social security numbers that fail verification. ****note: this policy must be applied to all prospective and current employees equally.**

Be sure that you have a W-4 **and** I-9 in your files for **every** employee. Keep a copy of the employee's social security card and driver's license or other picture i.d.

Verify **all** social security numbers by calling **1-800-772-6270**

If a number fails to verify on a new employee, do not allow him/her to work until correct information is provided!

If a number fails to verify on a current employee, you must take a specific series of steps to correct the situation. Otherwise, you may be in violation of government discrimination laws. The required steps are listed on the next page.

You may contact the "Safe Harbor Information Center" at 800-421-7105 with questions regarding no-match letters. And as always, feel free to call us if we can be of any help.

What to do if a Current Employee's Social Security Number Fails to Verify

First, check your records. Make sure that you have not made a clerical error of some kind. (i.e. perhaps what you thought was a middle name is the first part of hyphenated last name)

If you find no error, check back with the employee. Make another copy of his/her card, & compare it to what was already in your records. Make a note of the date & conversation in the employee's file.

If your records match the card the employee gives you, you should notify the employee (**in writing**) that there is a problem with the soc. sec. number, and that he/she needs to contact Social Security to resolve the issue. Be sure to keep a dated copy of the notification in the employee file.

The employee has **90 days** from the date of a no-match letter to produce corrected information. Be sure to call Social Security at **1-800-772-6270** to verify any new information. Make a note of the date & time you called to keep in the employee file.

If correct information can not be obtained, the employee gets one last chance to identify him/herself. You will have **3 days** in which to fill out a new I-9. Employee must provide identification that shows a different social security number than the one in question, and **must** include a picture i.d. Acceptable forms of identification are listed on the form.

Call the verification phone number again. If this information does not verify, then you **must terminate** the employee.

Reporting Payments Made To Vendors

All businesses make payments to vendors. But are you required to report these payments to the IRS? It depends on who you are making payments to and the amount being paid during the year.

Various types of Forms 1099 must be provided to certain type of payees by January 31, and to the IRS by February 28. Here's a rundown of some of the more common payments that may require an information return.

- ***Payments of $600 or more to contractors or other services providers*** (other than corporations) must be reported to the recipient and to the IRS on Form 1099-MISC.
- ***Payments to attorneys*** for business-related services must be reported to the attorney and to the IRS. These payments must be reported on Form 1099-MISC regardless of the amount and regardless of whether the attorney is incorporated or not.
- ***Rents*** totaling more than $600 paid to an individual landlord, partnership, or estate (but not rents paid to a corporation) must be reported on Form 1099-MISC. (However, rents paid to a real estate agent are generally not required to be reported.)

These forms must be mailed to the recipient by January 31 and to the IRS by February 28.

If we are preparing Forms 1099 for you, please use the 1099 worksheet in order to assist with the gathering of information necessary to file these returns. **Please provide us this information as soon as possible after December 31, but no later than January 15th** so that we may timely provide the returns to you to be filed.

Bear in mind that the penalties for failure to comply with these information-reporting requirements can be stiff. For example, you can be hit with a penalty as high as $50 for each return that is filed incorrectly or is not filed on time.

This issue has been receiving increased IRS scrutiny in recent years and we expect the trend to accelerate in the very near future. A special study and related audits of employer payroll tax returns begin in 2010 to further understand employment practices and how they affect payroll reporting.

Independent Contractors - How to Classify Workers

One of the steps we recommend to clients who use independent contractors and who therefore face a heightened risk of a costly IRS payroll tax or benefits audit, is a quick review of some of the key things the IRS tells its agents to look at in determining whether a worker is really an employee.

The primary inquiries fall into three categories. Who has financial control of the job? Who can exercise control over how the worker performs the specific task? And how do the parties themselves view the relationship? When reviewing the checklist, keep in mind that the IRS will make its decision based on the whole picture, not just a single factor.

Workers are more likely to be classified as independent contractors if they:

- Make a significant investment in business property (a home computer is not significant);
- Pay their own business expenses;
- Receive a flat fee that is not based on an hourly or similar rate;
- Are not prohibited from doing work for other companies;
- Can pay subcontractors to get the job done;
- Are not performing services as an integral part of your regular business;
- Have a contract with an enforceable liquidated damages provision;
- Can make a profit;
- Can suffer a loss.

Workers are more likely to be classified as employees if they:

- Are given specific instructions and on-going training in how to get the work done;
- Cannot work for others;
- Have expenses paid by your company;
- Are paid with a salary or hourly wage;
- Do not have a significant investment in their trade or business;
- Are an integral part of your regular business;
- Receive direct reimbursement for all, or almost all, expenses;

Less important is:

- Whether or not the work is performed on the business's premises;
- Whether the worker has flexibility in setting hours;
- Whether the relationship is temporary or short-term;
- Whether the work is full- or part-time;
- Whether the worker performs services for one or more businesses.

Travel and Entertainment Expenses

The IRS has certain requirements for the substantiation of travel and entertainment expenses. In connection with the preparation of the tax return you must be able to produce under audit the information and documentation necessary to substantiate travel, entertainment, transportation and business gift expenses that are deducted in your tax return. **This documentation includes, but is not limited to, mileage logs, detailed receipts, and/or canceled checks.**

Below please find a chart adapted from Internal Revenue Service Publication 463 that details how to substantiate these types of expenses:

<table>
<tr><th rowspan="2">If you have expenses for:</th><th colspan="4">THEN you must keep records that show details of the following elements:</th></tr>
<tr><th>Amount</th><th>Time</th><th>Place or Description</th><th>Business Purpose and Business Relationship</th></tr>
<tr><td>Travel</td><td>Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, daily meals for traveler, etc.</td><td>Dates you left and returned for each trip and number of days spent on business.</td><td>Destination or area of your travel (name of city, town, or other designation.)</td><td>Purpose: Business purpose for the expense or the business benefit gained or expected to be gained.

Relationship: N/A</td></tr>
<tr><td>Meals & Entertainment</td><td>Cost of each separate expense. Incidental expenses such as taxis, telephones, etc may be totaled on a daily basis.</td><td>Date of entertainment or meal. (Also see Business Purpose.)</td><td>Name and address or location of place of entertainment or meal if not otherwise apparent. (Also see Business Purpose.)</td><td rowspan="2">Purpose: Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment and meals, the nature of the business discussion or activity. If the meal or entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and entertainment activity.

Relationship: Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the</td></tr>
<tr><td>Gifts

(Note there is a $25 gift limit per year for each person to whom you provide a gift)</td><td>Cost of the gift</td><td>Date of the gift</td><td>Description of the gift</td></tr>
</table>

				entertainment was a business meal.
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	Purpose: Business purpose for the expense. Relationship: N/A NOTE: Travel and transportation does not include commuting costs.

Note that meals are deductible only to the extent you are traveling "away from home" in pursuit of a trade or business. The away from home requirement is not black and white for the deductibility of meals, but there is a court case where meals were disallowed for a taxpayer who ate 30 miles away from his place of business. So clearly, meals eaten in the same or nearby community as your place of business are not deductible.