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Converting a sole proprietorship to a limited liability company

Synopsis – As sole proprietors, business owners enjoy the advantage of simplified income tax reporting, but sole proprietorship status can expose a business owner's personal assets to the risks and liabilities of their business operation. To provide a broader protection from liability, state statutes generally allow a sole proprietor to conduct business as a limited liability company (LLC). This article explores the benefits of an LLC, but notes that a sole proprietor will need to weigh these against the initial legal and administrative costs of accomplishing the conversion.

Full Article – As sole proprietors, business owners enjoy the advantage of simplified income tax reporting via the use of Schedule C ("Profit or Loss From Business") within their Form 1040 ("U.S. Individual Income Tax Return"). However, sole proprietorship status can expose a business owner's personal assets to the risks and liabilities of their business operation.

State statutes generally allow a sole proprietor to conduct business as a limited liability company (LLC). The intent is to provide a broader protection from liability. The concept of the LLC statute is that the owner (technically referred to as a "member") does not have any liability for business debts solely by reason of being a member or owner. However, this does not relieve the owners of responsibility for their personal actions or for debts that they have personally guaranteed. But personal assets would be protected from claims arising because of ordinary business transactions. This liability protection could be particularly advantageous when there are employees working in the business. With a sole proprietorship, employees' actions may expose the business owner's personal assets. Sole proprietors interested in limiting personal liability should consult an attorney to more fully explore the protections that are relevant to their particular business situation.

The other attractive aspect of LLC status is that IRS regulations allow the business owner to continue reporting for income tax purposes as a proprietor, despite forming an LLC under state law. Gaining the extra legal protection of an LLC will not entail any extra filing with the IRS.

Of course, there will be transaction costs to create the LLC. It will be necessary for an attorney to draft an LLC document to be filed with the state. The attorney can provide an estimate of this cost, as well as any initial or recurring fees that must be submitted to the state office. Also, when conducting business as an LLC, it will be necessary to consistently use the LLC designation on business letterhead, the business's checking account, business licenses, and the like. The business owner would need to make sure someone goes through the process of adding the LLC designation to the various contracts and documents under which business is conducted.

In summary, a sole proprietor should weigh the advantages of the liability protection from LLC status against the initial legal and administrative costs of accomplishing the conversion. For most proprietors, the added liability protection will merit the costs of converting to LLC status, but this should be explored more fully with legal counsel. If you have any questions or wish to discuss this further, please give us a call.

Travel while giving to charity

Synopsis - While it's not possible to deduct the value of services donated to charity, it may be possible to deduct some of the out-of-pocket travel expenses incurred. This article describes expenses that are deductible and those that aren't.

Full Article - Do you donate your services to charity and travel to do so? While you can't deduct the value of your *services* that you give to the charity, you may be able to deduct some of the *out-of-pocket travel expenses* you incur.

For the travel expenses to be deductible, the volunteer work must be performed for a qualified charity. Most groups other than churches and governments must apply to the IRS to be recognized as a qualified charity. You can use the IRS's Select Check tool (http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check) to find organizations eligible to receive tax-deductible charitable contributions.

However, not all types of travel expenses qualify for a tax deduction. For example, you can't deduct your costs if a significant part of the trip involves personal pleasure, recreation, or vacation. Additionally, you can't deduct expenses if you only have nominal duties or do not have any duties for significant parts of the trip. But, you can deduct your travel expenses if your work is substantial throughout the trip.

Deductible travel expenses must be: (a) unreimbursed, (b) directly connected with the services, (c) expenses you had only because of the services you donated, and (d) not personal, living, or family expenses. These travel expenses may include air, rail, and bus transportation; car expenses (actual or the IRS standard rate of 14¢ per mile); lodging costs; meal costs; and taxi or other transportation costs between the airport or station and your hotel. You may pay the travel expenses directly or indirectly (you make a payment to the charitable organization and the organization pays for your travel expenses).

If a qualified organization selects you to attend a convention as its representative, you can deduct your unreimbursed expenses for travel, including reasonable amounts for meals and lodging, while away from home overnight for the convention. You cannot deduct personal expense for sightseeing, entertainment and other expenses for your spouse or children.

If the requirements are met, traveling while donating services to charity can be a win-win.

Simple tax savings techniques for security gains

Synopsis - The market swings over the last several years may cause some investors to wonder if it is time to capitalize on some market gains. This article offers a couple of tax-smart strategies to consider when analyzing investment opportunities and deciding what to do about recent gains. It addresses the issue of whether or not to wait to sell until the stock qualifies for long-term capital gains treatment, and whether to use the FIFO or the "specific ID" method to minimize taxes.

Full Article - The market swings over the last several years may have you wondering whether it's time to capitalize on some market gains. While taxes should not be the main purpose in this decision, they certainly need to be considered, as they can make a significant impact on your investment return. With that in mind, here are a couple of tax-smart strategies to consider as you analyze your investment opportunities and decide what to do about recent gains.

Should you wait to sell until the stock qualifies for long-term capital gains treatment?

If the stock sale qualifies for long-term capital gains treatment, it will be taxed at a maximum tax rate of 23.8%. Otherwise, the gain is taxed at your ordinary-income tax rate, which can be as high as 43.4%. You will pay less taxes (and keep more of your gains) if the stock sale qualifies for long-term capital gains treatment. The amount of tax saving depends on your ordinary-income tax bracket.

Are the tax savings that would be realized by holding the asset for the long-term period worth the investment risk that the asset's value will fall during the same time period?

To qualify for the preferential long-term capital gains rates, you must hold the stock for more than 12 months. The holding period generally begins the day after you purchase the stock and runs through (and includes) the date you sell it. These rules must be followed exactly, because missing the required holding period by even one day prevents you from using the preferential rates.

The question then becomes: Are the tax savings that would be realized by holding the asset for the long-term period worth the investment risk that the asset's value will fall during the same time period? If you think the value will fall significantly, liquidating quickly, regardless of tax consequences, may be the better option. Otherwise, the potential risk of holding an asset should be weighed against the tax benefit of qualifying for a reduced tax rate. Comparing the risk of a price decline to the potential tax benefit of holding an investment for a certain time is not an exact science. We'd be glad to help you weigh your options.

Use "specific ID method" to minimize taxes

If you are considering selling less than your entire interest in a security that you purchased at various times for various prices, you have a couple of options for identifying the particular shares sold:

1) The **first-in, first-out (FIFO)** method is used if you do not (or cannot) specifically identify which shares of stock are sold, so the oldest securities are assumed to be sold first.

2) The **specific ID** method allows you to select the particular shares you wish to sell. This is typically the preferred method, as it allows you at least some level of control over the amount and character of the gain (or loss) realized on the sale, which can lead to tax-savings opportunities. The specific ID method requires that you adequately identify the specific stock to be sold. This can be accomplished by delivering the specific shares to be sold to the broker selling the stock. Alternatively, if the securities are held by your broker, IRS regulations say you should notify your broker regarding which shares you want to sell and the broker should then issue you a written confirmation of your instructions.

While the methods above generally apply to individual securities (e.g., Apple, Ford Motor Co, etc.), they may also be used for mutual fund investments. However, the required tracking of cost for each share acquired by frequent investment deposits, reinvestment of dividends and sales can be cumbersome. In addition, the election to use the FIFO or specific ID method must be made at the time the first sale occurs in your mutual fund investment. Alternatively, the IRS allows the use of the **weighted average cost** method. Unless you specify otherwise, this is the default method used for mutual fund sales.

Swapping bonds to claim losses

Synopsis - Taxpayers holding bonds that have decreased in value may benefit from a bond swap, which enables a taxpayer to currently benefit from the decline in a bond's value and either increase or keep the same cash flow generated by the bond. To facilitate a bond swap, the taxpayer sells currently owned bonds

at a loss and immediately reinvests the proceeds in different bonds. This article also notes the importance of avoiding the wash sale rule.

Full Article - Taxpayers holding bonds that have decreased in value may benefit from a technique known as a bond swap. A bond swap enables a taxpayer to currently benefit from the decline in a bond's value and either increase or keep the same cash flow generated by the bond. To facilitate a bond swap, the taxpayer sells currently owned bonds at a loss and immediately reinvests the proceeds in *different* bonds. This technique is beneficial if the taxpayer has current capital gains, particularly short-term, that can be offset by the bond's capital loss, or the taxpayer's overall net capital loss following the bond disposition is $3,000 or less (which the taxpayer can offset with other ordinary income).

Taxpayers entering into bond swaps must steer clear of the *wash sale rule* to avoid having the loss from the disposition disallowed. If the replacement bond is purchased within 30 days before or after the sale of the old bond, it cannot be substantially identical to the original bond. Bonds issued by a different entity would not be substantially identical to the old bond. Bonds of the same issuer would not be substantially identical if they have coupon rates or terms different from those of the original bonds, provided such differences are not negligible. Also, the transaction charges (for example, brokerage commissions) associated with buying and selling bonds will reduce the economic benefit of a bond swap.

Tax Calendar - Fourth Quarter 2014

October 15

- Personal returns that received an automatic six-month extension must be filed today and any tax, interest and penalties due must be paid.
- Electing large partnerships that received an additional six-month extension must file their Forms 1065-B today.
- If the monthly deposit rule applies, employers must deposit the tax for payments in September for Social Security, Medicare, withheld income tax, and non-payroll withholding.

October 31

- The third quarter Form 941 ("Employer's Quarterly Federal Tax Return") is due today and any undeposited tax must be deposited. (If your tax liability is less than $2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until November 10 to file the return.
- If you have employees, a federal unemployment tax (FUTA) deposit is due if the FUTA liability through September exceeds $500.

November 17

- If the monthly deposit rule applies, employers must deposit the tax for payments in October for Social Security, Medicare, withheld income tax, and non-payroll withholding.

December 15

- Calendar-year corporations must deposit the fourth installment of estimated income tax for 2014.
- If the monthly deposit rule applies, employers must deposit the tax for payments in November for Social Security, Medicare, withheld income tax, and non-payroll withholding.

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