IT'S CRUNCH TIME.

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End-of-Year Tax
Guide for Businesses

With tax season looming, many business owners are asking for reliable tax prep tips. In response, Paro has assembled a team of professional tax accountants and pooled their knowledge to create an end-of-year tax guide.

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How to Use this End-of-year Tax Guide

If April 15th is the first date that comes to mind when you hear the word taxes, it's time to reset your mindset. Serious end-of-year tax preparation should begin in October and November, and really should be taking place all year long. If you're running behind, not to worry, that's what this guide is for! Jump around, skip sections that don't apply and note the additional linked resources available throughout. Happy reading and best of luck with tax prep!

About Paro

Paro helps growing companies gain confidence in their finances. From bookkeeping and accounting to financial modeling, KPI development, CFO guidance, and taxes, our finance experts provide remote, on-demand, hourly support when you need it. We only accept 2% of applicants into our highly curated network of experts, so you know you're working with the best of the best.

How Your Tax Process Should Work

The tax preparation process should be fairly painless, assuming your bookkeeper and accountant are doing what they should be to prepare for the tax preparer/tax accountant hand-off. Thing is, this is often not the case. The diagram below shows everyone's roles and responsibilities. While the roles sometimes overlap in smaller companies, it's important to evaluate whether the members of your finance team are on top of what they're responsible for. It will make all the difference come tax time.

- Quality checks bookkeeper's work
- Prepares monthly or quarterly financial reports
- Ensures quarterly tax payments are made
- Manages best accounting practices for your business

- Tracks expenses & reconciliations
- Administers payroll and ensures all necessary info is gathered from 1099 contractors
- Manages invoices
- Classifies all financial data

- Takes info provided by bookkeeper and accountant and makes any necessary tax adjustments
- Files annual reports/returns
- Prepares quarterly tax estimates of liability in order to make payments
- Provides strategic guidance on ways to reduce tax liabilities or deal with losses

Not all businesses have both an accountant and a tax preparer. Depending on your accountant's background, they can probably take care of the tax basics. However, as your business grows, it will be increasingly important to keep track of changing regulations and sales tax rules in the states do business in, which is why a subject matter expert like a tax preparer or tax accountant proves useful.

Learn more about the differences between an accountant and a tax preparer / tax accountant.

Understand How Your Business Structure Impacts Tax

Some of the tax decisions you make will depend on the legal structure of your company. Guidelines vary significantly, but a few general observations follow. Visit IRS.gov for details related to your business structure or discuss with your accountant--they should have this under control. **Already have this covered?** Skip to the next section.

LLCs or LPs

- LLCs that do not elect to be taxed as an S-Corp are pass-through entities; as a result, business profits and losses are run through personal tax returns.
- Business expenses, including investments in fixed assets, are still important considerations as a means of reducing tax liability.
- Be sure to consult your current payroll method with your tax accountant to make sure you're paying yourself in the most beneficial way for your personal taxes.

S Corporations (S Corp)

- All S Corp income flows through to owners who are then taxed on an individual level.
- The owner of an S Corp has tax-advantaged retirement plans available without the restrictions of a traditional individual retirement account.
- S Corp owners can establish a Safe Harbor 401(k) plan and to make tax-deferred contributions of up to $16,500 ($21,500 if over age 50) to their account each year; this does not include the corporation's matching contributions.
- If medical care coverage has been established by the S Corp, a 2% shareholder-employee is eligible for an above-the-line deduction in arriving at Adjusted Gross Income (AGI) for amounts paid during the year for medical care premiums. An S Corp with multiple shareholders must confirm that all distributions are equal based on ownership percentages.
- Who can elect to be taxed as an S-Corp? Learn more here.

C Corporations (C Corp)

- C Corps are not pass-through entities; therefore, federal and state taxes are based on year-end net income.
- Owner salaries should be run through payroll processing (instead of being drawn by or distributed to the owner) and are an expense to the business.
- If year-end bonuses are used to reduce the business's net income, funds should be issued as a paycheck; as a result, payroll taxes will apply and year-end tax adjustments will be necessary.

Are you a small business? Read the Top 20 Tax Questions from Small Business Owners **by one of Paro's freelance tax experts.**

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Tax Projections: Why You Need Them

A quarterly tax projection is an important piece of financial intelligence. Your accountant should stay ahead of the game by preparing quarterly tax projections that help establish "if this-then that" scenarios. These planning steps will allow you to flex quickly to maintain your financial strategy even in the presence of year-end adjustments to revenue.

Circumstances vary for every company, but the following questions are valid in every situation:

- How should we decrease tax liability for the current year?
- Do we have net operating loss carryovers to take against current year income?

If you know you're going to be profitable...

3 popular ways to reduce your tax liability:

Regardless of your overall tax strategy, you can count on some basic assumptions, one of which is that you will always want to limit your tax liability for the year. How you do that can vary, but a few strategies are commonly used.

1. ***Invest in Fixed Assets:*** If you need to invest capital back into your business in the form of fixed assets, doing so before December 31st can be a good choice; it shouldn't be a blind decision, though. For example, if you need a new truck, would invest in one within the next year, and can afford to absorb the cost, purchasing the truck before end-of-year is a good way to reduce your tax liability. On the other hand, dumping all of your net profit into the purchase of equipment that isn't necessary to improve operations is the wrong way to reduce your tax burden. Read more about writing off asset purchases.

   Please keep in mind that depreciation is one of those rabbit hole topics with a lot of complexity, so make sure to consult with your tax accountant on the amount of depreciation you'll be able to take in the current tax year if you decide to make this type of investment.

   Another thing to investigate If you are considering the purchase of fixed assets, is the Safe Harbor opportunity, which allows businesses to circumvent depreciation by expensing the full cost of any purchase of $2,500 or less. A little planning can make a big difference in your tax liability.

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2. ***Employee bonuses*** often come up as a point of discussion when a net operating profit is projected. While this can be a good option, the decision needs to be weighed against the burden of individual payroll taxes that will increase in relation to each person's bonus. Public companies might consider increasing dividends paid to shareholders in order to reduce corporate tax liabilities. **Do I need to pay these bonuses before the year is over? Read more here.**

3. ***Charitable contributions*** sometimes come up as a way of using profit to accomplish corporate responsibility. While end-of-year contributions are a consideration, businesses should only use this option if the contribution aligns with the company's existing financial strategy. For smaller companies and S corps, charitable contributions flow through personal returns, so it's important to understand your tax structure before you decide on end-of-year charitable contributions.

If you know you're going to take a loss...

Strategies to deal with a net operating loss:

There are several ways to think about those years when you have a net operating loss. With the proper tax planning, you can use some tax judo to mitigate the monetary loss of your business by offsetting it with tax savings. **Read more about managing net operating losses here.**

What You Absolutely Need to File Taxes

If you feel overwhelmed by tax terminology, expectations, and deadlines, don't feel alone. Federal and State tax codes are complex, and they change from year to year; that's why it is so important that your tax accountant remains current on tax laws, so he or she can provide sound guidance to help your company save money, eliminate penalties, and prevent audits. Begin by identifying your pain points; for many companies, these include payroll taxes related to 1099 and W2 employees, unemployment tax, taxable healthcare and fringe benefits, and sales tax.

Payroll

Payroll concerns are a headache for most companies, and the problems are compounded if your company gets behind on collecting and organizing payroll information.

Subcontractors

Managing subcontractors can be one of the biggest trip-ups when it comes to payroll, since they will be paid through Accounts Payable rather than through payroll. If the subcontractors are in the payroll system, it is important to do some research to confirm whether they truly are employees or contractors.

Have subcontractors complete a W9 before they start work.
Whether you have 1, 100, or 1,000 subcontractors, you need to have all employee identification numbers (EIN) or social security (SS) information on hand long before tax season rolls around. Construction companies and other businesses with high numbers of 1099 subcontractors can especially find this to be a pain point, because they end up scrambling to gather SS or EIN numbers, when all of this information should have been handled at the time of hiring. 1099s for the 2017 tax year are due January 31, 2018.

To further complicate matters, end-of-year holiday vacations can result in additional delays in subcontractor response times. Every delay in collection information translates into an even longer delay in tax preparation.

Avoid fines!
The fines for not having the correct EIN or SS information can be steep, ranging from $50 to $500 per subcontractor. If contracted workers don't provide sufficient information, you must withhold the Federal Income Tax at the 28% rate on every payment made to the subcontractor.

The primary takeaway regarding 1099 subcontractors is that your bookkeeper must consistently and thoroughly collect and verify all necessary information. **Read more about 1099s here.**

1. W2s

Your employees are your greatest asset, so it's important to understand that your tax practices can spill over to them. For example, if your payroll tax returns are poorly managed, you face an increased risk of audit; this risk transfers to your employees who are then more likely to be audited on their personal income tax filings.

The two most important questions to ask yourself are:

1. If you sell services, do you provide your services remotely or on-site? Depending on where you offer your services, you may need to pay taxes in several states. It's imperative your employees keep track of time spent at different locations and relay that information to the HR/payroll provider.
2. Are you using a payroll provider like Gusto, ADP, Paychex, Intuit Payroll, Sure Payroll, or OnPay (to name a few) or a professional employer organization (PEO)? If not, this is key to gaining efficiencies, eliminating extra work, and saving money paid out to your tax accountant, so ask your bookkeeper or accountant to set you up.

If you do use a payroll provider, congrats, you can skip to the next section!

For businesses that choose to handle all payroll functions for W2s themselves (which we adamantly advise against):

Prioritize and be accurate

Be sure your bookkeeper is prioritizing the accuracy of all W2s. Every field on the W2 must be an exact match with numbers reflected on your quarterly filings (941), including: pre-tax benefits, taxable fringe benefits, Federal Income Tax, State Withholding Tax, Social Security, and Medicare. Timing can be a challenge here for many businesses, because 4th Quarter payroll taxes are due at the end of January, and annual filings are due on the same time. There is very little room for identifying and resolving discrepancies if you do not plan ahead.

Stay current

Discrepancies in payroll taxes can create a red flag and trigger an IRS and/or State Department audit. Make sure your accountants are current on payroll requirements and that they're using the latest tools. For example, your 941 should be reconciled each quarter, and you must make sure there are no changes before the 4th quarter begins. If there are variances, be sure to resolve them right away.

2. Unemployment tax

Again for those who choose to handle payroll themselves rather than use a payroll provider, unemployment tax for both Federal and State pose another significant consideration at tax time, even if you have very few employees. As a business, you should be making quarterly deposits through the Electronic Tax Federal Payment System (EFTPS) for Federal and the State wage reports.

Timing can be especially tricky for Federal Unemployment Tax (FUTA) deposits, since a quarterly payment must be recognized by the IRS no later than the last day of the quarter in which it is filed. For example, the unemployment tax due for the second quarter must not only be paid by June 30, it must already be in the account as available funds, with no exceptions.

For year-end filing, FUTA Form 940 (FUTA) must be filed by January 31st to avoid penalties; confirm first, however, that your employees are not working in the credit reductions States, which can cause your FUTA premiums to be high.

These details are just one reminder of how important it is for your financial team to be educated on current tax laws and timely in filing all quarterly and annual returns. The best way to make sure all of these things are taken care of on time? Use a full service payroll provider.

3. Healthcare Benefits

Two employee healthcare issues have a significant impact on payroll taxes and your company's annual income tax return. The first is the Affordable Care Act, or Obamacare; the second is the benefits package you provide to your employees.

This is the year when many – if not most – businesses will find themselves facing penalties they have been avoiding for the past two years. Income tax filings for 2017 require mandatory compliance with the Affordable Care Act. Companies have had two years to get in compliance, and all options to delay the inevitable have passed. Form 1095C, which is required to demonstrate compliance, can be very tedious to manage. If you have not already communicated with your benefits provider to bet the information necessary to prepare the1095C, that discussion needs to begin immediately.

As far as benefits are concerned, employee medical coverage and health savings accounts (HSAs), flow through employee W2s. Other benefits do as well, including travel reimbursements, education allowances, relocation expenses, and other taxable fringe benefits. In determining the specifics on fringe benefits, your payroll team will need to determine the intention of the benefits in order to know if they are taxable or not. If this task is outside the realm of your in-house financial team, it is critical that your company reach out to professionals who are well-versed in the tax implications related to healthcare and other benefits.

Sales Tax

- Do you know what state every warehouse your goods are shipped out of is in?
- Are the trucks that deliver the goods owned or leased by the delivery company?
- Do you have W2 employees or lease space in several states?
- All of these impact where you pay taxes.

Sales tax often presents a challenge for product-based businesses. One important detail is that every field on the 4th quarter income form, which is due by January 31, 2018, must match all sales revenue on your annual income tax return. If the amounts paid and owed do not match on the balance sheet at the end of the year, an audit will more likely be triggered for a discrepancy of 5% or more.

One complication related to sales tax is that it is sometimes recorded inaccurately as an expense, rather than a liability. Customers pay sales tax, so it is an expense to them. If your sales tax has been recorded as an expense, your income has been understated; eventually, the tax burden will compound and create a financial hardship, even if the IRS doesn't act first. There are many complexities with regard to sales tax, which is why it's so important to talk with a tax accountant sooner rather than later to make sure you know

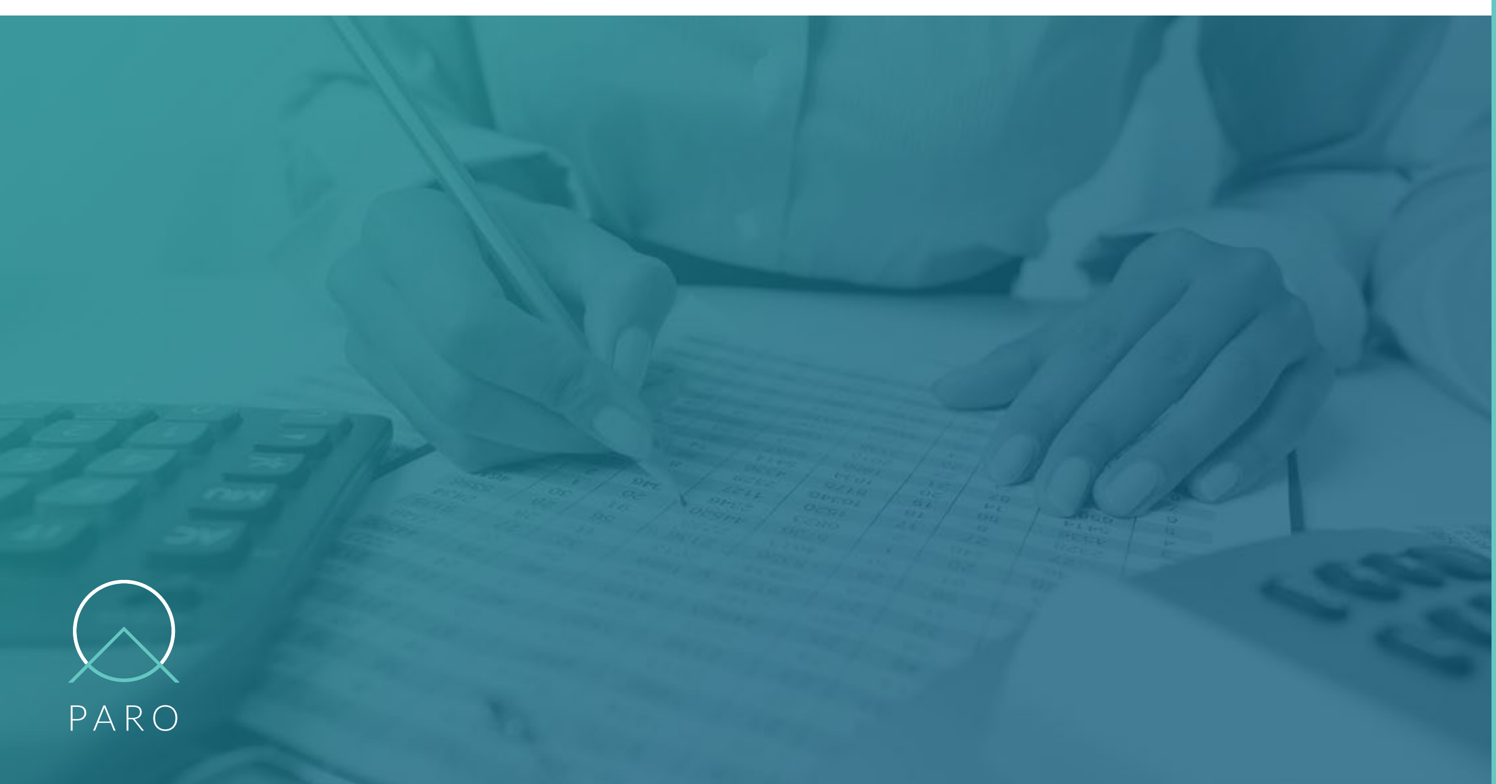
Get The Right Financial Team in Place

The strength of your company's financial strategy begins at the top with executive management, but without a cohesive team of financial experts, cracks will begin to appear in foundation of your company's financial practices. As you consider how to best structure your financial team, focus on the contributions of your bookkeeper, your accountant, and your payroll manager, as well as financial analysts and tax accountants.

- **When all parties understand their responsibilities and are executing on them every month and every quarter, tax prep should be a breeze.**

The main consideration--rather than scrambling to find all the necessary information--is communication. Encouraging consistent internal communication between all parties is key, and those parties should include: bookkeepers, accountants, department heads, management, and outsourced tax consultants. Without teamwork and communication, it can be very challenging to collect necessary information, and this shortcoming will translate into frustration, delays, inaccuracies, and penalties.

For additional tips and tricks to manage a remote team, read our article in Entrepreneur.



Follow These 18 Tax Prep Best Practices

If your company's end-of-year tax process is scattered, painful, and overly time-consuming, you can begin to improve the process by adopting a number of best practices:

1. Improve internal communications between your bookkeeper, accountant, and department heads, with the ultimate goal of accessing financial information that will support strategic decisions.
2. Ensure that your bookkeeper consistently applies good work habits and that all information is in order before it is turned over to an accountant to review; otherwise, you will end up paying a much higher hourly rate to a tax accountant to organize and correct what should have been handled already.
3. Keep all accounts reconciled on a regular basis: bank, investment, loan, and credit cards.
4. Have a bookkeeper record transactions on a consistent basis; relying on memory can result in the inaccurate categorization of expenditures.
5. When your accountant sends back adjusted journal entries, make sure they get entered immediately.
6. Make sure that the following items match:
    - Your retained earnings should match those on the previous year's balance.
    - Your balance sheet should match your tax return.
    - Your AP aging report should match accounts payable (if you use a separate software to track this).
    - Your accounts receivable should match your AR aging report (if you use a separate software to track this).
    - December 31st statements should match your trial balance.
7. Update fixed asset schedules to track all activity throughout the year; often asset disposals are not recorded, and this complicates property taxes and accurate depreciation.
8. Contact your tax accountant in October or November, and maintain consistent communication through the end of the year. With proper guidance, you will be much more likely to save money.
9. Make sure your accountant is tracking important metrics on a regular basis, including quarterly financials, budgets vs. actuals, and other key metrics that determine your financial help like working capital, debt to equity ratio, etc.
10. Don't slack off; tax preparation is an important part of your company's financial strategy.

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11. Avoid penalty and audit risks by keeping your quarterly tax filings and payments to both State and Federal agencies current.
12. Create a quarterly and annual tax processes document that includes: contact information for go-to sources of information, methods of internal controls; communication expectations, specific deadlines for stages of preparation and for filing.
13. Also ensure that your tax process details requirements related to the internal review of trial balances and other expectations that will reduce the volume of errors in quarterly and end-of-year tax returns.
14. In addition to your bookkeeper and accountant, engage your department heads and employees in the expense report process.
15. Don't regard your budget as an annual task; use it to gauge and redirect your decisions throughout the year. **Read more about the value of mid-year budget reviews.**
16. Engage external resources as needed to streamline activities and to capitalize on changing tax procedures.
17. Use a structured resource (**as in a checklist provided below**) to ensure that you are efficient in your preparation.
18. Ask for help. It will be worth your sanity and will very likely save you money in the long term.

Get Help (Before You Drown!)

Like many businesses, you might be dealing with staff shortages, or employees who are wearing multiple hats. It might not be feasible for your financial professionals to be trained in every aspect related to your tax obligations, especially given the ever-changing tax landscape.

If you are sensing a need for increased guidance from an external source, keep the following in mind: getting the proper tax advice can be an initial investment, but the savings related to reduced employee overtime, decreased tax liability, and the elimination of tax penalties can create immediate and long-term savings.

Case Study: The price of help goes up significantly the more you put it off.

A company that hadn't reconciled its bank accounts had an account balance of $2,000,000, while their balance sheet reflected a balance $1,500,000. No one in the company wanted to appear inept, but once the magnitude of the issue became evident, tax preparation was turned over to a trained tax accountant.

Backtracking and reconciling the accounts required a total of 50 hours; this is a significant increase in hours compared to the estimated 12 hours that might have been necessary to compile and file end-of-year tax returns. Because the work was completed by a tax accountant who charged a higher rate, the company spent a great deal more than they should have.

The lesson here is that the expense could have been avoided by having a clear in-house tax preparation and oversight process in place. While this example might be extreme compared to your tax challenges, the fact remains that many companies do have expensive discrepancies somewhere in their books.

Give serious consideration as to whether you need to rely on an outside tax expert who is able to remain current on new tax laws, state laws, and compliance concerns. If you do decide to seek advice, Fall is the best time to begin that relationship. The tax filing frenzy has not yet begun, and you are likely to receive more personal attention in your tax planning.

Keep in mind that your tax accountant absorbs some liability when preparing your taxes, so he or she will only want to sign a return they have been able to confidently prepare because you were able to provide all of the necessary information.

Tax Prep Checklist

What Your Tax Preparer/ Tax Accountant Needs From You

While each business is unique, you can use the following checklist as a guide to gather all that your tax accountant will need:

- [ ] Trial balance that reflects balances in each of your company's general ledger accounts
- [ ] Reconciled statements for the entire year, including: bank, investment, credit card, and loan accounts *(Don't have these prepared? Try outsourcing these now so you'll be in great shape come April)*
- [ ] Documentation for transactions within that past year that are especially unique to prior years
- [ ] Fixed assets purchased in the given tax year, with information necessary for depreciation, including: the year put into service, whether asset was new or used, cost, and weight (if a vehicle)
- [ ] Fixed assets disposed of in a given tax year, with the same details as needed for asset purchases
- [ ] Loan documentation that reflects principal versus interest payments
- [ ] Payroll tax returns for each quarter with form 941
- [ ] Sales tax returns from throughout the year
- [ ] Aging details for Accounts Receivable and Accounts Payable
- [ ] New rental, equipment lease, or utility agreements and related prepaid expenses
- [ ] Distributions to partners or owners
- [ ] All 1099 contractor information
- [ ] And, finally, If you're filing taxes on a cash basis but like to analyze your business on an accrual basis, be prepared to explain any adjustments that the tax accountant needs to back out to file on a cash basis (Learn more about the difference between cash and accrual accounting).

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Schedule a free consultation with one of our experts to evaluate your business's tax-time needs.

Disclaimer:

While Paro's End-of-Year Tax Guide for Businesses is an aid to tax preparation, it should not be construed as equivalent to independent tax advice. Federal and State tax codes are complex, and they change from year to year. Every business should seek out professional and reliable tax advice.

The following Paro freelancers contributed to this whitepaper:

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