GS Blog Round-Up

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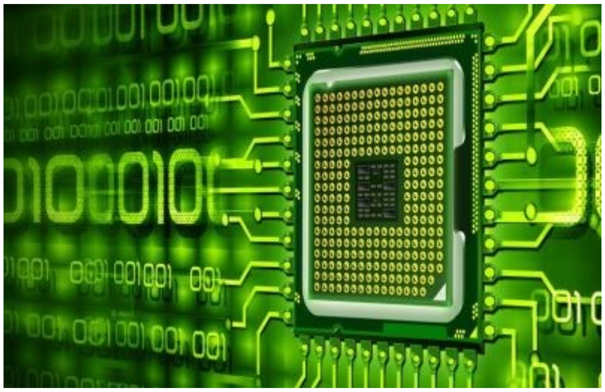
Tax and Accounting Considerations for Technology Businesses



If you run a technology business, you are aware of the high demands inherent in such a fast-paced field. The need to stay ahead of the competition demands forethought and innovation like no other industry. But have you considered your success may depend on more than having the best product.

Most high-technology businesses begin as private endeavors with the ultimate goal of going public. With that kind of growth on the horizon, it can be easy to get wrapped up in product development and fail consider how important accounting and tax advice is to your upward mobility. Without a solid plan for the correct business structure and tax strategies, your business may have to overcome more than the competition.

By The GS Tax Department

ATTRACTING TALENT

Attracting the best talent will be one of your first hurdles. Capital is likely tight while your product is still on the drawing board. This is the time to look at stock based compensation structures. Stock options and restricted stock units can be an enticing addition to compensation packages, helping you to compete with larger, more established, companies for the talent you need.

Stock Options: A stock option is the right to buy stock in the future at a fixed price. The options will typically have conditions attached, reflecting such items as expiration dates and requiring employment for a length of time (a vesting period). The option may even require the achievement of certain performance goals before the option is exercised.

Stock options can have favorable tax treatment for the employee, but only if the initial setup follows the rules for incentive stock options (ISOs). Otherwise, your options would be classified as non-qualified stock options (NQOs). ISOs can only be granted to employees, whereas NQOs can be granted to both employees and outside consultants.

Restricted Stock Units: A restricted stock unit (RSU) is a grant of company stock, but the stock is not handed over immediately. There will be certain restrictions or requirements before the stock that was granted is actually released to the employee. Some RSU agreements may require employees to pay a purchase price for the grant. The units are typically forfeited if the restrictions or requirements are not met.

RSUs differ from stock options in that stock options are the option to buy a stock at a set price. An RSU is stock that is granted, though the employee can be required to pay a price for the grant. Both will likely be subject to certain conditions and timing restrictions.

Make sure your advisor is knowledgeable in the rules for each type of stock option or grant so there are no surprises down the road.

CAPITAL FUNDING

Funding will be another initial challenge. You have many options to consider for funding your capital needs. Your business advisor can assist with suggesting potential funding sources, which may include bank loans or outside investors (venture capitalists).

Whether you are applying for a loan or presenting your idea to a potential investor, you should have a business plan in place ahead of time. Your business plan will show that you have a viable idea that you are approaching in a serious and professional manner.

MULTI-STATE NEXUS

Are you ready to do business across state lines? Technology businesses frequently do business or sell their product outside of the state, or even outside of the country. You will need to determine if you have "nexus" in states in which you do business.

Are you ready to do business across state lines? Technology businesses frequently do business or sell their product outside of the state, or even outside of the country. You will need to determine if you have "nexus" in states in which you do business. Nexus is defined as a means of connection, tie, or link and is the term that is used when determining if a business has a physical presence in another state.

States have become aggressive in recent years in claiming that businesses have nexus within their borders. This is a revenue source that states have begun fighting for. Federal law limits states' ability to assess income taxes on businesses that do not have a physical presence in their state, resulting in states using increasingly lower thresholds to determine if physical presence, or Nexus, is met.

You will need to be aware of each state's or country's income tax laws, and how it will affect the cost of doing business in that particular place. Also consider that there may be separate sales tax requirements in each state you reach. There is much at stake in determining Nexus and handling multi-state reporting.

These are just a few of the accounting and tax issues you will need to address for your technology start-up. As you can see, it is of vital importance to work closely with your tax and business advisors when starting your business, for they can help guide you through the myriad of financial and tax issues that are sure to come up as your business grows.

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Don't Skimp on Business Interruption Insurance

In recent years, many businesses have been pounded by a wide variety of disasters, natural and man-made. From coast to coast, some businesses have fought to keep their doors open despite floods, wildfires, hurricanes, mudslides, vandalism, riots and more. These disasters serve as sobering reminders to expect the unexpected.

Your business could become a victim of Mother Nature or other external forces without warning. After a disaster, an estimated 25% of companies are unable to reopen. Depending on your business and its financial stability, a few weeks of lost income can be enough to close your doors indefinitely.

Being Prepared for Disruption

Commercial property insurance doesn't typically pay the cost of disrupted operations. What can help you survive is business interruption coverage. This insurance allows you to relocate or temporarily close so you can make the necessary repairs — and still be provided with cash flow to cover lost revenue and expenses incurred while normal operations are suspended.

Before the next disaster strikes, consult with your insurance agent about business interruption coverage. To determine the proper amount of coverage, your financial adviser can help forecast a worst-case scenario and ask "what-if" questions to cover all possibilities. You don't want to *over* insure, but you also don't want to overlook critical risks, such as a long power outage.

Business interruption insurance isn't sold as a separate policy. Instead, it's added to your existing property insurance policy. There are two basic types of coverage:

1. **Named perils policies** cover only specific occurrences that are listed, such as fire, water damage and vandalism.
2. **All-risk policies** cover all disasters unless they're specifically excluded. Most all-risk policies specifically exclude damage from earthquakes and floods, but such coverage is generally available for an additional fee.

What is covered? Business interruption insurance usually pays for income that is lost while operations are suspended. It also covers continuing expenses, including salaries, payroll costs and other costs required to restart a business. Depending on the policy, additional expenses might include:

- Relocation to a temporary building (or permanent relocation if necessary);
- Replacement of inventory, machinery and parts;
- Overtime wages to make up for lost production time; and
- Advertising to announce your business is still operating.

By GS Editor

The key to continuity after a disaster is to file the proper insurance claims as soon as possible. But be warned: This type of insurance is complicated.

Business interruption coverage that insures you against 100% of losses can be costly. Policies typically cover 80% of losses while you shoulder the remaining 20%. After your business selects coverage to suit your needs, make sure you have a copy of the policy offsite so you can access it quickly if a disaster occurs.

Know Your Policy and Act Quickly

The key to continuity after a disaster is to file the proper insurance claims as soon as possible. But be warned: This type of insurance is complicated. Submitting a claim can be time consuming and requires careful consideration. Follow these steps as soon as it's feasible:

Notify the insurer about the damage. If your actual policy has been water damaged or destroyed, ask the company to send you another copy.

Review the policy. Read your policy in its entirety to determine how to best present your claim. It's important to understand the policy's limits and deductibles before spending time documenting losses that may not be covered.

Minimize losses. Make temporary repairs if possible and hire security guards if necessary to protect property. Then:

- Reopen as soon as practical, even if it's only for a limited number of hours.
- Block off unusable parts of the building and operate from less-damaged areas.
- Post updates on your website and social media announcing when you'll reopen. Consider taking out newspaper, radio or television ads to make announcements.
- Consider layoffs of nonessential support staff to limit continuing operating expenses.

Record losses. Maintain accurate records to support your claim. Reorganize your bookkeeping to segregate costs related to the business interruption. Among the necessary documents are:

- Pre-disaster financial statements and income tax returns;
- Post-disaster business records;
- Copies of current utility bills, employee wage and benefit statements, and other records showing continuing operating expenses;
- Receipts for building materials, a generator and other supplies needed for immediate repairs;
- Paid invoices from contractors, security personnel, media outlets and other service providers; and
- Receipts for rental payments, if you move your business to a temporary location.

Be as precise as possible, or your claim may be delayed or denied. Your accountant can review the records you plan to submit and organize them in anticipation of litigation if the insurer is reluctant to pay your claim. Taking the time to prepare for that possibility — even if it's remote — can save effort later.

Don't Skimp on Business Interruption Insurance

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Get Professional Assistance

The calculation of losses in business interruption insurance claims is complex and potentially contentious. Your accountant can be the primary contact with the insurer. Depending on the scope of a loss, the insurance company may enlist its own specialists to audit your claim. So you also may want to consult with an accountant who is experienced in business valuation and litigation support to help prepare your claim, quantify losses and anticipate questions from your insurer.

Are Business Interruption Proceeds Taxable?

Insurance proceeds received for the loss of property generally aren't taxable if you use the money to purchase replacement property. But business interruption proceeds are fully taxable to the extent that they're used to replace lost income.

Cash basis entities that file an undisputed claim with an insurance carrier must pay tax when they receive payment. For accrual basis taxpayers, the general rule of thumb is: Where liability is undisputed by the insurer and the amount of the recovery can be reasonably approximated, income accrues in the year of the loss, despite the fact that the amount of the recovery may not be known at the time of accrual.

For accrual basis entities, the timing of the tax liability is less straightforward if a business interruption claim is in dispute. To determine whether the proceeds should be recognized in the year the claim is filed, the IRS considers two main issues:

- Has the insurer recognized a liability for your claim?
- Can your proceeds be reasonably approximated?

The timing of tax liability hinges on the facts and circumstances. Sometimes, claims aren't includible in taxable income until the litigation between the parties is settled and the amount is set. Consult with your tax adviser.

Improve Your Odds of Survival

It's impossible to know when natural and man-made disasters will cause substantial damage. Business interruption insurance obviously won't solve all your problems if disaster strikes, but it can improve your odds of survival. Work with your accountant to quickly and efficiently assemble the information and calculations needed for a viable claim. Filing a well-crafted claim can result in a faster, easier resolution — and provide much-needed cash to get your business up and running again.

Don't Skimp on Business Interruption Insurance

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Property Tax and "Cap Rates"

Many cities and towns use a simple formula involving the capitalization, or "cap rate" to calculate property tax assessments. The cap rate is determined by dividing the property's net operating income by its sales cost.

But what sounds easy and fair on the surface can actually work against the unwary property owner. Here's why: Although the cap rate equation involves only straightforward math, the variables going into net operating income and sales figures can make applying the formula a challenge.

No Two Properties are Exactly Alike

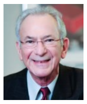
To calculate a building's valuation, the assessor first chooses several properties that seem comparable to yours and then, using those properties' net operating income and sales price, calculates a typical cap rate for the property type in your market.

The trouble is, no two properties are exactly alike. They carry unique financing (or none at all), have a different mix of tenants, and generate different expenses. They're never managed the same and, unless they're both fully occupied, they won't have the same vacancy rate. There can also be differences in the accounting used. And the sales price may, or may not, have included business value.

The Complexities of Calculation

Net Operating Income: The trickiest component of cap rate calculation is net operating income. Net income should include earnings, but not depreciation, business taxes or interest expense. Taxes paid and depreciation taken are excluded because depreciation depends on the initial cost paid for the property and taxes paid are often influenced by depreciation taken. Interest expense is also excluded so the property's value isn't influenced by the type, terms and amount of financing used to purchase it.

Rental Income: Rental income is a primary component of earnings. But which income should the assessor use? Both in-place current rents (based on current leases) and estimated rental values (open market rents) should be identified.



By **Raymond Blatt, Principal**

Director of State and

Local Taxes

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Expenses: There are many variables that may, or may not, be included in the expense calculation — Do the managers pay themselves a fee to run the building? Is that fee reasonable? Do they have on-site maintenance personnel who receive discounted or free rent as part of their compensation package, or do they use outside contractors to do the work? What's included in the list of expenses that appear on tax forms, such as office expenses and supplies?

When the property being valued is retail, industrial or office, the complexity of calculating net operating expenses increases dramatically. In addition to having more complex lease terms, commercial tenants build out their spaces individually. A sub shop and an upscale restaurant may both serve food, but they entail different business risks and would finish their interiors quite differently.

Working with Your Assessor and Your Advisors

Correctly determining a cap rate can be mind-numbingly complex. And yet, it's important that your assessor get it right when calculating property values for tax assessments. Get your financial advisor involved so you pay no more than your fair share of property taxes.

Property Tax and "Cap Rates"

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Work Opportunity Tax Credit Assistance for Employers

The IRS has recently granted "transitional relief" to eligible employers who are planning to claim the Work Opportunity tax credit (WOTC). The relief outlined in IRS Notice 2016-22 comes in the form of an extended deadline — until June 29, 2016 — to file a form necessary to claim the credit for certain eligible workers.

What is WOTC?

The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) extended the WOTC through 2019. The credit is for employers that hire individuals who are members of a "target group." The PATH Act also expanded the credit beginning this year to apply to employers that hire qualified individuals who have been unemployed for 27 weeks or more.

The amount of the tax credit depends on the:

- Target group of the individual hired,
- Wages paid to that individual, and
- Number of hours that individual worked during the first year of employment.

The maximum tax credit that can be earned for each member of a target group is generally $2,400 per adult employee. The credit can be as high as $9,600 per qualified veteran. Employers aren't subject to a limit on the number of eligible individuals they can hire. In other words, if there are 10 individuals that qualify, the credit can be 10 times the amount listed.

How can my business qualify?

Employers that hired targeted group members can claim the tax credit as a general business credit against their income tax. (Nonprofit organizations may be eligible for a credit against their payroll tax liabilities.) However, before an employer can claim the credit, it must obtain certification from a "designated local agency" (DLA) that the hired individual is indeed a targeted group member.

An employee isn't treated as a member of a targeted group for WOTC purposes unless the employer obtains certification from the DLA that the employee is a member or the employer completes IRS Form 8850, "Pre-Screening Notice and Certification Request for the Work Opportunity Credit," to the DLA no later than the 28th day after the individual begins work for the employer. The IRS has now extended the deadline to June 29, 2016.

By the GS Tax Department

June 29 is also the extended deadline for employers that hired (or hire) long-term unemployment recipients between January 1, 2016, and May 31, 2016, as long as the individuals start work for that employer on or after January 1, 2016, and on or before May 31, 2016. For long-term unemployment recipients hired on or after June 1, Form 8850 must be submitted by the 28th calendar day after the individual begins work.

An employer also must submit a Department of Labor Employment and Training Administration (ETA) Form 9061 ("Individual Characteristics Form") or 9062 ("Conditional Certification") to the DLA.

Form 8850 modified

In light of the guidance, the federal government is modifying **Form 8850** and **ETA Forms 9061 and 9062** so that employers can use them to request certification from the DLAs for qualified long-term unemployment recipients. Those modified forms and instructions will indicate the information that must be provided in order for the employer to receive certification from the DLA that the individual is a qualified long-term unemployment recipient.

The IRS anticipates that the modified forms will include a requirement that the individual signing the form attest that he or she meets the requirements to be a qualified long-term unemployment recipient and a requirement that the individual attest to the period(s) during which the individual was unemployed and received unemployment compensation.

The IRS anticipates that the modified forms will include a requirement that the individual signing the form attest that he or she meets the requirements to be a qualified long-term unemployment recipient

Act Quickly

The WOTC can lower your company's tax liability when you hire qualified new employees. However, a timely request for certification doesn't eliminate the need to receive a certification before claiming the credit. So you may need to file for a tax return extension. We can help you determine whether an employee qualifies, calculate the applicable credit and answer other questions you might have.

Work Opportunity Tax Credit Assistance for Employers

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6 Key Late Tax Filing Facts

April 18 was this year's deadline for most people to file their federal tax return and pay any tax they owe. If you are due a refund there is no penalty if you file a late tax return. If you owe tax, and you failed to file and pay on time, you will most likely owe interest and penalties on the tax you pay late. To keep interest and penalties to a minimum, you should file your tax return and pay the tax as soon as possible. The IRS provides some key facts for late filers.

Two penalties may apply.

One penalty is for filing late and one is for paying late. They can add up fast. Interest accrues on top of the penalties.

1. Penalty for late filing. If you file your 2015 tax return more than 60 days after the due date or extended due date, the minimum penalty is $205 or, if you owe less than $205, 100 percent of the unpaid tax. Otherwise, the penalty can be as much as five percent of your unpaid taxes each month up to a maximum of 25 percent.

2. Penalty for late payment. The penalty is generally 0.5 percent of your unpaid taxes per month. It can build up to as much as 25 percent of your unpaid taxes.

3. Combined penalty per month. If both the late filing and late payment penalties apply, the maximum amount charged for the two penalties is 5 percent per month.

4. File even if you can't pay. Filing on time and paying as much as you can will keep your interest and penalties to a minimum. If you do owe the IRS, the sooner you pay your bill the less you will owe.

5. Payment Options. Explore payment options with your tax advisor. For individuals, IRS Direct Payis a fast and free way to pay directly from your checking or savings account. The IRS will usually work with individuals to help resolve tax debt Also, payment plans are available.

6. Late payment penalty may not apply. If you requested an extension of time to file your income tax return by the tax due date and paid at least 90 percent of the taxes you owe, you may not face a failure-to-pay penalty. However, you must pay the remaining balance by the extended due date. You will owe interest on any taxes you pay after the April 18 due date.

Each and every taxpayer has a set of fundamental rights they should be aware of when dealing with the IRS. These are your Taxpayer Bill of Rights. Explore your rights and our obligations to protect them.

By the GS Tax Department

6 Tax Tips for the Self Employed

If you are self-employed, you normally carry on a trade or business. Sole proprietors and independent contractors are two types of self-employment. If this applies to you, there are a few basic things you should know about how your income affects your federal tax return. Here are six important tips from the IRS:

1. SE Income. Self-employment can include income you received for part-time work. This is in addition to income from your regular job.

2. Schedule C or C-EZ. You must file a Schedule C, Profit or Loss from Business, or Schedule C-EZ, Net Profit from Business, with your Form 1040. You may use Schedule C-EZ if you had expenses less than $5,000 and meet certain other conditions. See the form instructions to find out if you can use the form.

3. SE Tax. You may have to pay self-employment tax as well as income tax if you made a profit. Self-employment tax includes Social Security and Medicare taxes. Use Schedule SE, Self-Employment Tax, to figure the tax. If you owe this tax, attach the schedule to your federal tax return.

4. Estimated Tax. You may need to make estimated tax payments. Try IRS Direct Pay. People typically make these payments on income that is not subject to withholding. You usually pay estimated taxes in four annual installments. If you do not pay enough tax throughout the year, you may owe a penalty.

5. Allowable Deductions. You can deduct expenses you paid to run your business that are both ordinary and necessary. An ordinary expense is one that is common and accepted in your industry. A necessary expense is one that is helpful and proper for your trade or business.

6. When to Deduct. In most cases, you can deduct expenses in the same year you paid, or incurred them. However, you must 'capitalize' some costs. This means you can deduct part of the cost over a number of years.

By the GS Tax Department

The Adoption Tax Credit: 10 things you need to know

IRS UPDATE: If you adopted or tried to adopt a child in 2015, you may qualify for a tax credit. Here are ten things you should know about the adoption credit.

1. **Options.** The credit is nonrefundable. This means that the credit may reduce your tax to zero. If the credit is more than your tax, you can't get any additional amount as a refund. If your employer helped pay for the adoption through a written qualified adoption assistance program, you may qualify to exclude that amount from tax.

2. **Max Credit or Exclusion.** The maximum adoption tax credit and exclusion for 2015 is $13,400 per child.

3. **Unused Credit.** If your credit is more than your tax, you can carry any unused credit forward. This means that if you have an unused credit in 2015, you can use it to reduce your taxes for 2016. You can do this for up to five years, or until you fully use the credit, whichever comes first.

4. **Eligibility.** An eligible child is an individual under age 18 or a person who is physically or mentally unable to care for themselves.

5. **Expenses.** Adoption expenses must be directly related to the adoption of the child and be reasonable and necessary. Types of expenses that can qualify include adoption fees, court costs, attorney fees and travel.

6. **Adoption Type.** In most cases, you can claim the credit whether the adoption is domestic or foreign. However, the timing rules for which expenses to include differ between the two types of adoption.

7. **Special Needs Child.** If you adopted an eligible U.S. child with special needs and the adoption is final, a special rule applies. You may be able to take the tax credit even if you didn't pay any qualified adoption expenses.

8. **Qualifying for Credit and Exclusion.** Depending on the adoption's cost, you may be able to claim both the tax credit and the exclusion. However, you can't claim both a credit and exclusion for the same expenses. This rule prevents you from claiming both tax benefits for the same expense.

9. **Income.** The credit and exclusion are subject to income limitations. The limits may reduce or eliminate the amount you can claim depending on the amount of your income.

10. **File Online.** You can use IRS Free File to prepare and e-file your federal tax return for free. File Form 8839, Qualified Adoption Expenses, with your Form 1040. Free File is only available on IRS.gov/freefile

By The GS Tax Department

The IRS Needs to Know if You Change Your Name

By the GS Tax Department

A name change can have an impact on your taxes. All the names on your tax return must match Social Security Administration records. A name mismatch can delay your refund. Here's what you should know if you changed your name:

- **Report Name Changes.** Did you get married and are now using your new spouse's last name or hyphenated your last name? Did you divorce and go back to using your former last name? In either case, you should notify the SSA of your name change. That way, your new name on your IRS records will match up with your SSA records.
- **Make Dependent's Name Change.** Notify the SSA if your dependent had a name change. For example, this could apply if you adopted a child and the child's last name changed.

If you adopted a child who does not have a Social Security number, you may use an Adoption Taxpayer Identification Number on your tax return. An ATIN is a temporary number.

Get a New Card. File Form SS-5, Application for a Social Security Card, to notify SSA of your name change. Your new card will show your new name with the same SSN you had before.

Report Changes in Circumstances when they happen. If you enrolled in health insurance coverage through the Health Insurance Marketplace you may receive the benefit of advance payments of the premium tax credit. These are paid directly to your insurance company to lower your monthly premium. Report changes in circumstances, such as a name change, a new address and a change in your income or family size to your Marketplace when they happen throughout the year. Reporting the changes will help you avoid getting too much or too little advance payment of the premium tax credit.

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