Spring & Co.
CERTIFIED PUBLIC ACCOUNTANTS

Tax & Business Alert

OCTOBER 2017

HOW TO STEER CLEAR OF TAX ISSUES RELATED TO SHAREHOLDER LOANS

Owners occasionally need to borrow funds from their businesses. If your business is structured as a corporation and it has extra cash on hand, a shareholder loan can be a convenient and low-cost option — but it's important to treat the transaction as a bona fide loan. If you don't, the IRS may claim you received a taxable dividend or compensation payment rather than a loan.

TAKING A CLOSER LOOK

A corporation can make de minimis loans of $10,000 or less to shareholders without paying interest. But, if all of the loans from the corporation to a shareholder add up to more than $10,000, the advances may be subject to a complicated set of below-market interest rules *unless* you charge what the IRS considers an "adequate" rate of interest. Each month the IRS publishes its applicable federal rates (AFRs), which vary depending on the term of the loan.

Right now, although interest rates are starting to rise, they're still near historic lows, making it a good time to borrow money. For example, in July 2017, the adjusted AFR for short-term loans (of not more than three years) was only 1.22% (up from 0.71% in July 2016). The rate was 1.89% (up from 1.43% in July 2016) for midterm loans (with terms ranging from more than three years to not more than nine years).

The AFRs are typically below what a bank would charge. As long as the corporation charged interest at the AFR (or higher), the loan would be exempt from the complicated below-market interest rules the IRS imposes.

The interest rate for a demand loan — which is payable whenever the corporation wants to collect it — isn't fixed when the loan is set up. Instead it varies depending on market conditions. So, calculating the correct AFR for a demand loan is more complicated than it is for a term loan. In general, it's easier to administer a shareholder loan with a prescribed term than a demand note.

STAYING UNDER MARKET

If a corporation lends money to a shareholder at an interest rate that's below the AFR, the IRS requires it to impute interest using the below-market interest rules. These calculations can be complicated. The amount of incremental imputed interest (beyond what the corporation already charges the shareholder) depends on when the loan was set up and whether it's a demand or term loan. There are also tax consequences for this imputed interest to both the corporation and the shareholder.

Additionally, the IRS may argue that the loan should be reclassified as either a dividend or additional compensation. The corporation may deduct the latter, but it will also be subject to payroll taxes. Both dividends and additional compensation would be taxable income to the shareholder personally, however.

MAKING IT BONA FIDE

When deciding whether payments made to shareholders qualify as bona fide loans, the IRS considers a variety of factors. It assesses the size of the loan, as well as the corporation's history of earnings, dividend payments and loan repayments. It also looks at the shareholder's ability to repay the loan and power to make corporate decisions.

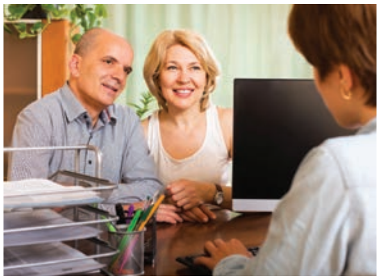
In addition, the IRS will factor in whether you've executed a formal, written note that specifies repayment terms — including the interest rate, maturity date and collateral.

GETTING STARTED

Under the right circumstances, a shareholder loan could be a smart tax planning move to make this year. Contact our firm to help you set up and monitor your shareholder loans to ensure compliance with the IRS rules. ■

WILLS AND LIVING TRUSTS: ESTATE PLANNING IMPERATIVES

Well-crafted, up-to-date estate planning documents are an imperative for everyone. They also can help ease the burdens on your family during a difficult time. Two important examples: wills and living trusts.



THE WILL

A will is a legal document that arranges for the distribution of your property after you die and allows you to designate a guardian for minor children or other dependents. It should name the executor or personal representative who'll be responsible for overseeing your estate as it goes through probate. (Probate is the court-supervised process of paying any debts and taxes and distributing your property after you die.) To be valid, a will must meet the legal requirements in your state.

If you die without a will (that is, "intestate"), the state will appoint an administrator to determine how to distribute your property based on state law. The administrator also will decide who will assume guardianship of any minor children or other dependents. Bottom line? Your assets may be distributed — and your dependents provided for — in ways that differ from what you would have wanted.

THE LIVING TRUST

Because probate can be time-consuming, expensive and public, you may prefer to avoid it. A living trust can help. It's a legal entity to which you, as the grantor, transfer title to your property. During your life, you can act as the trustee, maintaining control over the property in the trust. On your death, the person (such as a family member or advisor) or institution (such as a bank or trust company)

TAX CALENDAR

October 16

Personal returns that received an automatic six-month extension must be filed today and any tax, interest and penalties due must be paid.

- The Financial Crimes Enforcement Network (FinCEN) Form 114, "Report of Foreign Bank and Financial Accounts (FBAR)," must be filed by today, if it hasn't been filed already, for offshore bank account reporting. (This report received an automatic extension to today if not filed by the original due date of April 18.)
- If a six-month extension was obtained, calendar-year C corporations should file their 2016 Form 1120 by this date.
- If the monthly deposit rule applies, employers must deposit the tax for payments in September for Social Security, Medicare, withheld income tax and nonpayroll 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 15

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

December 15

Calendar-year corporations must deposit the fourth installment of estimated income tax for 2017.

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

you've named as the successor trustee distributes the trust assets to the beneficiaries you've named.

Assets held in a living trust avoid probate — with very limited exceptions. Another benefit is that the successor trustee can take over management of the trust assets should you become incapacitated.

Having a living trust doesn't eliminate the need for a will. For example, you can't name a guardian for minor children or other dependents in a trust. However, a "pour over" will can direct that assets you own outside the living trust be transferred to it on your death.

OTHER DOCUMENTS

There are other documents that can complement a will and living trust. A "letter of instruction," for example, provides information that your family will need after your death. In it, you can express your desires for the memorial service, as well as the contact information for your employer, accountant and any other important advisors. (Note: It's not a legal document.)

Also consider powers of attorney. A *durable power of attorney* for property allows you to appoint someone to act on your behalf on financial matters should you become incapacitated. A *power of attorney for health care* covers medical decisions and also takes effect if you become incapacitated. The person to whom you've transferred this power — your health care agent — can make medical decisions on your behalf.

FOUNDATIONAL ELEMENTS

These are just a few of the foundational elements of a strong estate plan. We can work with you and your attorney to address the tax issues involved. ■

SHOULD YOU CHANGE YOUR BUSINESS — OR TRANSFORM IT?

As its market and technological needs evolve, every company needs to change. There's even a formal term for the undertaking: "change management." From an operational standpoint, change involves opening up the hood and switching out old engine parts for new ones. Even if it affects the business as a whole, change means focusing on specific areas and making alterations over relatively short periods.

At some point in the existence of many companies, the organization needs to go beyond change to transformation. This is much different. Business transformations aren't so much about switching out parts as overhauling the entire engine, possibly modifying the frame and even applying a new coat of paint. Let's look a little more closely at the distinction.

REINVENT YOURSELF

Say a large commercial construction company was having trouble meeting its sales goals because of environmental regulations. So, it decided to augment its sales teams with environmental engineers who could better assess the compliance impact. The company applied change management principles — such as building a case for the idea and adjusting its business culture — and was successful. This was no doubt an important *change*, but the business itself wasn't *transformed*.

The objective of a true transformation is to essentially reinvent the company and implement a new business model. And that model needs to be a carefully, formally devised chain of interlocking strategic initiatives that apply to the entire organization.

Perhaps the most obvious and universal example of a business transformation is Apple. The technology giant, once a head-to-head competitor with IBM on the personal computer market, found itself struggling in the 1990s. So, under the tutelage of the late Steve Jobs, it transformed itself into a mobile technology company. It still makes computers, of course, but the company's *transformative* success can really be attributed to its mobile devices and operating systems.

THINK AND ACT WISELY

Every business transformation differs based on the history, nature and size of the company in question. But there are best practices to keep in mind. For example, start with your customers, visualizing what they need (even if they don't know it yet). Also, build a chain of initiatives, so you're not trying to do everything all at once. And use metrics, so you can track specific dollar amounts and productivity goals throughout the transformation.

Above all, be ready for anything. Even the best-planned transformations can produce unpredictable results. So keep expectations in line and take a measured, patient approach to every initiative involved.

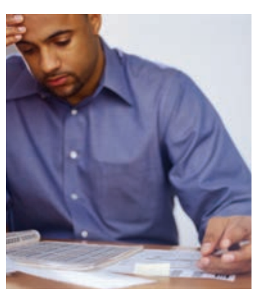
BRING ALONG HELP

Successful business transformations can be spectacular and profitable. But, make no mistake, the risk level is high. So if you decide to embark on this journey, bring along your trusted financial, legal and strategic advisors. ■

3 STRATEGIES FOR HANDLING ESTIMATED TAX PAYMENTS

In today's economy, many individuals are self-employed. Others generate income from interest, rent or dividends. If these circumstances sound familiar, you might be at risk of penalties if you don't pay enough tax during the year through estimated tax payments and withholding. Here are three strategies to help avoid underpayment penalties:

1. **Know the minimum payment rules.** For you to avoid penalties, your estimated payments and withholding must equal at least:
   - 90% of your tax liability for the year,
   - 110% of your tax for the previous year, or
   - 100% of your tax for the previous year if your adjusted gross income for the previous year was $150,000 or less ($75,000 or less if married filing separately).
2. **Use the annualized income installment method.** This method often benefits taxpayers who have large variability in income by month due to bonuses, investment gains and losses, or seasonal income — especially if it's skewed toward year end. Annualizing calculates the tax due based on income, gains, losses and deductions through each "quarterly" estimated tax period.
3. **Estimate your tax liability and increase withholding.** If, as year end approaches, you determine you've underpaid, consider having the tax shortfall withheld from your salary or year-end bonus by December 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may trigger penalties for earlier quarters.



Finally, beware that you also could incur interest and penalties if you're subject to the additional 0.9% Medicare tax and it isn't withheld from your pay and you don't make sufficient estimated tax payments. Please contact us for help with this tricky tax task. ■