



# Tax Newsletter

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## MARCH 2021

### Upcoming dates:

**March 15** - Due date for partnership and S corporation tax returns (Forms 1065, 1120S)

### Spring is almost here!

With April 15th right around the corner, get answers to common tax questions in this month's newsletter. Also included is a look at how bank reconciliations still play an important part of your financial health, and a reminder to every small business owner to classify their workers correctly, or pay a heavy price with the tax authorities.

### **Answers to Common Tax Questions**

With the April 15 tax filing deadline right around the corner, here are answers to some common tax questions.

- **When will I get my refund?** The pandemic and additional stimulus payments will, in all probability, delay refund payments. But as of now, here are the old wait times to receive your refund.
  - \* E-file return with a direct deposit - 1 to 3 weeks
  - \* E-file return with a mailed check - 1 month
  - \* Paper file return with a direct deposit - 3 weeks
  - \* Paper file return with a mailed check - 2 months

**NOTE:** If you want exact information on the status of YOUR refund, go to [www.irs.gov/refund](http://www.irs.gov/refund) and follow their instructions.

- **What's the most common delay in completing a tax return?** Missing items! W-2 and 1099 forms are some of the most common tax documents to go missing. If you have multiple jobs, whether full-time or part-time, you'll be getting multiple documents in the mail. It's easy to lose track of all these documents if you don't have one place you put them once received.

March 14, 2021



- **Can I still get a stimulus payment?** If you're still waiting on either the 2020 or 2021 stimulus payment, file your 2020 tax return and claim the Recovery Rebate Credit. This is why it is important to keep track of any payments you receive from the government during the year. You will need them to account for any missing payments or underpayments.
- **Can I correct a tax form that has an incorrect dollar amount?** If you receive a tax document with incorrect information, contact the company that issued the document and try to get it fixed immediately. If you can't get a corrected form right away, include both the incorrect form and the correct dollar amount when turning in your tax documents to have your return prepared.
- **Can I deduct charitable contributions if I don't itemize?** In 2020, you can claim a \$300 charitable contribution deduction regardless of whether or not you itemize your deductions. If you missed this window of this above-the-line donation in 2020, never fear as it is also available in 2021 with an increased limit to \$600 for married couples. So save those donation receipts!
- **Is this taxable?** While there are always exceptions, the most common taxable items that are questioned include unemployment benefits and withdrawals from non-Roth retirement accounts. Some things, like Social Security, are often, but not always, taxable.

### ***The New World of Bank Reconciliations***

Here's a look at the new world of bank reconciliations and some ideas to use to ensure your bank account is accurate.

#### **The Bank Reconciliation Purpose**

In a nutshell, a bank reconciliation ensures your account is accurate. This is done by comparing all your activity with what the bank is reporting.

#### **The Importance of Timely Bank Reconciliations**

There are several reasons for conducting these account reviews on a timely basis:

- **Catch a mistake by the bank.** Banks make mistakes. Reconciliations can help you catch these bank errors. And errors are more common with digital payment systems...often a small transposition or machine misread of a number can create a payment error.
- **Catch a mistake by you.** It's difficult envisioning making an error, but that happens, too. It is easy to record the wrong payment amount. The only way to catch this is to look at your account and compare it to what you think you paid.
- **Catch unauthorized use.** If someone hacks into your mobile phone's payment app and spends \$20 of your money, how would you ever find out? Reconciliations uncover fraudulent activity you may have missed.
- **Properly monitor automatic payments.** With monthly payments automatically coming out of your account, it is easy to forget to account for these payments and have less in your account than you think you do. Timely reconciliations also help you identify ongoing payments that should be discontinued.

#### **Tips for reconciling your accounts**

- **Reconcile every week (or every day!).** Gone are the days when you need to wait for your monthly bank statement in the mail to reconcile your account. Use your bank's online tools to reconcile once a week, or even once a day. This will help identify problems as they occur and is especially important in identifying possible hacking or theft.

- **Use your favorite app to capture your spending.** Secure online applications are now replacing the traditional check register. You'll still need to be disciplined to use the online tool when you spend money, so look for an application that is easy to record your spending.
- **Combine reconciling with budgeting.** Use your reconciliations as an opportunity to become better with budgeting your money. Use reporting functions to help classify your deposits and payments. Then compare them with what you think they should be. This moves the discipline from simple reconciliation to a more planned approach, to comparing your budget to actual spending.

The way bank reconciliations are done may have changed over the past 20 years, but the vital role they play in maintaining your financial health will never disappear.

### ***Get Your Contractor or Employee Classification Right!***

#### ***Tax challenges can be VERY expensive***

As a small business owner, you may face the issue of whether to classify workers as employees or as independent contractors.

Classifying your workers as independent contractors generally saves you money. That's because you avoid paying employment taxes and benefits on their behalf.

If the IRS determines that you misclassified your employees as contractors, you could end up paying all of the employment taxes and benefits that would have been paid over the years. Depending on the size of your work force, the cost to your business could be substantial.

In determining whether the person providing a service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered. There are three primary categories of control and independence that the IRS considers when determining if a worker is a contractor or an employee:

- **Behavioral.** Does the company control or have the right to control what the worker does and how the worker does his or her job? If yes, the worker is an employee.
- **Financial.** Are the business aspects of the worker's job controlled by the payer? This includes things like how the worker is paid, whether expenses are reimbursed, and whether the employer provides tools and supplies. If yes, the worker is an employee.
- **Type of relationship.** Are there written contracts or employee-type benefits? If contracts are involved, the worker may be a contractor. If benefits such as a pension plan, insurance, and vacation pay are made available, the worker most likely is an employee.

Deciding whether a worker is a contractor or employee can get complicated. And remember that there are significant financial consequences for incorrectly classifying a worker. Please call if you have a question about how to classify one or more of your employees.

### ***The \$24,000 Tax Time Bomb***

#### ***A terrible tax surprise everyone should know***

What follows is a true story. A story with a sad ending. But one that has a lesson for everyone. Stick with the story, with a high degree of certainty, you probably know someone in this exact situation.

## The ingredients

Back in the 1970s, U.S. Savings Bonds were a popular savings alternative. Grandparents purchased them for kid's college. Many used them to build funds for retirement. Even better, you paid ½ the face value and later (usually 20 years), the bonds matured at twice what you paid for them. So, a \$1,000 investment yielded \$2,000 when it reached maturity. In our case, this tax bomb had the following ingredients:

- Converted old Series E savings bonds with deferred interest;
- Series HH savings bonds with annual taxable interest;
- Owning uncashed savings bonds that no longer earn interest;
- Little help from the bank; and
- Confusing information from federal tax authorities about impending tax obligations.

## The bomb is set

Joe purchased Series E saving bonds each year in the 1970s. With half down and promise of double value upon maturity, Joe amassed a nice \$140,000 retirement fund. After 20 years, the bonds matured. Joe did not yet need the money, so he converted them to Series H savings bonds. This effectively deferred the interest income on the Series E bonds, since the bonds were not cashed.

With the new Series H savings bonds, Joe paid federal income tax each year on the interest earned. Meanwhile the taxable interest from the series E bonds continued to be deferred.

The result? Joe thought he was paying tax on the interest each year...BUT there was a sleeping tax bill on interest of \$70,000 just waiting until Joe cashed in his series H bonds!

## The bomb explodes

Joe received word that his series H bonds would no longer pay interest. So he tells his grandson to go to a bank and cash in the bonds. Heck, why have bonds that no longer pay interest? And...it's no big tax deal because he has been paying tax on his Series H bond interest each year. The grandson has financial power of attorney so he does as his grandfather asks.

Surprise! He receives a notice from the IRS saying he owes them \$24,000! This includes plenty of penalties and tax.

## Lessons for all of us

- **Never disregard 1099s or printed details.** When the grandson cashed the bonds, if he looked closely on the face of the bonds, he may have noticed the deferred interest. But it would contradict what grandpa had told him. Further, his grandpa probably received a Form 1099 that was disregarded because he believed he was already paying the tax.
- **Old savings bonds can be confusing.** There are many different issues and flavors of savings bonds. When you see any uncashed bonds, conduct the necessary research to understand your potential obligations. This is especially true for bonds past their maturity date.
- **Ask before you sell.** Always understand the tax consequences BEFORE you sell any property. Even the most innocent of transactions can have their own tax time bomb. So call an expert before you buy or sell.

- **Tax planning matters.** While Joe would always owe federal income tax when he cashed the bonds, he could have reduced his effective tax rate by cashing them over time instead of all in one year. In this case, it exposed a lot of income to a much higher tax rate. He could have saved over \$10,000 in tax with a little planning!

Because neither the bank, nor federal taxing authorities believe it is part of their duty to help you make knowledgeable tax decisions, you are on your own. This one-way street of knowledge makes having an expert on your side more important than ever!

### ***Starting a Business Now Could Make a Lot of Sense***

The same factors that we've been dealing with for the past 12 months during the pandemic can also create an opportunity, if you are considering starting a small business.

#### **Problems create opportunity**

For one thing, fewer businesses in the marketplace can mean fewer potential competitors. For a start-up company, that can be good news.

Also, a slower economy can mean cheaper prices for certain goods and services you'll need to get up and running. As companies close branch offices, they may be willing to sell office equipment, furniture, electronics, and other items at discounted rates. Commercial property managers have tons of empty space with no rent income. They may be willing to cut you a deal.

Skilled labor is also more readily available in a slow or uncertain economy. With today's employment outlook, skilled workers may be willing to take lower salaries, at least for now. As your business prospers, you may be able to ramp up salaries and offer other benefits.

#### **Some time-tested suggestions**

If you're thinking about starting a small business now, while the short-term economic outlook is still slow or uncertain, here are some time-tested suggestions:

- **Start small.** Test the market for your product or service without risking too many resources. This could be as simple as a concept test that you share with a few prospective customers. Or it might be creating a pop-up restaurant with pick-up or delivery only. Not only does this approach take less money, it also develops a proven business model you can then present to bankers to possibly obtain more funding when you wish to expand. So consider taking it slow and letting it build.
- **Under promise and over deliver.** With customers hard to come by in some industries, consider wowing your customers even more than you normally do to try and quickly gain their loyalty. Remember, success is not always defined by what you do or make, but how well you do it!
- **Seek advice.** Find other small business owners and pick their brains for suggestions about overcoming obstacles, keeping the business focused, and prospering during hard times.
- **Look for jump starts.** Sometimes there is a similar business that could use your help, or is willing to sell at a reasonable price. Starting out with a book of business and systems already in place can save a substantial amount of time and money.
- **Create a plan.** Start with a feasibility study of your idea and then translate that into a well-developed introductory plan. This review and road map will help you succeed when starting your business.

- **Build a team.** Successful businesses have great accountants, legal advisors, and trusted suppliers. Start networking to build your team. You'll need your team both in the short-term as you start your business and in the long-term as you look to grow your business.

Please call if you would like additional suggestions for getting your business started.

As always, should you have any questions or concerns regarding your tax situation, please feel free to call.

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