Coleman & Associates
Fully Integrated Tax, Accounting & Financial Services

## Monthly Newsletter - July 2021

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## Coleman & Associates Has Successful Review By Peers

The partners and staff of Coleman & Associates are pleased to announce the successful completion of an independent peer review of our accounting practice. This review was undertaken as a condition of membership in the American Institute of Certified Public Accountants (AICPA), the national organization of CPAs in public practice, industry, government, and education.

In 1988, the members of the AICPA overwhelmingly approved a bylaw amendment requiring members active in practice of public accounting to participate in a practice-monitoring program. With the adoption of this proposal, the AICPA implemented a peer review program of unprecedented scope in the CPA profession or any other. Our participation in peer review demonstrates our firm's desire to meet the profession's high standards of professionalism and our commitment to maintain and improve the quality of our practice.

Our peer review was conducted by a team appointed by the Illinois CPA Society. The reviewers verified that professional standards were followed in a representative sample of our accounting engagements for the year ended 2020.

Our firm is committed to periodic peer reviews to foster quality performance. If requested, the firm will provide a copy of the report on the results of the review to all interested parties, although it is not required to do so.

Bankers, bonding agents, investors, suppliers, legal advisors and others use the financial statements our firm reviews or compiles. We think those people, our clients, and our own staff deserve independent quality assurance that our firm provides quality services. We are proud of our peer review results and would be happy to answer any questions you might have.

## <u>Illinois Issues Duplicate Refund Checks</u>

If you have received a duplicate individual income tax refund, **cash only one check**. Cashing both checks may result in a fee from your financial institution. You can either destroy the second check or mail it back to Illinois State Comptroller at 325 West Adams, Springfield, Illinois 62704. **Do not mail your check to the Illinois Department of Revenue.** If you have any further questions, please contact the department at 800 732-8866 or 217 782-3336.

No reason was provided by Illinois as to the reasons for the duplicate checks.

## <u>IRS Has a Backlog of 30 Million Returns</u>

The IRS has a backlog of about 30 million individual and business income tax returns that require manual processing – meaning that employee involvement is generally required before a return can advance to the next stage in the processing pipeline. Unprocessed paper tax returns account for almost half the backlog. Returns suspended during processing, meaning returns set aside because of issues that require additional review, account for just over half.

These processing backlogs matter greatly because most taxpayers overpay their tax during the year and are entitled to receive funds when they file their returns. In addition to repaying overpayments of tax, refunds may include Earned Income Tax Credit (EITC) benefits that can be worth up to $6,000, Additional Child Tax Credit benefits that can be worth up to $1,400 per qualifying child and, this year, Recovery Rebate Credits (RRCs). The IRS's backlog of 30 million income tax returns means that most individual taxpayers in this group and many business taxpayers will not receive their refunds until the IRS eventually processes their returns.

After the pandemic forced IRS office closures last March, the IRS over time was able to make a significant amount of its work portable, and it instructed its field examination and collection employees to postpone the start of examinations, liens, and levies. Most employees could perform their jobs from home. To protect the confidentiality and security of tax return information, however, the IRS could not allow employees who open and enter data from paper tax returns to take them home, requiring employees to work in the IRS campuses and, only when necessary, gather information from local offices.

The IRS received approximately 17 million individual income tax returns and an estimated 50 million other tax returns on paper last year, in addition to more than 13 million pieces of correspondence. The shutdown of processing operations meant these returns and letters sat unopened on trucks <u>for months</u>. When IRS employees slowly returned to their jobs, the backlogs were overwhelming.

As of May 1, the IRS has a backlog of about 12.9 million paper tax returns waiting to be processed. The backlog includes 2.5 million tax returns received in 2020 and 10.4 million returns received in 2021. They are split about evenly between individual returns and business returns.

In addition, there is a second group of about 15.1 million returns suspended during processing. These returns generally require employee review to verify the legitimacy of some aspect of the return. There are also about 2.5 million amended returns awaiting processing.

The breakdown of the processing backlog is as follows:

**Status of Inventory Requiring Manual Processing (as of May 1, 2021):**

| | Individual | Business | Not Specified | Total |
|---|---|---|---|---|
| **Paper Returns Awaiting Processing** | | | | |
| Calendar Year 2020 | 1,000,000 | 1,500,000 | | 2,500,000 |
| Calendar Year 2021 | 4,900,000 | 3,700,000 | 1,800,000 | 10,400,000 |
| **Total Paper Returns Awaiting Processing** | **5,900,000** | **5,200,000** | **1,800,000** | **12,900,000** |
| **Paper and Electronic Returns – Processing Suspended** | **13,200,000** | **1,900,000** | | **15,100,000** |
| **Amended Returns Inventory** | **1,900,000** | **500,000** | | **2,500,000** |
| **Total Unprocessed Returns** | **21,000,000** | **7,600,000** | **1,800,000** | **30,500,000** |

** Excerpt from Written statement of Erin M. Collins before the Subcommittee on Financial Services and General Government, U.S. Senate. Subject: Hearing on IRS: Narrowing the Tax Gap and Improving Taxpayer Services on 5/19/2021. You can read the full statement at the link below.

https://www.irs.gov/pub/irs-utl/national-taxpayer-advocate-testimony-senate-approps-fsgg-hearing-5-19-2021.pdf

## Ideas to Lower Your 2021 Tax Bill

Now is the time to begin tax planning for your 2021 return. Here are some ideas:

1. **Contribute to retirement accounts.** Tally up all your 2021 contributions to retirement accounts so far, and estimate how much more you can stash away between now and December 31. Increase your contributions to your employer-provided retirement plans or consider investing in an IRA. Remember, you can reduce your 2021 taxable income by as much as $19,500 by contributing to a retirement account such as a 401(k). If you're age 50 or older, you can reduce your taxable income by up to $26,000!
2. **Contribute directly to a charity.** If you don't have enough qualified expenses in order to itemize your deductions, you can still donate to your favorite charity and cut your tax bill. For 2021, you can reduce your taxable income by up to $300 if you're single and $600 if you're married by donating to your favorite charity.
3. **Consider a donor-advised fund.** With a 2021 standard deduction of $12,550 if you're single and $25,100 if you're married, you may not be able to claim your charitable donations as a tax deduction if the total of your annual donations is below these dollar amounts. As an alternative, consider donating multiple years-worth of contributions to a donor-advised fund if you have the available cash so you can exceed the standard deduction this year. Then make your cash contributions from the donor-advised fund to your favorite charities over the next three years.
4. **Increase daycare expenses.** If you and/or your spouse work and have children in daycare, or have an adult that you care for, consider using a daycare so you and a spouse can both work. (Both spouses must be working for this benefit). This is because there is a larger tax break in

2021. If you have one qualifying dependent, you can spend up to $8,000 in daycare expenses while cutting your tax bill by $4,000. If you have more than one qualifying dependent, you can spend up to $16,000 in daycare expenses while cutting your tax bill by $8,000. To receive the full tax credit, your adjusted gross income must not exceed $125,000.

5. **Contribute to an FSA or an HSA.** Interested in paying medical and dental expenses with pre-tax dollars? Then read on...If you have a flexible spending account (FSA), you can contribute up to $2,750 in 2021. This allows you to pay for medical expenses in pre-tax dollars! Even better, unspent funds in an FSA can now be rolled from 2021 to 2022. And if you have a health savings account (HSA), you can contribute up to $3,600 if you're single and $7,200 if you're married. So add up all your contributions to your FSA or HSA so far in 2021 and see how much more you can contribute between now and December 31.

Please call to discuss these and other tax planning opportunities.

## Pitfalls of IRS Small Business Audits

In late 2020, the IRS announced that it will increase tax audits of small businesses by 50% in 2021. Here are several sound accounting practices that avoid audit pitfalls and are essential to a successful IRS exam.

- **Report all of your income.** IRS auditors focus on under-reported income. If you're a business that handles cash, expect greater scrutiny from the IRS. The same is true if you generate miscellaneous income that's reported to the IRS on 1099 forms. Be proactive by tracking and documenting all income from whatever source. Invoices, sales receipts, profit and loss statements, bank records—all can be used to substantiate income amounts.
- **Be profitable.** Some small businesses struggle in the early years before becoming profitable. If your company's bottom line never improves, the IRS may view your enterprise as a hobby and subsequently disallow certain deductions. As a general rule, you must earn a profit in three of the past five years to be considered a legitimate business.
- **Document your deductions.** Do you really use your home office exclusively for business? Does your company earn only $50,000 a year but claim charitable donations of $10,000? Do you write off auto expenses for your only car? The key to satisfying auditors is having clear and unequivocal documentation. They want source documents such as mileage logs that match the amount claimed on your tax return and clearly show a business purpose. If you can't locate a specific record, look for alternative ways to support your tax return filings. In some cases, a vendor or landlord might have copies of pertinent records.
- **Complete expense reports.** If you use your credit card for business, create an expense report with account numbers and attach it to each statement. Then attach copies of the bills that support the charges. This is an easy place to blend in personal expenses with business expenses and auditors know it. Create a clear path to your deductions.
- **Keep separate books, bank accounts, and credit cards.** Never run personal expenses through business accounts and vise versa. Have separate bank accounts and credit cards. A sure sign of asking for trouble is not keeping the business separate from personal accounts and activities.

Call us. We are here to help you if you are audited or need recordkeeping guidance.

## Manage Your Business's Unemployment Taxes

As a business owner, you're required to pay three different types of payroll taxes.

1) FICA (Federal Insurance Contributions Act) is the tax used to fund Social Security and Medicare programs.
2) FUTA (Federal Unemployment Tax Act). Employers pay this federal tax to provide unemployment benefits to laid-off workers.
3) SUTA (State Unemployment Tax Act). State governments also collect taxes known as SUTA that finance each state's unemployment insurance fund.

While FICA may be easy to understand, unemployment tax calculations are easily misunderstood.

**The FUTA calculation.** The federal unemployment tax rate is 6% on the first $7,000 of each employee's income, regardless of where the company does business. In addition, employers who pay their state's SUTA taxes on time can receive a maximum credit of 5.4%, reducing the FUTA rate to 0.6% (this is the rate most businesses pay in Illinois). Certain employee benefits – employer contributions to health plans, pensions, and group life insurance premiums, for example – are also excluded from the calculation.

**SUTA taxes are more complicated.** Tax rates and taxable thresholds (known as wage bases) vary from state to state, industry to industry, and business to business. In Illinois, the first $12,960 of an employee's salary is taxed under SUTA. Other factors affecting SUTA tax liability include the business's history of on-time payments to the state insurance fund and the number of former employees receiving unemployment benefits.

**How to reduce your SUTA and FUTA tax bills**

- **Hire cautiously.** If you employ someone who doesn't work out, you could end up with additional unemployment claims and a higher SUTA tax rate.
- **Train vigorously.** To increase productivity and reduce turnover, target your investment in continuing education. Keep employees happy and loyal. Again, high turnover leads to unemployment claims, which leads to bigger SUTA tax bills.
- **Terminate judiciously.** If you must reduce personnel, consider offering severance or outplacement benefits to terminated employees. The sooner they return to the job market, the fewer the unemployment claims that will be factored into your company's SUTA tax calculation.
- **Dispute carefully.** Take the time to verify the accuracy of unemployment claims, as bogus representations by former workers can drive up your SUTA taxes. If an employee was fired for gross misconduct and thus disqualifying himself or herself from collecting unemployment, have strong documentation to support the termination.
- **Pay regularly.** Under federal guidelines, employers who make their SUTA contributions on time can reduce the amount of FUTA taxes by up to 90%.

As always, contact the office with questions by emailing us at info@colemancpas.com or calling 773-444-3100. We are here to help.