2017 Tax Report

It's become a bit of a tradition around here to talk about what I learned while doing my taxes each year. It seems each year I have to learn a new schedule or form. This year there were a lot of new things to learn. I made some mistakes too, which isn't unusual, whether you do your taxes yourself or pay someone else to do it. Let's get into it.

Learning New Tax Forms

If your financial situation is pretty stable, you can pretty much just copy last year's return with new numbers. Unfortunately, our financial situation has never been stable and this year was no exception. There were several forms that were new to me this year. Early in the year, we declared that WCI, LLC was going to file taxes as an S Corp from now on. We did this primarily in order to save on Medicare taxes. An S Corp splits its payments to its owners into salary and distributions, and pays payroll taxes only on the salary. We figured this would save us $20K or more in taxes this year. So I had to figure out how to tell the IRS that. At first I thought that mean Form 8832 and Form 2553, but in the end it turned out that Form 2553 was enough. If you're on a calendar year, you have until March 15th to turn in that form.

I also had to start filing Form 941, “Employer’s Quarterly Federal Tax Return” and its state equivalent. Unfortunately, I screwed it up. Which meant I got to learn form 941X too. The IRS knows the tax code sucks and that people are going to screw it up. So for every form you can file, there’s a way to fix it. I’ve filed plenty of 1040Xs in the past and this year I got to learn how to file all kinds of other correction forms too. I screwed up the W-2s as well. So I got to file a Form W-2c. Unfortunately, you don’t file those with the IRS like the W-2, you file it with the Social Security administration. That was fun.

During the year I got a notice that I’d screwed up Form 1065 (partnership return for WCI) on my 2016 taxes and I owed $800. I disagreed. So I told the IRS why they were wrong. They agreed with me and it went away. Apparently, they have as much trouble calculating my taxes as I do.

The big new forms I had to learn this year were the corporate tax return, the 1120S for an S Corporation and in Utah, the TC-20S. It really wasn’t much worse than Form 1065 for a partnership, and in some ways much easier. As an S Corp, you don’t have to obtain nor enter 1099 forms from the various companies that paid you. So I got to ignore a whole big stack of paper that people sent me throughout the year. It’s a five page return that the IRS estimated would take me 240 hours to fill out.

Table 1 – Taxpayer Burden for Entities Taxed As Partnerships

Forms 1065, 1065-B, 1066 and all attachments			
Primary Form Filed or Type of Taxpayer	Number of Returns (millions)	Average Time per Taxpayer (hours)	Average Cost per Taxpayer
All Partnerships	3.9	290	$5,700
Small	3.7	270	$4,400
Large*	0.2	610	$29,000
*A large business is defined as one having end-of-year assets greater than $10 million. A large business is defined the same way for partnerships, taxable corporations, and pass-through corporations. A small business is any business that does not meet the definition of a large business.			

Table 2 – Taxpayer Burden for Entities Taxed As Taxable Corporations

Forms 1120, 1120-C, 1120-F, 1120-H, 1120-ND, 1120-SF, 1120-FSC, 1120-L, 1120-PC, 1120-POL and all attachments			
Primary Form Filed or Type of Taxpayer	Number of Returns (millions)	Average Time per Taxpayer (hours)	Average Cost per Taxpayer
All Taxable Corporations	2.1	315	$6,300
Small	2.0	280	$4,000
Large*	0.1	1,250	$68,900
*A large business is defined as one having end-of-year assets greater than $10 million. A large business is defined the same way for partnerships, taxable corporations, and pass-through corporations. A small business is any business that does not meet the definition of a large business.			

Table 3 – Taxpayer Burden for Entities Taxed As Pass-Through Corporations

Forms 1120-REIT, 1120-RIC, 1120S and all attachments			
Primary Form Filed or Type of Taxpayer	Number of Returns (millions)	Average Time per Taxpayer (hours)	Average Cost per Taxpayer
All Pass-Through Corporations	4.9	245	$3,500
Small	4.8	240	$3,100
Large*	0.1	610	$30,800
*A large business is defined as one having end-of-year assets greater than $10 million. A large business is defined the same way for partnerships, taxable corporations, and pass-through corporations. A small business is any business that does not meet the definition of a large business.			

I'm pleased that they were wrong. It probably took me 1/100th of that time to do the form, and I did it by hand. Of course, I probably should have spent a little more time on it, since I screwed that up too. There is no 1120SX, you just file Form 1120S again and check a box for "amended return." This return was due on March 15th for WCI, and by March 29th I had to fix it. My big error? I used profit where I should have used revenue on the first line! So I'd deducted all the business deductions twice. Oops. What tipped me off? When I started plugging my personal numbers in to Turbotax and it told me I was getting a huge refund instead of having to make the huge payment I was expecting. Since there was no significant deadline on turning in the amended form, I decided to just hold on to it until I was done with my personal return in case I screwed something else up. Which was good, because not only did I screw up this form once, I did it twice. It turns out you don't deduct your business mileage on your corporate return the same way you do on a partnership return- you reimburse the employees for their mileage and then deduct that reimbursement as a business expense. I also forgot to put all the payroll taxes the business paid for Katie and I on to the form as a business expense. The first time with any form can be painful. I often discover that the state tax forms are even more painful than the federal ones. The TC-20S has 13 pages compared to the 5 pages of the 1120S. Luckily I only had to fill out 6 of them.

The corporate return also has another requirement that partnership returns don’t have- you have to report a balance sheet for the business to the IRS. Since we’re just flying by the seat of our pants over here at WCI, we’d never actually made an official balance sheet. So I got to learn all about balance sheets. I should have been a business major I guess instead of a molecular biologist. Luckily, this business doesn’t own much, so it wasn’t too hard. Assets? Well, the bank account and the paypal account. Liabilities? Well, there’s a credit card account that we put a few expenses on. Inventory? None. The only other real asset is the website itself, which is pretty tough to value, so I just made something reasonable up.

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
	Assets	(a)	(b)	(c)	(d)
1	Cash				
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts	( )		( )	
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10a	Buildings and other depreciable assets				
b	Less accumulated depreciation	( )		( )	
11a	Depletable assets				
b	Less accumulated depletion	( )		( )	
12	Land (net of any amortization)				
13a	Intangible assets (amortizable only)				
b	Less accumulated amortization	( )		( )	
14	Other assets (attach statement)				
15	Total assets				
	Liabilities and Shareholders' Equity				
16	Accounts payable				
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement)				
19	Loans from shareholders				
20	Mortgages, notes, bonds payable in 1 year or more				
21	Other liabilities (attach statement)				
22	Capital stock				
23	Additional paid-in capital				
24	Retained earnings				
25	Adjustments to shareholders' equity (attach statement)				
26	Less cost of treasury stock		( )		( )
27	Total liabilities and shareholders' equity				

Form **1120S** (2017)

By the time I'd finished all this corporate tax stuff up, I was about ready to hire an accountant to do it all for me in 2018. It wasn't that the screw-ups bothered me; I stopped worrying about errors on tax returns a long time ago. It was simply the time required to do it all. So that may be in my future, we'll see. Certainly all this stuff is way easier the second (and third) time.

Safe Harbor Screw Up

But wait! There's more. Just when you thought I couldn't screw up even more on my taxes, I found out I had a $1,000 penalty due. I'm quite familiar with the Safe Harbor rules. Heck, I've written a blog post about them. A lot of people don't realize the difference between what is withheld and what is actually owed, but the IRS requires you to withhold a certain amount of money as you go along throughout the year no matter what you owe at the end of the year. Since that can be hard to calculate, especially with a variable income, there are some rules that if you follow you will be able to avoid any penalties, although you'll still have to pay any taxes due on April 15th. Basically, the safe harbor rule we use is paying 110% of what we owed last year as we go along. But this year it wasn't as simple as prior years, when I had just taken what I paid last year, multiplied it by 110%, divided it by four, and sent that amount in once a quarter as an estimated quarterly payment. Not only did I have to make those estimated quarterly payments, but I also had to send in money with Form 941. I overestimated how much I would have to pay with Form 941, and thus made quarterly estimated tax payments that were too small. By the time I realized the error, it was too late. The penalty for underwithholding works out to be about 2.66% per year, and since I underwithheld about $50K, that worked out to be a penalty of a little over $1,000. The only good news is my portfolio did much better than 2.66% last year, so I actually probably came out ahead "borrowing" this money from the IRS to invest. I'll make larger quarterly payments this year to avoid that penalty. I was actually amazed how little I was required to withhold with Form 941 once I calculated it correctly.

The Home Office Deduction

In previous years I've never taken the home office deduction, simply because we didn't qualify because there was no space we used regularly and exclusively for the business. Well, this year we set up a bedroom downstairs as the video/podcasting studio. Since it was such a big pain to set up and take up, we just left it up and our use of that room by the business became exclusive. And since we make podcasts every month, well, our use became regular. Voila! We qualify. I love the new simplified version of this deduction. It's $5 per square foot for 2017 and you don't have to keep track of utilities, insurance, mortgage interest, or depreciation. 30 seconds with a tape measure and the $775 deduction was mine. It might not be much, but it beats a kick in the teeth.

Bunching

Our effective tax rate this year was 30%, which is actually LOWER than last year despite having a higher income. This is for two reasons. The first is all that Medicare tax we saved by becoming an S Corp. The second is due to all of the bunching we did at the end of the year due to the changes in the tax code for 2018. Regular readers know we gave away more than we spent in 2017. In reality, we gave away twice as much as we spent for 2017, because we bunched 2018 charitable deductions into 2017 to take advantage of the change in tax rates. In addition, I paid my 2017 Utah state taxes in December instead of April like I usually do. This effectively doubled our itemized deductions, significantly lowering our taxes. We'll be taking the standard deduction for 2018, especially given the SALT limitation and the fact that we no longer have mortgage interest. In reality, our 2017 taxes look artificially low and our 2018 taxes will look artificially high, but overall, we'll come out ahead for bunching those deductions.

K-1 Annoyance

If you've been involved in partnerships, either for your practice or for investments, you know that K-1s seem to take forever each year. You haven't even started your taxes and other people already have their refunds. In fact, lots of partners file an extension for their taxes simply because of this issue. While W-2s and 1099s are supposed to be distributed by the end of January, K-1s don't have to be distributed until March 15th. However, since the penalty for distributing K-1s late is only $50 per partner, it happens all the time. I had one K-1 from Equity Multiple that I was still waiting for the week taxes were due and its not uncommon for K-1s to come AFTER April 15th. If you get into a lot of "accredited investments" be prepared for this hassle and expense. One more great reason to stick with index mutual funds I suppose.

Minnesota Tax Return

I also got to learn the Minnesota tax return this year thanks to my investment in Physician on FIRE. I just used Turbotax, and while it cost me $50, it only took a few minutes. In general, Minnesotans like their government a lot more than Utahns and send them a lot more of their money. However, they have a pretty cool little provision for non-residents that if your "Minnesota Gross Income" is less than about $10K, you don't owe any taxes. I still had to file the return because PoF withheld some taxes for me, but I should get them all back. A nice little boost to my ROI I can't wait to file a "West Coast" return next year for PIMD.

Utah Tax Return

Speaking of getting money back, I'll be getting a few thousand back from Utah too, despite the fact that I'll be writing a big check to the feds. That estimated tax payment I made in December was a little too big. But that's a good thing because the income that gets added back into my 2018 taxes due to that refund will be taxed at a lower rate. I probably should have written an even bigger check!

Looking Forward To Next Year

2018 tax planning is the most exciting it has been for years. Not only will we benefit from all these lower tax brackets, but we also expect a huge deduction for the pass-thru business deduction for WCI, LLC. A reader tells me the ideal amount for us to pay ourselves as salary is 28% of profit, which seems about right. That maximizes our pass-thru deduction while minimizing the Medicare tax due. We’ll be hurt by not being able to deduct our state taxes anymore (at least beyond $10K for state income and property taxes combined) but we won’t be doing that anyway this year as we’ll be taking the new higher standard deduction. I think when you add it all up, our effective tax rate will be about the same for 2018 as for 2017, but it’s really a guess at this point. Last year, I budgeted 32% of income for taxes, and it came in at 30%, so that difference was a nice “windfall” to invest this month. Maybe we’ll see another “windfall” next year.

What do you think? What did you learn this year doing your taxes? What mistakes did you make? How much of your taxes do you think are worthwhile doing yourself? How much do you pay for tax prep? Comment below!