MANUFACTURER

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HERTZBACH
certified public accountants · consultants

www.hertzbach.com

Baltimore
800 Red Brook Boulevard
Suite 300
Owings Mills, Maryland 21117
410.363.3200

Greater Washington, D.C.
1803 Research Boulevard
Suite 215
Rockville, Maryland 20850
301.315.2150

Northern Virginia
1530 Wilson Boulevard
Suite 700
Arlington, Virginia 22209
703.351.6600

Deducting travel and entertainment expenses with confidence

Owners, managers and salespeople often incur travel and entertainment expenses. Manufacturers and distributors need to understand how to legitimately claim these deductions and properly substantiate them to ward off unwanted IRS attention.

Travel expenses

Your company can deduct ordinary and necessary expenses that owners, employees and other business associates (such as prospective customers, suppliers or professional advisors) incur when traveling on business. These expenses include the travel costs of getting to and from your business destination, as well as any business-related expenses at your business destination. Examples include:

- Transportation by car, bus, train, boat or plane,
- Car rental at your destination,
- Shipping and baggage fees,
- Lodging and meals,
- Dry cleaning and laundry,

- Tips, and
- Phone and Wi-Fi access charges.

You can deduct all travel expenses if your trip was entirely business related. But be careful to deduct only business-related expenses if you extend your business trip for a personal side trip.

In addition, if you have an accountable plan, you can exclude any qualifying employee reimbursements for such expenses from the employee's taxable income — which also will reduce employment taxes.

Substantiation requirements

Travel expenses, along with meals and entertainment costs, are IRS hot buttons. If your business claims these expenses for tax purposes, expect the IRS to review your records at some point. So, it's important to keep track of all expenses, using a log, diary, notebook or any other written record. Hold on to all this documentation for several years in case the IRS inquires about the deductions, including the expense's:

- Amount,
- Time and place, and
- Business purpose.

If the expense is for meals or entertainment, you also must show the business relationship to the taxpayer of any person entertained. In general, business-related meals and entertainment costs are only 50% deductible — and they can't be lavish or extravagant.

Business vs. personal expenses: What's deductible?

Family-owned manufacturers tend to toe a fine line between personal and business expenses — and the IRS knows it. For example, a business owner might try to deduct the cost of an airplane ticket for a spouse to accompany the owner to attend a business convention. But unless there's a bona fide business reason for the spouse's presence, this expense isn't deductible for business tax purposes.

When a bill contains both personal and business expenses, it may seem easier to charge it all to the business. However, such shortcuts could lead the IRS to disallow the *entire* deduction. So, it's critical to maintain clear and detailed records of how you've split the bill to prove you're complying with the tax rules.

Commingling business and personal expenses may extend beyond travel. Owners may be tempted to deduct, say, salary expense for family members who don't render services to the company, personal legal fees or home renovation costs as business expenses. There are also some gray areas, such as home office renovations and family birthday parties that are attended by key customers.

It's important for business owners to understand what qualifies as a business expense and to *always* keep business accounts separate from personal accounts. If not, the business and its owners could wind up in hot water with the IRS.

Alternative methods

The IRS's requirements can turn expense reimbursement into a tedious, time-consuming process. As the employee travels, he or she must collect paper receipts and keep a log of all business meetings.

Then he or she typically submits a monthly expense report for all travel expenses. These reports usually require managerial approval. Administrative delays may occur if documentation is incomplete or a supervisor questions the business purpose (or reasonableness) of an expense item.

The IRS does, however, allow some recordkeeping shortcuts that may be worthwhile. For example, a sales rep who sees the same customers on a regular basis may be able to enter just the customer's name in her day planner or Outlook calendar, rather than repeat all of the details for every visit.

To simplify matters further, some businesses opt to use IRS-approved per diems, instead of reimbursing employees for their actual expenses for lodging, meals and incidentals while traveling.

Incidental costs *don't* include: 1) transportation between places of lodging or business and places where meals are taken, or 2) mailing costs of filing travel vouchers and paying employer-sponsored charge card billings. These costs must be reimbursed for separately from per diems.

Per-diem rates vary, depending on where and when the employee travels. If your company uses per-diem rates, employees don't have to meet the usual recordkeeping rules required by law. Rather, the employer simply pays the specified allowance to employees. However, they still must substantiate the time, place and business purpose of the travel. In addition, individuals who own 10% or more of the business can't be reimbursed using per-diem rates.

Planning and training

Recordkeeping is critical when it comes to deducting travel and entertainment expenses. With proper planning and training, a tax advisor can help your company implement strong travel and entertainment expense reimbursement policies and procedures that will withstand IRS scrutiny. ■

Human vs. robot

Carefully weigh the pros and cons of automation

Manufacturers and distributors face rising costs of labor and benefits, burdensome government regulations and a shortage of skilled workers. In light of these human resource challenges, investing in automated equipment may seem like a smart alternative to relying on people. But automation can sometimes be more expensive and time-consuming than management expects.

Be realistic about the upsides

Have you ever heard a robot complain about long hours or unsafe conditions, ask for a longer lunch break, take a sick day or demand expanded health benefits? Automation can reduce a company's human resource headaches and decrease labor and benefits costs.

Good help can be hard to find. Automated equipment can help manufacturers meet production demands, especially in remote areas with limited sources of trained workers. Automating your plant may be easier and less expensive than, say, training existing workers or luring skilled people from urban areas to work for you.

Other potential upsides include:

Greater efficiency and quality. Robots, if properly programmed and integrated into the surrounding systems, can perform *certain* tasks faster and with fewer errors and less waste than humans. Automated equipment is well suited for large production runs, as well as repetitive, dangerous and labor-intensive tasks. Examples include welding parts, performing pick-and-place tasks and cleaning up chemical spills. But if you run small batches of custom work, it might make sense to stick with humans.

Enhanced brand image. Automated production lines and the use of robots can help differentiate your business from competitors. For example, press releases and social media posts about your investment in automated equipment could boost your brand's image as an innovator and/or a high-quality producer.

Improved morale. Employees are seldom satisfied doing the same mundane tasks, day after day. By automating repetitive tasks, your workers are free to perform high-tech custom work and program robots for the next run. In addition, assigning dangerous or strenuous work to robots can reduce work-related stress, accidents and health issues among employees. Of course, morale benefits will be tempered if automation results in the elimination of several positions or employees fear their jobs are in jeopardy.

Consider a full range of pitfalls

The biggest downside to automation is the initial cost. So, it's critical to crunch the numbers before making the investment.

Rather than purchase equipment outright, most companies finance or lease the equipment to spread the cash outflows over five to ten years. However, financing costs could increase significantly if interest rates increase or lawmakers eliminate the federal tax deduction for interest expense. (Check with your tax advisor for the latest information on tax reform.)

Also consider how much it will cost to train employees to operate, program and repair the equipment, along with incremental insurance, utilities, and repair costs. You may even need to revise your production line to avoid unexpected bottlenecks that may occur as throughput, cycle times and setup times are altered by automation.

Though machines don't complain or call in sick, they do break down and show wear, necessitating a formal maintenance program. If you aren't disciplined enough to follow a maintenance schedule, consider leasing the equipment from a company that will also maintain it.

Additionally, as with any type of technology, it's important to evaluate cyberthreats that automation might bring. Could your robots be hacked or infected with a virus that shuts down your production line?

Plan ahead

The key to successful automation is proper planning. Your financial advisors can help evaluate whether the benefits of transitioning from humans to robots justify the costs. ■

E-Verify helps confirm employment eligibility

Employers are required, under federal law, to verify employment status with Form I-9, "Employment Eligibility Verification." When submitting this form, employees also must produce certain legal documents — such as a driver's license, a Social Security card and/or a visa — to prove they're eligible to work in the United States. But dishonest workers sometimes use fake or stolen IDs to get hired.

The Department of Homeland Security (DHS) created the E-Verify system to help employers comply with the law. This system is currently voluntary for private sector employers in most states. But that could soon change.

How does it work?

E-Verify is a *free* online system that compares information from an employee's Form I-9 to data from DHS and Social Security Administration records to confirm employment eligibility. More than 600,000 employers currently use E-Verify to verify employment status.

The process is generally simple: You enter information from an employee's work authorization documents on a form online. Then, the system generates: 1) a confirmation of the consistency of the data, or 2) a temporary nonconfirmation (TNC).

A TNC requires the employee to call:

- The Social Security Administration to appeal the TNC if the issue is an inconsistency on the Social Security number, and/or

- The U.S. Citizenship and Immigration Services for a "noncitizen immigration document mismatch."

Most TNCs can be cleared up with additional explanation and supporting documents. But if an employee fails to resolve the issue or appeal the TNC within eight days, the system generates a "final nonconfirmation" report. Then you must either terminate the employee or rescind his or her job offer.

Who must use it?

The federal government is required to use E-Verify for all its employees and contractors. But individual states currently can adopt their own rules on using E-Verify.

Without uniform standards, it's difficult for employers with locations in multiple states to maintain compliance. So, the Accountability Through Electronic Verification Act was introduced earlier this year. The bill would require all employers to use E-Verify within one year of enactment. Critics, however, say that the bill would be costly to implement and ineffective in achieving its goals. (Contact your employment law advisor for the latest information on the bill.)

Should you E-Verify?

Under existing law, employers are held liable for hiring illegal workers. Noncompliance can result in audits, fines and even forfeiture of company assets. Whether or not you're required to use it, E-Verify can offer extra peace of mind that you're in compliance. ■

Close-up on forensic accounting investigations

What should you do if you suspect an employee is stealing assets or cooking the books? Here's how business owners can handle fraud suspicions to minimize disruptions, preserve evidence and mitigate losses.

How to investigate fraud

Managing the Business Risk of Fraud: A Practical Guide, a joint publication of the Association of Certified Fraud Examiners (ACFE), the American Institute of Certified Public Accountants and the Institute of Internal Auditors, outlines the approach a qualified expert will take to execute an effective, coordinated fraud investigation. According to the guide, fraud investigations generally follow a basic 10-step process:

1. Categorize issues.
2. Confirm the validity of the allegation.
3. Define the severity of the allegation.
4. Identify types of information that should be kept confidential.
5. Define how the investigation will be documented.
6. Manage and retain documents and information.
7. Escalate the issue or investigation (when appropriate).
8. Refer issues outside the scope of the program (when appropriate).
9. Conduct the investigation and fact-finding.
10. Resolve or close the investigation.

Work with legal counsel and your forensic accounting expert to determine the appropriate process for the particular matter at hand. You'll need to give the expert authority to conduct the investigation and work with internal departments, including human resources, in-house counsel, senior management, IT and internal audit.

How investigations work

A forensic expert typically starts by interviewing third-party witnesses, corroborative witnesses, the alleged perpetrator and any co-conspirators. The expert will also gather relevant evidence from internal documents, such as personnel files, internal phone records, email, financial records, security camera tapes, and physical and IT system access records. External sources of evidence could include public records, customer and vendor information, media reports and private detective reports.

Then, the expert will review and categorize the information collected, conduct computer-assisted data analysis and test various hypotheses. He or she will document and track every step in the investigation. Appropriate documentation covers:

- Privileged or confidential items,
- Requests for documents,
- Electronic data and other information,
- Memoranda of interviews, and
- Analysis of documents, data, interviews and conclusions drawn.

Finally, the expert will deliver a report of his or her findings. Discuss with your attorney the appropriate format for the report and how distribution will be affected by the need to protect legal privileges and avoid defamation.

How to prevent future losses

To minimize its legal liability, a company must take some corrective action in response to an expert's fraud findings. The company may even consider taking action *before* the investigation is complete, when necessary to maintain confidentiality, preserve evidence or mitigate losses. Management could, for example, suspend or reassign an employee or commence legal action to restrain specific assets.

After the expert has completed the investigation, the company can make a criminal referral and may even be required to do so by law. Alternatively, the company might pursue civil litigation, impose disciplinary action, file an insurance claim, extend the investigation, or revise business processes or internal controls.

Why pursue prosecution

More than 40% of fraud victims choose *not* to formally refer perpetrators to law enforcement authorities for prosecution, according to the 2016 *Report to the Nations on Occupational Fraud and Abuse* published by the ACFE. Why? Many victims fear negative publicity. Others felt internal discipline (usually termination of employment) was sufficient, or they settled the case privately.

However, failing to pursue prosecution of white collar crime sends an undesirable message to other employees. That is, if you commit fraud against this employer, management is unlikely to report it to the police. Without fear of prosecution, other employees may feel emboldened to test the waters.

Moreover, when management doesn't refer fraud cases to law enforcement, there's no criminal record created for the perpetrator, allowing him or her to commit similar crimes against future employers. Fraudsters tend to be habitual offenders — and they become craftier and bolder with each new scam.

Need help?

If fraud strikes, a formal investigation can protect your company (and others) from future scams. By understanding how your expert will conduct the investigation, you can ensure you're providing the information and assistance necessary for it to be successful. ■

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800 Red Brook Boulevard
Suite 300
Owings Mills, MD 21117

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800.899.3633
www.hertzbach.com
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