11 Ways Entrepreneurs Overpay and How To Stop It Now!

BY: DIANE GARDNER, EA, CTC

Praise for *Stop Overpaying Your Taxes!*

As an entrepreneur and business coach, I am always seeking effective, efficient strategies to help myself and my clients accelerate profit and income growth. After reading Diane's book *Stop Overpaying Your Taxes!*, it is clear that tax planning is a must for entrepreneurs who are serious about impacting their bottom lines. This book provides clear and specific strategies that small business owners can use right away to start earning more (without spending more or working longer hours). A fantastic read that definitely got the wheels turning.

—Kelly Roach
Business Growth Strategist
www.KellyRoachCoaching.com

As a thirty-year entrepreneur, I love Diane Gardner's new book, *Stop Overpaying Your Taxes! 11 Ways Entrepreneurs Overpay and How to Stop It Now!*

I picked up tips from every single chapter. For example, do you know the five questions the IRS uses to determine if a meal is tax deductible?

Did you know as a sole proprietor you are not required to pay Social Security and Medicare tax on your child working for you until they are eighteen, or that you may avoid paying unemployment tax on your child working for you until they are twenty-one? These two tips, right here, would have saved me a boatload of cash, as my daughter worked for me from the time she was twelve to twenty-two.

This book is an easy read, chock-full of excellent tax-saving tips. Anyone who is self-employed should read it and keep it on their bookshelf as a valuable resource.

—Jean Kuhn
Author, *F-Ups: Franchisee Screw-Ups That Can Cost You Thousands*
www.JeanKuhn.com

Most tax books just tell you how to fill out tax forms. Diane Gardner's *Stop Overpaying Your Taxes!* gives you the savings you REALLY want. It's full of valuable strategies that will pay dividends every day. And if you're an entrepreneur or business owner like I am, it's information you NEED.

—Edward A. Lyon, JD

Author, *How to Beat Obamacare*

Stop Overpaying Your Taxes! shares real stories about real business professionals to give tangible, illustrative examples for each of the eleven ways entrepreneurs overpay their taxes.

Each chapter is devoted to one of the eleven ways. The book is written in plain language that is relatable in ways that other books or conversations with my own CPA haven't been for me. When my CPA mentioned some of these same topics a few years back, I know I had the deer-in-the-headlights look on my face and left her office nothing but confused. Perhaps my business wasn't mature enough. Perhaps the illustration used just didn't click for me. But this book pulled everything together.

Then the wheels in my mind started turning and the conversations with my spouse took place. He, too, has his own business (his an S Corp, mine an LLC), so there are many strategies that we can leverage for our respective businesses. We found ourselves making notes and preparing for some conversations with our CPA. I plan to bring this book along as a conversation starter for saving tax money in my own business as well as my spouse's business.

Entrepreneurs owe it to their businesses to read this book and then have the "talk" with their tax advisor. This book takes the scary out of taxes and makes the planning something to look forward to.

—Ruth Martin
Maplewood Virtual Assistance
www.MaplewoodVA.com

In a world seemingly filled with more hype and “quick-fix” books than ever, Diane’s book, *Stop Overpaying Your Taxes!,* is not only easy to read and understand, but it is clearly written from a genuine place of serving and wanting to help other entrepreneurs and small business owners.

All too often small business owners throw their arms in the air when it comes to understanding their taxes and how to pay their fair share—but not a penny more! Diane is not only one of the most genuine people I’ve met, her book and all of her teachings are down-to-earth and just what is needed today in an ever-growing, complex business world.

I highly recommend reading this book and implementing what she recommends.

—Jim Palmer
Your Dream Business Coach
www.GetJimPalmer.com

Diane Gardner has written a clear and easy-to-understand tax guide for entrepreneurs. It's a must-read if you want to make sure you are taking advantage of all the legal tax deductions.

—Kathy Tagenel
President, Go-Givers International

I was very impressed with this book! I can see that the book as a whole will be valuable year-round.

I felt especially comfortable knowing that Diane goes the extra mile to keep up on all things IRS, and continues taking classes that keep her up-to-date so we know our taxes are being handled by the best in the business.

If something is there to save money for us, she will catch it.

—Kris Storey
Rathdrum, Idaho

Stop Overpaying Your Taxes!

11 Ways Entrepreneurs Overpay
and How to Stop It Now!

by Diane Gardner
EA, ATP, CTC

Biz Success Publishing
www.TaxCoach4You.com

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Foreword

The American Dream—Once You Grow It, This Is How to Keep It

I've spent many years as a practicing CPA honing my skills, working with businesses of all sizes, seeking out the top tax strategies, and coaching others to achieve maximum results. One thing I've noticed is no matter the size of the business, everyone is actively trying to get ahead. Young or old, experienced or just starting out, each person strives for a piece of the American Dream. Somewhere within each of us lies the belief that if we work hard, our wealth will grow and our results will pay off in the end.

Yet it takes more than working hard to grow your wealth. You must also know how to *keep* it. That's why I'm so excited about *Stop Overpaying Your Taxes!*

Diane Gardner, EA, CTC, is one of a select few tax professionals across the United States certified in the expertise of tax planning. In fact, there are fewer than 400 Certified Tax Coaches. Like her CTC peers, Diane has scoured the tax code, and she thoroughly examines her clients' income and business options to rescue every deduction, tax advantage, and credit possible.

In the pages of this book, you'll notice the emphasis on year-round proactive planning to ensure that business owners can utilize every available legal loophole and savings opportunity. You'll be guided through some of the most impactful ways to keep more of what you earn.

Did you know there's a way to do that? You'll understand more when you read the first chapter so you can

learn the improvements a good plan can leave on your bank account.

Not all business advisors are the same! Be sure to thoroughly read Chapter 3, where you'll learn how to convert your tax advisor fees from a *cost of doing business* to an *investment*, complete with increased profits for your business.

Finally, Diane shares concise steps to build your own road map of what you should be doing in the next ninety days to gain control over your taxes and make a huge difference in your bottom line. And, along the way, she shares stories of how she's helped business owners keep as much as hundreds of thousands of dollars each year more!

Some readers of the book's early manuscript found it helpful to skip chapters and focus on the topics most meaningful to their businesses. Others enjoyed reading the book in its entirety because it stimulated their thinking about how they might apply what they'd learned to their own situation.

In any case, I hope each time you reread *Stop Overpaying Your Taxes!* you'll find something new and useful to help you work proactively to minimize your greatest expense and grow your wealth. As Diane and I like to say, "It's not how much you make that really matters, but how much you keep that brings you success."

—Dominique Molina,
CPA CTC
President, American Institute of Certified Tax Planners
San Diego, California

A Note from Diane

Dear Reader,

I've spent many years working with business owners and entrepreneurs as their accountant and trusted advisor. In my early years of being an accountant, I thought I was helping my clients by making sure they had good, solid financial records and accurate tax returns. I didn't yet know about the tax-planning and -saving strategies that I've outlined for you in the following chapters.

Sadly I had been under the impression that income tax was paid on the net profit of a business, and that there wasn't much that could be done about it. Tax-planning classes weren't offered during my college career, nor was the subject even discussed—then or afterward in any of the continuing education classes I invested in each year.

As a young accountant, I often heard people make comments about tax planning being wrong somehow, or even bordering on illegal. I was confused myself as I didn't know about legal tax-saving strategies.

That changed the day I saw an ad for proactive tax planning that guaranteed all strategies were IRS approved and court tested. That really caught my attention, since I had many clients who paid large amounts of income tax each year

I invested in the training program. This specialized training allowed me to become a Certified Tax Coach. Since then I've become part of the Certified Tax Coach community, which consists of about 400 Certified Tax Coaches across the United States.

The accountants who belong to this community are an elite group of accountants, in that *their primary focus is to reduce taxes* for each of their clients. Every month, they invest time in continuing education to learn more about legal tax-saving strategies.

Many of these accountants operate regular accounting practices where they prepare tax returns and offer bookkeeping and other accounting services. Some of them represent various financial services.

Certified Tax Coaches are located in most states. To my knowledge, I am the only Certified Tax Coach in Idaho. I offer tax-planning services to local business owners, plus technology has enabled me to assist business owners across the United States with their tax-planning needs.

When I'm able to work with a business owner and develop a customized plan to save them thousands of dollars in tax each year, I feel a genuine sense of accomplishment. More of a thrill, actually. I get excited helping families have greater means to invest in themselves.

Congratulations on taking the first step toward reducing your tax liability! I hope you enjoy reading about the tax strategies I've outlined on the upcoming pages. The stories are real, but names have been changed to protect people's confidentiality. I know you will benefit from their stories.

Please contact me if you have any questions or would like additional information. I'm always willing to chat for a few minutes with my readers. I look forward to hearing from you.

You can call me at (208) 687-0508 or (800) 841-0212. You can also e-mail me at Diane@TaxCoach4You.com if

that is more convenient. Be sure to check out my Web site www.TaxCoach4You.com for weekly tax tips, blogs, videos, and other great information.

When you contact me, please request your free copy of my survey, “How Much Do You Know about Your Taxes?” Your answers may surprise you!

Now it’s time to buckle up and enjoy the ride! Happy reading!

Yours truly,

Diane Gardner

—Diane Gardner
EA, ATP, CTC

P.S. I would like to take a moment to thank a few people for their part in this book. First of all, I would like to thank my loving husband for his complete and total support throughout this project. Next I would like to say a special “thanks” to my business coaches: Dominique Molina, Ed Lyon, and Jim Palmer for their input and support over the last few years. I can’t forget to say a big “thank you” to Tammy Barley, editor, who has taken my manuscript and made it even better. You make me look good! I would be remiss if I didn’t mention my good friend and fellow author, Jeanne Hardt and all her wonderful support. Last, but not least, I would like to say “thank you” to God for blessing me with skills and talents that I would have never dreamed possible. The glory goes completely to Him!

Chapter 1

Tax Preparation, Tax Projections, or Tax Planning: Who's Really in Charge of Your Checkbook?

Recently I met with a new client. I'll call him Ron. Ron is a self-employed chiropractor. He was looking for an accountant who could help him with his income tax needs. He'd been working with a tax professional over the past couple of years but was struggling with the large amount of tax he seemed to owe each year.

In the course of our discussion, I looked at his last two years' tax returns. I saw the usual stuff—wages for his spouse, interest income, and business income. I also saw that he was itemizing his deductions, which means he was able to write off expenses such as property taxes, mortgage interest, and charitable contributions.

Ron has two children, so I saw some Child Care Credit and Child Tax Credit. All in all, this was a very normal looking tax return. But in my perusal of his tax return, I noticed something quite alarming. (More on that in just a moment.)

I continued to visit with Ron, and he told me he wasn't happy with his tax preparer because he always owed so much money at the end of the year. His business was growing consistently, and his profits were increasing as well. Ron had an in-house employee who handled all of his business bookkeeping needs, including payroll processing

and the preparation of compliance items, such as payroll tax returns and sales tax returns.

After asking a few questions, I discovered that the only contact Ron had with his tax preparer was when he brought his tax information into the tax preparer's office at tax time each year. He was wondering why his tax preparer wasn't doing a better job of saving him money on his tax return.

I found myself thinking of dozens of similar conversations I've had with prospects and new clients. For some reason, the popular belief is that tax preparers have some sort of "magic wand" which they can simply wave over the pile of papers and tax forms, and have these forms miraculously align themselves into proper order and record themselves in the appropriate areas so as to give the taxpayer the best possible tax outcome.

In reality, there isn't much a tax professional can do at tax time with a stack of receipts or other financial documents, except to record them in the correct places of the tax return.

In the tax profession, we call this "looking in the rearview mirror." You are looking at the past (history), and your only choice is to record it correctly.

Now, back to Ron. It seems that Ron's prior tax preparer had offered to meet with him each fall, and had even offered to prepare a tax projection. Ron didn't think this was necessary. Plus he was concerned that he would be billed for some consultation time, and possibly even for additional hours to work up a tax projection.

I knew I had my work cut out to educate Ron. It was going to be a challenge to convince him of the importance of being proactive with his accounting records and tax

information. It was going to be important for me to show him how tax planning can minimize the amount of tax paid each year.

So, I set out to educate Ron on the differences between tax preparation, tax projections, and tax planning.

Ron seemed surprised to learn that the **tax preparation** engagement only includes the actual recording of various financial numbers on the appropriate forms and lines of the tax return. It does not include cleaning up his QuickBooks file, identifying changes and corrections to be made in his QuickBooks, or even searching for missing deductions (though most tax professional do make it a habit to inquire as to common deductions that appear to be missing).

As we continued to work, I noticed that it appeared there were some potentially missing deductions on his prior tax returns.

I questioned him about the lack of auto and truck expenses. Ron explained that over the course of the year, he probably drove his vehicle about 10,000 miles, since he had two offices in neighboring towns. When asked if he kept a mileage log, I received a blank look and a side-to-side shake of the head.

I began to see the seriousness of Ron's tax situation.

After we finished discussing the tax preparation items, I went on to explain how the preparation of a tax projection works and what it's supposed to accomplish.

A **tax projection** is simply the analysis of two or three different tax scenarios.

Oftentimes, tax projections are prepared in the autumn as a means to estimate what the net profit of the business

may be and the subsequent income tax liability that may be owed. The client can then make an informed decision as to the possible purchase of a piece of equipment, additional contributions to a retirement plan, or even additional deductions for things such as year-end bonuses for their staff or year-end charitable contributions. An adjustment may need to be made to the last estimated tax payment or two.

In addition, tax projections can be used to determine other possible scenarios, such as opening a second business location, adding additional product lines or staff, looking at a potentially different niche market, bringing in a business partner, and so on.

There are many valuable uses for tax projections, but mainly they look at particular scenarios and determine what would be the expected outcome if certain factors change.

I could see the light start to go on in Ron's head. He began to grasp the importance of looking at his financial information from a tax standpoint and not just from a management or compliance viewpoint.

He then asked me to prepare a tax projection for his business so he could have a good estimate of how much tax he might owe for the current year. I agreed to assist him and wrapped up our meeting.

Immediately I sat down with his QuickBooks backup and began to print off some financial reports. I delved into the gross income, cost of sales, and overhead expenses for his business over the past three years.

Then I began the process of preparing a tax projection. Since it was already September, I only had to estimate the sales, cost of sales, and overhead expenses for four

months—September to December. This was accomplished by referring to the prior years' financial reports and the information I'd gleaned from our conversation. I could see a pattern to the income and expenses in the last four months of each year.

Next, I prepared a "mock" or pretend tax return. This mock tax return utilized the information from his prior two years' tax returns, his current year estimated business income and expenses, and other information.

Armed with this information, I was able to calculate an estimated amount of tax that would be owed for both the federal tax return and the state tax return.

Estimated tax payments are commonly made by self-employed individuals. Business owners who don't receive payroll from their businesses don't have withholding paid in on their behalf like employees do. Therefore, they may need to pay their estimated tax liability in four payments throughout the year:

1. April 15
2. June 15
3. September 15
4. January 15

Estimated payments may also be required for business owners who have pass-through income from their businesses that is reported on a K-1 form, either from a Partnership or from an S Corporation.

The actual calculation of the payments is too technical for this discussion. For more information about this topic, be sure to contact your tax professional.

I then prepared adjusted estimated tax payments for the September 15 and January 15 payments and packaged up the information.

Do you remember earlier I'd noticed something alarming? The area that was the biggest concern to me was that it appeared Ron was utilizing an incorrect business entity type for his business, and it was costing him about $23,000 in income tax each year.

I knew something had to be done, and quickly!

So I did what any good tax coach would do. I called Ron and explained the need for a second consultation.

I was ready with my tax projections and had completed a tax analysis, which identified several areas in his business where it appeared he was overpaying his income tax.

Ron came into my office, and we spent the next hour going over his numbers. My goal was to make sure he really understood where the numbers were coming from and how much tax liability I had estimated he would owe for the current year.

Then I went on to explain the difference between tax preparation, tax projections (such as the ones I had just prepared), and true **tax planning**.

Business owners have two ways to put cash in their pockets: 1) a financial defense—the ability to spend less money, or 2) a financial offense—the ability to generate more sales and make more money.

For most people, spending less is easier than making more money.

The Government Accountability Office estimates that business owners overpay their taxes by $50 billion each year. This is shocking news! So, if taxes are your biggest

expense, then it makes sense to concentrate your efforts where you spend the most.

Tax planning guarantees results. You can spend all sorts of time, energy, and money on promoting your business, but there are no guaranteed results. Or you can set up a retirement account and immediately see tax savings from this strategy.

These guaranteed results start with planning. You can't expect results if you don't invest in tax planning to begin with. Tax planning is an investment in the future of your business growth. (What would you do with an extra $5,000, $8,000, or even $10,000 each year? What about $30,000 or $50,000 each year? How could this money benefit your business or your family?)

Ron stated that he would like to use his tax savings each year to open a retirement account of some sort and start saving for his retirement, even though he still had quite a few years before retirement would become a reality.

Now that he was more knowledgeable about his finances and his tax situation, he agreed with the need to go to the next step. It was time to prepare a customized tax plan that would minimize his taxes legally—by using IRS-approved, court-tested strategies.

At this point it was time for me to dig in and go to work once again. At our next meeting, I presented Ron's customized tax plan to him. The tax savings identified in the plan were substantial. Ron was momentarily speechless! He then asked me why his prior tax preparer hadn't told him about these tax savings.

I reminded him of the differences of the three different engagements: tax preparation, tax projections, and tax planning.

Find a Certified Tax Coach to assist you with tax planning to help stop any overpayment of taxes on your tax returns. Don't be an over-payer statistic!

Summary

- There isn't much a tax-preparation professional can do with a stack of receipts at tax time except record them in the correct places of the tax return.
- **Tax preparation** records history—various financial numbers are recorded on the appropriate forms.
- A **tax projection** is the analysis of one or more tax scenarios.
- Tax projections are often used to calculate and/or adjust estimated tax payments.
- **Tax planning** is an investment in the future of your business growth.
- A tax analysis is the first step in the tax-planning process.
- Tax planning guarantees results year after year.
- Find a Certified Tax Coach to assist you with your tax-planning needs.

Chapter 2

Choosing the Wrong Business Structure Can Crumble Your Dreams and Cost You Money

I received a phone call from a potential new client. My staff set up an initial consultation so I could visit with Darlene and her husband, Jim, who were getting ready to start up a new business. I really like to meet with new business owners prior to them actually starting their businesses, because it gives me the opportunity to gather information and help them make the best decisions possible, which ultimately affects the future of their business success.

Darlene and Jim were starting a trucking company. They were in the middle of negotiations to purchase a truck, they had already set up all their Department of Transportation (DOT) identification numbers, and they had their insurance all lined up.

It was now time to meet with an accountant to determine what type of entity they should become. They wanted to know which entity type was best for them.

I was thankful they'd made the effort to get their information from a knowledgeable source. Too often people listen to rumors and other misconceptions from less-than-informed sources and ultimately make decisions that aren't based on complete and accurate information.

We spent a little time discussing the ramifications of the five choices for entity types.

1. Sole Proprietorship
2. Partnership
3. S Corporation
4. C Corporation
5. Limited Liability Company

(These terms will be capitalized throughout the book in order to clearly specify each entity type being discussed.)

Each entity type has legal, liability, and financial ramifications, in addition to the advantages and disadvantages of each type.

Business and/or personal liability protection can be provided by certain entity types. There may also be significant tax savings, and costs, depending on the industry type.

Prior to making this very important decision, all factors should be weighed carefully. I told Darlene and Jim to keep in mind the following.

- The wrong entity can cost you thousands of dollars in wasted tax.
- Without careful planning, your business may outgrow your entity type, leaving you with an entity that isn't working on your behalf.

It's very important to plan for the future when choosing your business entity type.

Next I began to describe each of the five entity types to Darlene and Jim.

1. Sole Proprietorship

This is probably the most common type of entity due to the fact that if you don't legally pursue one of the other entity types, you will operate as a sole proprietor.

Business Structure

A Sole Proprietorship is generally you doing business in your own name *or* using a trade name/DBA (doing business as).

It's quite common to see real estate agents, hair stylists, and people who work in the multi-level marketing world utilizing this type of entity and doing business in their own names.

With a Sole Proprietorship, you deposit your business income into a business bank account and pay your expenses from this same account.

One advantage of a Sole Proprietorship is the ease with which it can be formed. It's also the least expensive of the five entity types during the formation process.

A disadvantage of a Sole Proprietorship is the lack of business continuity. If something happens to you, the business is gone. There's no way for it to continue to operate in your absence.

Liability

A Sole Proprietorship doesn't have the benefits of liability protection. Therefore, you are personally liable for any claims against your business. If there is a lawsuit, personal assets may be used as a means to settle the lawsuit.

The only way to reduce your liability exposure is through the purchase of insurance, such as general liability insurance, an umbrella package, or even errors and omissions insurance coverage.

(Insurance is generally an inexpensive way to lessen the risk in any type of business entity, and is highly recommended.)

Taxes

At tax time, you will file a Schedule C—Profit or Loss from Business—which is a schedule that is attached to your personal tax return.

Another disadvantage of a Sole Proprietorship is in the area of taxes.

- **Income tax** is calculated on the net profit of the business. (Gross business income – business expenses = net profit.) If your net profit is $30,000 and you're in the 15% tax bracket, your federal income tax would be $4,500.
- Don't forget about state tax, if you live in a state that has income-tax rates.
- Net profit is also subject to **self-employment tax**, which is currently 15.3%. (Example: Net profit of $30,000 x 15.3% = $4,590 in self-employment tax.) So, if you are a sole proprietor, you would pay $4,500 in income tax plus $4,590 in self-employment tax, for a total of $9,090 in tax.
    - What is self-employment tax? As a sole proprietor, you are acting as both the employer and the employee for purposes of Social Security and Medicare taxes. When you're an employee, you have 7.65% withheld from your gross pay for Social Security and Medicare tax. Your employer matches this amount, which results in a total of 15.3%. This tax is remitted to the IRS on a regular basis and is reported on your W-2 form. The

employer receives a deduction for the 7.65% employer's share of the tax that is paid on your behalf.

- When you operate as a sole proprietor, you pay both parts of the Social Security and Medicare tax—15.3%—and it's reported on your personal tax return.

Audit Warning: The IRS really likes to audit active Sole Proprietorships netting over $100,000 in profit. This category of business is one of the most heavily audited groups.

Best Candidate(s)

The best candidate for operating as a Sole Proprietorship would be a small start-up business with low liability exposure. The reduced costs of start-up and administration make this an attractive type of business entity.

It's quite common for businesses to begin with this entity type and later find they've outgrown their entity. They realize their exposure to liability has increased and they're paying higher taxes. They also see an increase in their audit risk. Generally businesses will move away from this business structure once the business is established and profitable.

Darlene and Jim looked at each other and shook their heads. They'd had no idea about the risk of liability

exposure they could be facing. Truck drivers carry a significant amount of potential liability exposure due to driving many miles each day and coming into contact with other drivers, bad weather, and other unforeseen scenarios.

2. Partnership

This entity type operates as an unincorporated entity in which multiple individuals manage the business. There are General Partnerships and Limited Partnerships.

Business Structure

In a **General Partnership**, partners equally share the work, responsibilities, and control of the business.

In a **Limited Partnership**, there is always at least one general partner and at least one limited partner. General partners equally share the work, responsibilities, and control of the business. The big difference is that the limited partners are not active participants but are chiefly investors.

Liability

Like Sole Proprietorships, Partnerships do not have any liability protection, and all general partners are liable for each partner's actions. Creditors usually go after the strongest partner to satisfy a debt, but they may pursue the partners individually as well.

In **Limited Partnerships**, the general partner(s) are responsible for any liabilities of the entity, but limited partners receive liability protection limited to their investment in the entity.

Taxes

Partnerships file an annual tax return, Form 1065, U.S. Return of Partnership Income. The business doesn't pay

any tax because the income is passed through to the partners via a K-1 form. This form reports each partner's share of the income or loss, basis in the business, and allocation of Partnership debt. The figures from the K-1 form are reported on each partner's personal income tax return.

Each partner's basis consists of the amount of money or other assets contributed to the business plus the partner's share of profits less the partner's draws that have been taken. A partner's basis may also be increased by their share of debt owed by the partnership.

General partners are subject to self-employment tax on their share of the active business income. The net effect is very similar to that of a Sole Proprietorship as far as the amount of tax that is paid.

Limited partners typically are not subject to self-employment tax because they're not active participants in the business.

Darlene and Jim thought for a moment and decided to pass on this entity type as well, due to the unlimited liability exposure they would have and the amount of self-employment tax they could potentially pay.

Corporations (S Corporation and C Corporation)

Business Structure

Corporations are separate legal entities from their owners (shareholders) and must be treated as such.

The Corporation has the ability to continue in operation even if the main shareholder(s) leave the business. This

allows the Corporation to have the ability to exist almost infinitely.

Individuals, Partnerships, Limited Liability Companies (LLCs), trusts, and so on can own shares in a Corporation. Most large businesses that need to attract investors are almost always Corporations.

Corporations require some additional paperwork in the formation process. I highly recommend meeting with an attorney to discuss and implement the appropriate paperwork. There are online corporate document filing services, but I usually see the best success when there has been a face-to-face meeting with an attorney. The owners develop a better understanding of the corporate record-keeping and tax-filing requirements when they've met with an attorney and have had the opportunity to get questions answered.

Liability

Corporations provide limited liability to their owners. If the Corporation is operated correctly, creditors generally can't get beyond the corporate shield to get to the personal assets of the owners. This means the creditors would be limited to only the corporate assets.

An exception to this would be when corporate debt is required to be guaranteed personally. This is common when the Corporation is seeking financing of some sort. The bank or mortgage company may require the owners to guarantee the liability personally. This would allow the financing agency the ability to go after personal assets in the event the Corporation defaults on the loan.

An example of this is the purchase of a large piece of equipment, such as a truck. The financing company may

require the officers to sign the loan documents and, in addition, then require the owners to guarantee the loan personally. If the Corporation defaults on the loan, the financing company may go after the personal assets of the owners to satisfy the obligation.

Taxes

Corporations file a Form 1120 or 1120S, U.S. Corporation Income Tax Return, depending on which type of Corporation is chosen.

Dividends issued to the owners are not deductible at the corporate level but are considered income to the owners. This is what is referred to as *double taxation*.

There are ways to generally get around the dividend issue by utilizing bonuses to the shareholders, increasing salaries, and the like. This allows some control of the net profit amount, and thereby the dividend amount, that may need to be reported.

Current corporate rates range from 15% to 39%. Corporations do not get the benefit of reduced capital gains rates like individuals receive. All gains are considered ordinary income and are taxed at the regular corporate tax rate. Generally, you don't want to hold appreciating assets in a C Corporation since the potential tax rate is significantly higher than individual tax rates.

3. Corporations: S Corporation

Business Structure

S Corporations are limited to one hundred owners (shareholders) and have other important ownership restrictions. The owners must be U.S. persons.

Additionally, you must elect to be treated as an S Corporation, and there are deadlines for this election.

Not all states recognize the S Corporation classification, so be sure to check with a local professional.

Since S Corporation shareholders must be U.S. persons, typically Partnerships, Corporations, other S Corporations, Limited Liability Companies (LLCs), and most trusts are excluded as owners of an S Corporation.

Liability

Owners of S Corporations experience the same limited liability protection as the owners of C Corporations or Limited Liability Companies (LLCs).

Taxes

S Corporations file a Form 1120S U.S. Income Tax Return of an S Corporation. Much like a Partnership, the profits and losses flow through to the shareholders and are reported on a Form K-1 for each shareholder. The owners then report the profits and losses on their individual income tax returns, and the tax is then paid on the individual tax returns.

There is one major difference between a Partnership and an S Corporation when defining basis. In a Partnership, basis may include the debt of the Partnership. This isn’t true for S Corporations. Only the amounts loaned by the shareholders to the entity are included in basis. Loans from third parties, such as banks, are not included.

Shareholder basis affects the deductibility of losses. A shareholder must have sufficient basis to deduct the losses on their individual tax return. If they don’t have sufficient basis, the losses become suspended until such time as basis is restored.

One of the major advantages to an S Corporation is that corporate profits and distributions to the owners are not subject to self-employment taxes. This can result in significant tax savings on the owners' individual income tax returns.

To benefit from this tax savings, the IRS requires the owners to pay themselves a "reasonable" salary, which is subject to payroll taxes. The challenge is to determine what portion of the profits should be paid out as salary subject to the appropriate payroll taxes and what portion can be paid as a distribution, which is not subject to payroll taxes.

Remember our previous example of a business with a net profit of $30,000? Let's change our previous example to be an S Corporation with a net profit of $100,000. A reasonable salary must be paid to the owners, and payroll taxes must be withheld and paid. If that reasonable salary was in the $50,000 range, then there would be significant tax savings. Reasonable salary may vary depending on the industry type, hours worked, skill level of the owners, and so on.

By utilizing the S Corporation entity type, you can potentially save $7,650 ($50,000 x 15.3% = $7,650) in tax simply because the net profit of the Corporation is not subject to self-employment tax. This is a substantial tax savings, and this money can now be used for business growth, to pay down debt, or even to invest in retirement planning, among other things.

4. Corporations: C Corporation

Business Structure

C Corporations often have more than one hundred owners (shareholders). C Corporations are also separate legal entities from their owners.

Liability

Owners, or shareholders, of C Corporations experience the same limited liability protection as the owners, or shareholders, of S Corporations. This is one of the perks that make corporations attractive as an entity type.

Taxes

There is a primary difference between an S Corporation and a C Corporation in the areas of filing and paying taxes.

A C Corporation files its tax return and the tax is paid on that tax return at the corporate level.

Sometimes shareholders take additional money out of the corporation over and above their salaries. This transaction is considered to be a dividend to the shareholders. Each shareholder is required to pay tax on the dividends they receive.

The end result is the double taxation that you hear so much about: the corporation has paid tax on the business profits and the individual shareholders must pay tax on dividends.

Also, some businesses like to deduct fringe benefits, such as health insurance, long-term-care insurance, and medical expenses. C Corporations are generally the best entity for these types of write-offs.

Darlene and Jim weren't sure if this was the best entity type for them or not. I quickly informed them that we still had one final entity type to discuss.

5. Limited Liability Company (LLC)

Business Structure

An LLC is the most flexible entity type of all the entity types.

You have a few choices when deciding to utilize an LLC. A business can be a single-member LLC or a multi-member LLC.

By default, a multi-member LLC is a General Partnership.

LLCs are formed under state law similar to S Corporations and are not available in every state.

They generally require upkeep and maintenance much like a Corporation, which varies from state to state.

Liability

A single-member LLC typically provides less liability protection than a multi-member LLC, as it is considered to be a disregarded entity. The courts generally have recognized a lower level of liability protection than with a multi-member LLC.

Taxes

A single-member LLC will file a Schedule C, Profit or Loss from Business, which is reported on the owner's individual income tax return. It is a disregarded entity, which means it will be treated as a sole proprietor for tax purposes.

A multi-member LLC is required to file a separate tax return, apart from the tax returns of its owners. The default tax return will be a Partnership Tax Return, Form 1065.

The IRS allows a multi-member LLC to elect to be treated as an S Corporation or a C Corporation for income tax purposes. This may provide some tax savings and/or allow for the deduction of various types of fringe benefits.

Therefore, an LLC may be taxed and treated like a Sole Proprietorship (Schedule C), a Partnership (Form 1065), an S Corporation (Form 1120S), or a C Corporation (Form 1120). This often makes an LLC the entity of choice due to this flexibility. (Please check the rules in your state.)

If a business starts out as an LLC, later on it may elect to be taxed as an S Corporation or even a C Corporation. All changes can be done while keeping the same business name, tax identification number, bank accounts, and so on. The only thing that changes is the type of tax forms that are filed.

Darlene and Jim thought for a few minutes. A lot of information had been shared over the course of our consultation. After asking a few final questions, they made the decision to start their business as a multi-member LLC.

I thought their decision was a wise one, since we live in a very “LLC-friendly” state. The formation costs and the annual filing costs are minimal. This entity type will allow them the opportunity for growth as their business evolves over the years.

Choosing an entity type is a complex matter that should not be taken lightly. You should consult a qualified tax professional to make sure your business purpose fits with

the entity type you choose. Making the mistake of a wrong entity type may cost you thousands of dollars in wasted tax. Therefore it's worth the investment in the future of your business to consult a tax professional.

Entity Comparison Guide				
Entity Type	**Limited Liability**	**How Taxed**	**Subject to Self-Employment Tax?**	**Fringe Benefits**
Sole Proprietor	No	Individual	Yes	Limited
Partnership	No	Individual	Yes	No
S Corp	Yes	Individual	On payroll	Limited
C Corp	Yes	Corp & Individual	On payroll	Yes
LLC	Yes	Corp or Individual	Depends on how taxed	May be limited

Summary

- The five entity types are Sole Proprietorship, Partnership, S Corporation, C Corporation, and Limited Liability Company (LLC).
- The wrong entity type can cost you thousands of dollars in wasted tax each year.
- **Sole Proprietorship** is the most common entity type due to the ease of formation.
- There is no liability protection outside of insurance for a business operating as a Sole Proprietorship or as a Partnership.
- Net profit is subject to the self-employment tax rate of 15.3% for Sole Proprietors and Partnerships.

- **Partnerships** allow multiple individuals to own and operate a business.
- Partnership income tax is paid at the partner level and is subject to self-employment tax.
- **Corporations** are separate legal entities from their owners (shareholders).
- Limited liability protection is provided by the corporate entity type.
- There are two types of Corporations: S Corporation and C Corporation.
- Additional paperwork is required during the formation of a Corporation, and additional record keeping is required during the life of the Corporation.
- Income tax for an **S Corporation** is paid at the shareholder level, while income tax for a **C Corporation** is paid at the corporate level.
- **Limited Liability Company (LLC)** offers several choices of entity types and tax filing.
- Choosing an entity type is a complex matter and should not be taken lightly.

Chapter 3

Why Selecting the Right Tax Professional for Your Business Is Like Dating!

While attending a Chamber of Commerce meeting a couple of months ago, I overheard a conversation that I think takes place all too often. Tom and Larry were talking about having used an off-the-shelf piece of software to prepare their tax returns and were discussing the outcomes of their individual and business tax returns.

As I listened in (okay, I was eavesdropping), I could tell they were quite knowledgeable about their businesses and their industries. Their level of business knowledge had led them to believe they could do a good job in the area of taxes as well. After all, they were armed with a well-known piece of tax software and they just knew they could trust the software to make sure the tax returns were prepared correctly. Both of them seemed to be relatively pleased with the outcome of their tax returns.

As their conversation continued, I was thinking about various tax deductions that appeared to be missing, and a few times I wondered about the legality of some of their deductions.

Our tax code is so complicated that it's impossible to be great at income tax preparation unless you make it your profession and spend countless hours studying the IRS code and learning about various tax court cases. (I know this may sound boring, but some of us actually enjoy learning more about the tax code and its effect on our clients.)

Most business owners typically don't know much about income taxes and their effect on cash flow. They think all you have to do is file the tax return and pay the tax that is due. Oftentimes these business owners get their tax advice from everyone but a licensed tax professional!

Both Tom and Larry could benefit from aligning themselves with a good tax professional as part of their team. Not only would their tax returns be more accurate, but a licensed tax professional will often spend time each year preparing a tax projection and even reminding them of estimated tax payment due dates.

Most tax professionals do a good job of recording your history—putting the right numbers on the right forms. They may even make sure you file your forms on time. But then they call it a day. Their job is to record history.

Did you realize (before you read this book) that there is a difference between conventional tax advisors and tax strategists or tax planners? The biggest difference lies in your tax advisor's perspective regarding income taxes. Tax professionals generally do a good job on what you hire them to do—income tax preparation. I contend this is only the tip of the "tax iceberg."

You've undoubtedly seen a photo of a huge chunk of ice floating in the ocean. Did you realize that the photo only shows about 15% of the total piece of ice, only the part sticking out above the water? The remaining 85% is below the surface and not visible. Well, your taxes work in much the same way.

Tax preparation, while an important piece of your tax iceberg, is only a small part of the whole equation. The rest of the equation consists of *determining tax strategies that*

will minimize your income tax liability, and then implementing the various tax strategies that will insure you pay the least amount of tax legally possible.

Tax strategists, or tax planners, take a much different approach than conventional tax professionals. They look not only at your historical records, but also at the present circumstances and future goals and desires of your business.

In short, tax planners focus on the future instead of the past.

Most tax professionals who focus on tax planning have undergone specialized training in the areas of tax law and tax strategies. At the completion of this training, they are awarded the Certified Tax Coach (CTC) designation.

A tax professional with the CTC designation following their name considers your unique circumstances and combines that information with their specialized tax knowledge of legal tax strategies, credits, deductions, and loopholes to identify tax-saving strategies that will work best for you and your business. These tax-saving strategies will result in a greatly reduced tax bill. The annual savings may be as low as two to three thousand dollars and may range to millions of dollars per year, with many of the strategies continuing to save you money year after year.

One more difference between conventional tax advisors and tax planners is the area of fees. Tax preparation fees are typically considered a cost of doing business each year. These fees are related to income tax preparation, which includes the preparation of a tax return and the calculation

and preparation of estimated tax payments. The required documents are then filed timely, and the transaction is complete.

When you engage the services of a tax planner or tax coach, you're making an investment in the future of your business. This investment will pay off year after year and will generate increased profits for your business. Your bottom line will grow larger than the fee itself, which gives you the ability to compute a return on your investment.

As a seminar speaker, tax coach, and best-selling author, I've coached with many business owners to lower tax bills over the years. It's rewarding to not only see them pay less tax each year but also to show them how the IRS will cover my fees and also grow their bottom line!

No doubt you've heard the phrase "work your strengths and hire your weaknesses." This truly is proven, success-oriented advice that we should all be following. I'm not great with technical "stuff," so I've hired an excellent computer technician to keep our computer systems running smoothly.

I've also hired a graphics design firm that helps me with a lot of my marketing. They've redesigned my logo, created banners, tabletop displays, created various parts of my shock-and-awe package, made signs, developed a window display, and created my book covers. It's more cost effective for me to utilize their creativity and graphics skills than it is for me to attempt to play in this arena.

I realize the importance of hiring various professionals to assist me with the skills I'm lacking. This has resulted in a smoother running business and considerably less stress. The price I pay for their professional assistance is cheap

when compared to the wasted hours I could be spending on something I would struggle with and probably never really accomplish.

How to Select the Right Tax Advisor for Your Business

So how do you choose a professional tax advisor to help you with important functions, such as income tax preparation and tax planning? How do you know if you're working with ("dating") the right tax advisor? What should you look for when choosing a tax advisor?

Here are twenty-five questions to consider.

Qualifications

1. What licenses does the tax advisor have?
2. Do they have the CTC designation behind their name?
3. Does the tax advisor have in-depth tax knowledge and several years' experience?
4. Does the tax advisor have training and experience in proactive tax planning?
5. How much continuing education does the tax advisor invest in each year?
6. What is the tax advisor's experience with the IRS?

Success

7. How long has the tax advisor been in business?
8. Is the tax advisor's business growing?
9. Does the tax advisor have a Web site? If so, are there reputable testimonials?
10. Is the tax advisor available year around?
11. Does the tax advisor have sufficient staff to meet your needs today and in the future?
12. Who will be doing the work?

13. Is the tax advisor active in the local community?
14. What type of reputation does the tax advisor have?

Fit

15. Is this tax advisor familiar with your industry?
16. What type of guidance can the tax advisor offer your business?
17. Is the tax advisor conservative or aggressive? (It's best to have someone candid rather than timid advising you.)
18. How frequently does the tax advisor communicate with their clients?
19. How available is the tax advisor for phone calls, meetings, and e-mails?
20. How does the tax advisor bill for their services?
21. Are they philosophically aligned with your ideas and beliefs?
22. What do they love most about what they do?

Clientele

23. Who is the tax advisor's target client?
24. Does the tax advisor have clients who are raving fans?
25. Who are some of the tax advisor's clients?

Good tax professionals are easy to find, but if you're really serious about building a successful business, it's worth the extra effort and money to find a great tax planner/strategist, since this is an important position on your team.

Great tax advisors have a wealth of business knowledge and experience, and ideally they have experience with other businesses in your industry. It's best to find someone who

thinks like an entrepreneur, since they will understand your business better.

They have the ability to think strategically and not emotionally about your business. They continually offer ideas and suggestions of ways to grow your business and reduce your taxes.

They also invest the time and effort to execute a customized tax plan that legitimately allows you to keep more of what you earn and to pay the least amount of tax legally possible.

They are candid and direct in their conversations and communications. You want your trusted advisor to tell you when they think you're heading down the wrong road and why. They should also have similar beliefs that line up with your beliefs.

Your tax advisor is so much more than just a tax professional. He or she is your trusted advisor and knows more than just about anybody when it comes to your finances. They can help you make sound judgments, which are beneficial to both your personal and business finances.

Certified Tax Coach (CTC)

Earlier I mentioned looking for a tax planner who displays the distinguished letters *CTC* behind their name. Well, I'm proud to be a member of this highly specialized group of tax advisors/strategists. When you see this designation, you can trust you are in good hands!

Fees charged by great tax advisors will vary depending on the complexity of your tax-planning needs. There is a great quote from Paul Neal "Red" Adair, the famous oil fire

fighter, “If you think it is expensive to hire a professional to do the job, wait until you hire an amateur.”

Summary

- Our tax code is so complicated that it’s impossible to be great at income tax preparation, unless you make it your profession and spend countless hours studying the IRS code and learning about various tax court cases.
- The biggest difference between conventional tax preparers and tax strategists or tax planners lies in your tax professional’s perspective regarding income taxes.
- **Tax preparation**, while an important piece of your “tax iceberg,” is only a small part of the whole equation.
- Most tax professionals who focus on **tax planning** have undergone specialized training in the areas of tax law and tax strategies.
- When you engage the services of a tax planner or tax coach, you’re making an investment in the future of your business.
- Good tax professionals are easy to find, but if you’re really serious about building a successful business, it’s worth the extra effort and money to find a great tax planner/strategist/advisor/coach, since this is an important position on your team.
- Great tax advisors have experience with other businesses in your industry, and they have the ability to think strategically and not emotionally about your business. They continually offer ideas and suggestions of ways to grow your business and reduce your taxes.

- Your tax planner is so much more than just a tax professional. He or she is your trusted advisor and knows more than just about anybody when it comes to your finances.
- Your tax planner is an extremely important part of your business team.

Chapter 4

Tax Strategies for New Entrepreneurs

I took a phone call last week. The caller had just purchased a small retail business. We quickly set up an appointment to talk about the new business.

I showed up for the appointment and had the pleasure of meeting Dean and his wife, Dena. They seemed like a nice young couple and had a small child. They'd never owned a business before, and they wanted to make sure they knew what kind of records should be kept and what was required by the various government agencies.

One of my first thoughts was, *I'm sure glad they came to see me now instead of later when they could be in trouble for not filing the necessary forms or not filing them correctly*. It's so much easier to teach a new business owner how to do things correctly than to dig them out of trouble later when they've developed some very bad habits.

It's both scary and rewarding to own a business. Most new business owners don't have a plan of any sort, and that can result in disaster down the road. Having a plan is similar to following a recipe when cooking. Without the recipe, you generally don't know what ingredients are needed or how long the dish should cook or bake.

I explained to Dean and Dena that owning a business is one of the last legal "tax shelters." A business that utilizes a solid tax plan will help to legally shelter your income well within the boundaries of the law. You will be able to sleep at night because you know you've done everything possible

to reduce your risk of an audit, and more importantly, eliminate any negative risk in an audit.

We then discussed the two basic strategies in their goal to make more money. The first strategy is to simply earn more.

This concept presents a challenge, since most people are seeking to earn more. Many business owners think this can be accomplished simply by selling more of their services or products. However, there's no guarantee that people will purchase more of what you sell, even if you increase your advertising and marketing campaigns or run a big sale.

The second strategy is to utilize a financial defense. Your financial defense mainly consists of spending less.

For most Americans, taxes are our biggest expense. Therefore, it makes sense to focus your financial defense where you spend the most. Financial defense, primarily in the area of tax planning, guarantees results, as I pointed out in an earlier chapter. You can spend all sorts of time, effort, and money promoting your business, but that won't guarantee results.

Dean seemed to be thinking about these concepts for several moments. Then he then asked the question that had apparently been simmering in his mind. "How do you reduce your tax and keep more of what you earn?"

I asked them, "Do you know who Warren Buffet is?"

Dena asked, "Isn't he the one who pays less tax than his secretary?"

I nodded. "Yes, he's the one." Warren Buffet makes his tax information available to the public so that others can see the importance of owning a business and taking

advantage of every available tax break as a way to increase your wealth. Business owners have the most opportunity to cash and wealth, because they have the most loopholes, deductions, credits, and tax breaks available to them. Being a business owner creates the possibility of earning more and keeping more through tax planning.

The reason the wealthy pay less in tax is not *because* they earn more money but because of *how* they earn it. Many people believe the rich pay less in tax just because they're rich. This simply is not true. They pay less in tax because they educate themselves and they can afford the right team of people to provide them with knowledge.

All business owners can do what the rich do and put a plan in place to keep more of what they earn.

The majority of self-made millionaires are business owners who have utilized tax-planning strategies and who have decided to live below their means and invest their money regularly. They don't spend unnecessary money on cars, homes, fancy dining, exotic vacations, or fancy clothes.

Many small business owners have a roadblock when it comes to the concept of tax planning. They think they can't afford tax planning. They also think the IRS will come after them if they claim too many deductions. Some even think they don't have enough time to keep all the records required by the IRS.

There's no such thing as a business that is too small to take advantage of tax planning. There are lots of tax deductions and tax-saving strategies available to business owners, regardless of the business size. The only trick is using your business as a way to maximize these deductions and strategies.

Some people think you have to make a lot of money in your business in order to utilize tax-planning strategies. This simply is not true. You don't even necessarily need to show a profit to take advantage of deductions, credits, and other tax strategies.

Many business owners have a real fear of the IRS. The IRS isn't any different from your local policeman. Is there any reason to fear a policeman if you aren't breaking the law? The fear comes from those who are doing something illegal, not from law-abiding citizens. The IRS is simply the law enforcement of taxes. So, as long as you aren't doing anything illegal, you don't have anything to fear.

Record Keeping

It's very important to always take the time to keep accurate and complete business records. Lack of time is not a good excuse and won't stand up to the IRS's questioning. It's important to have a good record-keeping system in place. If you aren't comfortable with this part, get some professional help. This isn't an area where you should be cutting corners, since this is vital to the future of your business.

It's quite common for new business owners to show a loss for the first few years while they build their businesses and develop their customer bases. There is a myth out there that says a business must show a profit every so many years in order to be considered to be a legitimate business. That is only a myth; it is not true.

The most important thing is for your business to show a profit motive. You must also act like a business by doing the following.

- keep good records
- utilize a business bank account
- have written goals
- file the appropriate paperwork with your state
- file the appropriate tax returns
- have business cards and brochures
- set up a Web site
- do some marketing and advertising
- show a profit intent

You just need to prove you're actively trying to make a profit.

Now, if your business is still losing money after several years, you may want to ask yourself if this is really a business or if it has become a hobby.

There are distinct rules concerning hobbies and the amount of deductions that are allowed. If the IRS determines your business is a hobby, you will be required to claim all the income but the deductions will be limited. A hobby simply can't report a loss.

Dean and Dena were relieved to find out they didn't have to report a profit within the first three years. They'd been talking to some of their friends and had been quite

confused, and even a bit worried, about this area of business.

Vehicle Mileage Record Keeping

We went on to discuss the ability to write off part of the cost of operating their vehicles. It's very important to document all the miles driven on behalf of your business. Most businesses incur quite a few miles each year, which results in a sizable tax deduction.

A mileage log must contain the following.

- the **date** the miles are driven
- the **number of miles** driven
- the **business purpose** for the trip

Most business owners rely on the **standard mileage method** because it's easier and requires less record keeping. The standard mileage rate lets you deduct 57.5 cents/mile (2015 rate) for every business mile that is driven.

For example, if you drive 10,000 miles in a year, your deduction would be 10,000 x $.575 = $5,750. That's a sizeable deduction on your tax return.

You can also use the **actual expense method** to record this deduction. Each year AAA publishes a survey, "Your Driving Costs," which details the actual costs of operating your vehicle. It's estimated that the average cost to drive a car is now 60.8 cents/mile. This cost is higher than the 57.5 cents/mile the IRS allows as the standard deduction.

The **actual cost method** takes into account what you actually spend for gas, repairs, tires, oil changes, car washes, vehicle licensing, and parking costs. You may also deduct a portion of the interest paid on your car loan and deduct some depreciation for your car.

To be able to take this deduction, you will have to:

- determine the business use percentage of your vehicle.
- keep a mileage log and record *all* miles driven, as well as the business miles—this will help to substantiate the business percentage each year.
- keep your receipts for gas, repairs, tires, oil changes, car washes, vehicle licensing, and parking costs.

I took a moment to remind them that **commuting miles** are generally the miles from your home to your first business stop each day or the place where you conduct business. The last trip of the day, from your office to your home, is also considered commuting costs. These miles are not deductible for tax purposes.

Personal miles are also not deductible for tax purposes.

The only miles that may be deducted are those for legitimate **business purposes**, such as going to the bank or post office, picking up office supplies, picking up merchandise, meeting with a business associate, meeting with your accountant, attending a meeting or conference, and the like.

To determine the business use percentage of your miles, you must divide the business miles by the total miles driven

(total miles include business miles, personal miles, and commute miles). The higher your business use percentage, the greater your deduction will be.

If you have a home office where substantially all your record keeping is performed or you meet customers or clients at this office, then you will increase your business use percentage due to the simple fact you no longer have any commute miles. You simply step out of your home office and begin deducting business miles as long as you drive to a business stop.

I could see the wheels spinning in both of their heads as they thought about the potential for this mileage deduction on their tax return. I gave them a book to keep track of their miles so they wouldn't miss out on this important deduction.

Dena mentioned they had gone to dinner with the previous business owner to talk about the final steps of the transition from the old owner to the new owner. After hearing a bit more about this meeting, it sounded like the miles would be deductible as business miles. I then reminded them that the miles they drove to meet with me were deductible business miles too.

During the meeting with Dean and Dena, we talked about several ways to lower their tax bill as new entrepreneurs, and none of them involved spending additional money that wasn't being spent anyway in the general course of doing business. Each strategy had taken money that would be spent already and simply found a way to legally deduct it through their business.

By now both Dean and Dena were smiling, glad they'd made the effort to meet with a tax planner. They could both see that tax savings would have been missed due to a lack of knowledge on their part, savings they could now take advantage of.

Summary

- Utilize a financial defense to save money in your business.
- Take advantage of tax planning, no matter the size of your business.
- Keep accurate and complete business records.
- It's okay to show a business loss as long as you have a profit motive.
- Keep a mileage log to take advantage of deductible vehicle expenses.

Chapter 5

Discover the Buried Treasure Hidden in Your Business

Recently in one of my coaching sessions, Wayne asked me if I had a list of all available business deductions. This got me thinking. I wasn't aware of any such list. So, I decided I would put together a list for him. (This list doesn't contain every possible tax deduction, but it contains many of them.)

In my discussion with Wayne, I mentioned, as I often do, that owning a business is the last legal tax shelter. Over the last several years, I've seen numerous people start their own businesses, either because they lost their jobs during the recession or because they wanted the freedom that goes along with having businesses of their own.

Many of them have found out the hard way that a lack of proper record keeping and tax planning can result in a very high income tax bill. In some cases they've gotten into trouble with either the IRS or their state taxing authority. They come to me and want to know what to do to get out of the mess they're in.

As I've said, one of the best things a business owner can do is to develop a great record-keeping system. With proper records, you have a much better chance when the auditors come knocking at your door. A lack of documentation will result in a loss of business deductions.

My recommendation is always to start immediately with proper record keeping and tax planning to minimize

taxes from the beginning. This strategy will save literally thousands of dollars over the life of the business. Implementing tax planning allows business owners to legally reduce their tax bill without worry or fear of audit red flags.

Legal Tax Deductions

Let's look at what makes a business expense deductible from the IRS's standpoint. For any expense to be deductible, it must be "ordinary and necessary" in your line of business. **Ordinary expenses** are those expenses generally accepted as part of doing business in your industry. **Necessary expenses** are generally accepted as expenses that are required, and that facilitate smooth operation in your line of business.

Any expense that helps your business can be a deduction if documented correctly. You must have the required receipts, invoices, logs, calendars, and other records to back up your claim in the event of an audit.

We'll start with some of the more common deductions and then move on to industry-specific deductions. (This list does *not* contain all possible deductions; please consult IRS Publication 17 for more information.) Deductible items are arranged according to topic for easy reference, so some items may appear in more than one place.

Common Business Deductions

- Accounting and tax-preparation fees
- Advertising and marketing—includes print, radio, TV, Internet, yellow pages, Facebook, Google ads, etc.
- Automobile expenses—fuel, oil, tires, auto maintenance, auto insurance, and licenses *or* you may utilize the standard mileage method (both methods require a written mileage log)
- Bank charges—charges from your bank, merchant fees, ATM fees, etc.
- Commissions—fees paid to others as a service to your company; for example, agent fees or sales commissions
- Company parties—entire cost may be deducted if all employees are invited
- Continuing education—books, CDs, DVDs, conferences, seminars, Webinars, etc.
- Courier service—used by your business
- Depreciation—expensing of equipment over a period of time, usually ranging from three to seven years
- Disabled access—costs incurred to make your business accessible to people with disabilities (there may be some credits associated with this)
- Dues and subscriptions—Chamber of Commerce dues, union dues, membership fees that help you to grow your business, subscriptions to trade journals or magazines that help you in your business, mastermind group dues, alumni dues, MLS dues, etc.
- Employee benefits—cost of meals provided to employees (can only be deducted if there is a business reason for having them eat at work)

- Equipment and furniture—generally equipment exceeding $500
- Equipment rental—rental of equipment used in your business
- Fees—referral fees, appraisal fees, contingent fees, miscellaneous office fees, lab fees, loan fees, etc.
- Freight or shipping—postage, UPS, FedEx, other delivery mediums
- Gifts—usually less than $25 per recipient
- Home office—business percentage of mortgage interest/rent, property taxes, homeowners or renters insurance, utilities, home repairs, etc.
- Insurance—errors & omissions, liability, workers' compensation, etc.
- Interest—credit card, line of credit, loans, etc.
- Internet—cost of Internet service
- Janitorial—cleaning supplies, janitorial services
- Lease payments—for equipment, vehicles, etc.
- Licenses—industry required licenses, government required licenses (such as business license, etc.)
- Meals and entertainment—generally are 50% deductible (unless they are DOT meals which are then 80% deductible; see Chapter 6 for more information on this topic)
- Miscellaneous—various expenses that do not fit in a particular category; they may be infrequent in nature
- Moving costs—costs incurred to move your business from one location to another location
- Office equipment and furniture—computers, scanners, printers, copiers, desks, file cabinets, wall décor, etc.

- Office supplies—paper, toner or ink, staples, paper clips, forms, small office equipment less than $500
- Outside or contract services—services provided by independent contractors for your business
- Payroll—salaries and wages for you and/or your staff
- Payroll taxes—employer's share of taxes owed to federal, state, or local government agencies
- Permits—permits required in the course of doing business or for particular projects
- Postage—stamps, postage machine postage, other mailing costs, etc.
- Printing—business cards, brochures, letterhead and envelopes, signs, etc.
- Professional fees—bookkeeping, payroll processing, accountant, tax preparation, business coaching, legal, etc.
- Purchases—items purchased for resale
- Refunds—refunds issued to customers/clients/patients
- Rent—building rent, storage rent, post office box rent, other rents paid in the course of doing business
- Repairs—equipment repair, building repairs, etc.
- Retirement plans—employer matching of retirement contributions for SEP, SIMPLE Plans, 401(k)'s, KEOGH, Defined Benefit Plan, etc.
- Safety equipment—safety harness, helmet or hard hat, gloves, steel toe boots, braces, etc.
- Samples—product samples
- Security—security system installation and monitoring
- Small tools or equipment—equipment costing less than $500 used in the course of your business

- Software—software used in the course of doing business
- Supplies—miscellaneous supplies used in your business; for example, paper towels, toilet paper, extension cords, flashlights, buckets, tarps, party supplies, first aid kit, gloves, fire extinguisher, lock boxes, signs, coffee, snacks, greeting cards, etc.
- Taxes—federal or state income tax, local agencies tax, sales tax, etc.
- Telephone—business land line, cell phones (business use percentage), etc.
- Travel—airline/train/bus/taxi charges, parking fees, tolls, lodging, car rental, meals while away from home, dry cleaning or laundry services while away from home, etc.
- Uniforms—usually consists of clothing not worn in the day-to-day "normal" lives of you and your staff; may contain logos and brands, etc.
- Utilities—water, sewer, garbage, electric, natural gas, propane, cable, etc.
- Vehicles—trailers and vehicles used in your trade or business that are licensed to be driven on roads
- Web site—hosting fees, setup fees, monitoring fees, update fees, etc.

When Wayne got to the end of the list he exclaimed, "Wow! I didn't realize there were so many deductions for a business owner to make use of."

I told him there were additional deductions that pertained to specific industries, such as trucking,

entertainment, clergy, construction, day care, sales, medical professionals, realtors, and so on.

He was curious as to some of the specialized deductions that are available to these industries, so I compiled industry-specific lists.

Long-Haul Truck Driver:

- Accounting and tax-preparation fees
- Annual DOT-required physical
- ATM fees
- Bank charges
- Batteries
- Business cards, brochures, etc.
- Car rental and gas
- CB radio
- Cell phone
- Coveralls
- Depreciation
- Dispatching fees
- Dues and subscriptions
- Employee benefits
- Equipment rental
- Fax services
- Fees
- File cabinets
- First aid kit
- Flares
- Food (may deduct actual costs or $59/day per diem)
- Freight or shipping
- Fuel
- Gloves

- GPS/maps
- Heavy vehicle taxes
- Highway taxes
- Home office
- Ice chest/Thermos
- Insurance
- Internet
- Laundry and laundry supplies
- Lease payments
- Legal and professional services
- Licenses and permits
- Load and scale fees
- Loan interest
- Locker fees
- Miscellaneous
- Office equipment and furniture
- Office supplies
- Oil/lube/tires
- Outside or contract services
- Parking and tolls
- Payroll
- Payroll taxes
- Pilot car(s)
- Postage
- PrePass fees
- Printing
- Qualcomm fees
- Safety classes
- Safety equipment
- Salaries and wages
- Security bond

- Shower fees
- Sirius radio
- Supplies
- Tarp repairs
- Tarps
- Taxes
- Taxi
- Telephone
- Tie-downs
- Tire chains
- Toiletry supplies
- Tools
- Trade publications
- Travel
- Truck/trailer purchase
- Truck/trailer repairs
- Truck supplies
- Truck washes
- Union dues
- Web site

Construction:

- Accounting and tax-preparation fees
- Advertising and marketing
- Air compressor
- Auto repairs
- Auto/trailer licenses
- Bank charges
- Bond
- Brooms and other cleaning supplies
- Buckets

- Business cards, brochures, etc.
- Computers and other office equipment
- Conference or seminar fees
- Continuing education
- Coveralls
- Depreciation
- Diesel
- Dues and subscriptions
- Dump fees
- Employee benefits
- Equipment and furniture
- Equipment rental
- Equipment repairs
- Fees
- File cabinets
- Flashlights
- Freight or shipping
- Fuel
- Generator
- Hammers and other small tools
- Hardhats and other safety equipment
- Home office
- Insurance
- Interest
- Internet
- Janitorial
- Job materials
- Ladders
- Lease payments
- Legal fees
- Licenses and permits for jobs

- Licensing fees
- Lodging
- Meals and entertainment
- Meals—away from home
- Miscellaneous
- Office equipment and furniture
- Office supplies
- Outside or contract services
- Payroll
- Payroll taxes
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Propane
- Rain gear
- Refunds
- Rent
- Rope
- Safety classes
- Safety equipment
- Saws and other power tools
- Security
- Small tools
- Software
- Subcontractors
- Supplies
- Taxes
- Telephone
- Tool bags
- Toolboxes

- Trade association dues
- Trade publications
- Trailers
- Travel
- Uniforms
- Utilities
- Vehicles
- Web site

Day Care Provider:

- Accounting and tax-preparation fees
- Advertising and marketing
- Arts and crafts supplies
- Automobile expenses
- Bank charges
- Business cards, brochures, etc.
- Car seats
- Child-proofing devices
- Children's books
- Computer
- Continuing education
- CPR training
- Cribs
- Depreciation
- Dishwasher
- Dues and subscriptions
- Employee benefits
- Equipment and furniture
- Fencing
- Field trips
- File cabinets

- Food and snacks (may use actual costs or standard rate)
- Gifts
- High chairs
- Home office
- Insurance
- Interest
- Internet
- Janitorial
- Legal fees
- Licenses and permits
- Miscellaneous
- Office equipment and furniture
- Office supplies
- Outside or contract services
- Payroll
- Payroll taxes
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Purchases
- Refunds
- Rent
- Repairs
- Software
- Staff training
- Supplies, such as bottles, formula, cleaning supplies, laundry supplies
- Swing set and other yard toys
- Taxes
- Telephone

- Toys
- Trade publications
- Travel
- TV, DVD player
- Uniforms
- Washer, dryer
- Web site

Entertainer or Public Speaker:

- Accounting and tax-preparation fees
- Advertising and marketing
- Audition expenses
- Automobile expenses
- Bank charges
- Booth rental
- Business cards, brochures, etc.
- Cleaning of costumes, suits, etc.
- Commissions paid to agents, publicists, etc.
- Computer
- Conference or seminar fees
- Costumes
- Depreciation
- Dues and subscriptions
- Employee benefits
- Equipment and furniture
- Fan mail service
- Fees
- File cabinets
- Gifts
- Giveaways
- Graphic design

- Hair care
- Home office
- Insurance
- Interest
- Internet
- Janitorial
- Legal fees
- Licenses and permits
- Lodging
- Makeup
- Manicure
- Meals and entertainment
- Meals—away from home
- Miscellaneous
- Music training, arranging, recordings, etc.
- Office equipment and furniture
- Office supplies
- Outside or contract services
- Payroll
- Payroll taxes
- Portfolio expense
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Professional photos
- Props
- Publicist
- Rehearsal hall rentals
- Rent
- Repairs—clothing, equipment, etc.

- Software
- Special shoes
- Supplies
- Taxes
- Telephone
- Thank-you gifts
- Training—music, dance, voice, etc.
- Travel
- Web site

Doctor and Other Medical Professional:

- Accounting and tax-preparation fees
- Advertising and marketing
- Answering service
- Automobile expenses
- Bank charges
- Billing service
- Briefcase
- Business cards, brochures, etc.
- Collection fees
- Conference or seminar fees
- Continuing education
- Depreciation
- Dues and subscriptions
- Employee benefits
- Equipment rental
- Fees
- File cabinets
- Gifts
- Home office
- Insurance—liability, malpractice, etc.

- Interest
- Internet
- Janitorial
- Lab fees
- Lease payments
- Legal fees
- Licenses and permits
- Meals and entertainment
- Medical equipment
- Merchant fees
- Miscellaneous
- Office equipment and furniture
- Office supplies
- Outside or contract services
- Payroll
- Payroll taxes
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Purchases
- Reference materials/books
- Referral fees
- Refunds
- Rent
- Repairs
- Scrubs
- Security
- Software
- Special shoes
- Supplies

- Taxes
- Telephone
- Transcription services
- Travel
- Uniform cleaning and repair
- Uniforms
- Utilities
- Web site
- Workers' compensation insurance

Real Estate Professional:

- Accounting and tax-preparation fees
- Advertising and marketing
- Appraisal fees
- Automobile expenses
- Bank charges
- Business cards, brochures, etc.
- Calculator
- Chairs
- Client gifts
- Commissions
- Computer
- Conference or seminar fees
- Continuing education
- Courier service
- Depreciation
- Desk
- Desk rent
- Dues and subscriptions
- E & O insurance
- Employee benefits

- Fees
- File cabinets
- Gifts
- GPS/maps
- Home office
- Internet
- Janitorial
- Keys
- Legal fees
- Licenses and permits
- Lockboxes
- Meals and entertainment
- Memberships
- Miscellaneous
- Office equipment and furniture
- Office rent
- Office supplies
- Open-house expenses
- Outside or contract services
- Payroll
- Payroll taxes
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Rent
- Repairs
- Signs
- Small tools
- Software
- Subcontractors

- Subscriptions
- Supplies
- Taxes
- Telephone
- Travel
- Uniforms
- Utilities
- Web site

Other Business Professional:

- Accounting and tax-preparation fees
- Advertising and marketing
- Answering service
- Automobile expenses
- Bank charges
- Briefcase
- Business cards, brochures, etc.
- Calculator
- Camera
- Chairs
- Commissions
- Computers
- Conference or seminar fees
- Continuing education
- Customer lists
- Depreciation
- Desk
- Dues and subscriptions
- Employee benefits
- Equipment and furniture
- Equipment rental

- Fees
- File cabinets
- Finance charges
- Freight or shipping
- Gifts
- Home office
- Insurance—liability, workman's compensation, etc.
- Interest
- Internet
- Janitorial
- Lease payments
- Legal fees
- Licenses and permits
- Materials and supplies
- Meals and entertainment
- Memberships
- Merchant fees
- Miscellaneous
- Office equipment and furniture
- Office supplies
- Outside or contract services
- Payroll
- Payroll taxes
- Postage
- Printing
- Professional fees, including business coaching, mastermind group, etc.
- Purchases
- Refunds
- Rent
- Repairs

- Samples
- Security
- Small tools
- Software
- Storage fees
- Subcontractors
- Subscriptions
- Supplies
- Taxes
- Telephone
- Tools
- Travel
- Uniforms
- Utilities
- Web site

Wayne was impressed with the lengthy lists I provided him. He thanked me for the valuable information and decided he'd better take a look at his business expenses to see if he was missing important deductions. He wanted to be sure he would be ready for tax season with accurate financial information.

Summary

- Owning a business is the last legal tax shelter, so it's important to take advantage of every legal deduction that is available.
- One of the best things you can do is to develop a great record-keeping system.
- For any expense to be deductible, it must be "ordinary and necessary" in your line of business.

- Any expense that helps your business can be a deduction if documented correctly.
- Be ready for tax season with accurate financial information for the preparation of your tax returns.

Chapter 6

Eat Hearty! How to Maximize Your Meals and Entertainment Deduction

At last month's mastermind meeting, Ray, one of my mastermind members, came up to me with a question. He wanted to be sure he was taking advantage of the meals and entertainment deduction for his business. He'd heard me talk about this particular deduction at one of our monthly meetings and was concerned that he didn't have adequate records.

Ray is a real estate agent and spends quite a bit of time and money in meeting prospects and clients for coffee or meals. He also throws an annual party where he invites prospects, clients, and people from various title companies as a way to increase his listings. In addition, he belongs to the Lions Club and a couple of the local Chambers of Commerce and attends many of their functions. He wanted to make sure he had covered his bases in the event of an IRS audit.

The concept with the meals and entertainment deduction is to deduct the cost of meals that you host with a bona fide business purpose. Business purpose means costs you incur while dining with prospects, customers/clients/patients, referral sources, and business colleagues.

Just what documentation is required to be kept for a meals and entertainment deduction? Well, the IRS requires five pieces of information for a meal or other entertainment expense to be deductible. Receipts aren't needed for

expenses under $75, but you do need good documentation that includes the following five pieces of information:

1. How much you spent.
2. Where you spent it.
3. When you spent it (date and time of the transaction).
4. The business purpose of the meal.
5. Who was present at the meeting and the business relationship between the taxpayer and the person(s) in attendance.

Fortunately, a receipt answers the first three criteria. Now all that is left is to record the business purpose and who was present at the meeting and their relationship to your business.

Sounds pretty simple, doesn't it? This is where good record keeping comes into play. However, over the years I've seen countless receipts that don't have anything written on them as to the business purpose of the meeting or who attended.

Here's an example of what a documented receipt should look like:

Red Lobster Restaurant
Coeur d'Alene, Idaho
12/1/2014 5:30 p.m.

Met with Mr. & Mrs. Brown,
new clients who were
referred by Mark Potts

Dinner meeting to discuss a potential
listing for their commercial building located
in downtown Coeur d'Alene

Next Ray and I discussed the general rules for deducting business-related meals and entertainment. These types of expenses are deductible if incurred while traveling on business or while entertaining a customer, client, or employee. The deduction is figured either by determining the actual cost of a meal *or* by taking the standard meal allowance. (See the per diem schedule, which is a listing of average meals and incidental costs by city and state throughout the United States.)

Meals and entertainment deductions generally are limited to 50% of the expense incurred (80% if DOT related), as long as they aren't "lavish or extraordinary."

The IRS has determined that 50% of the cost is considered to be the personal part of the deduction and is therefore not deductible. This rule holds true whether you pick up the whole tab or only pay for your part of the meal or entertainment.

You can deduct the cost of food, drinks, taxes, and tips. Charges for coat check and valet parking are also included!

If Ray's business was regulated by DOT, such as airline pilot or crew, interstate truck operators or bus drivers, railroad engineers/conductors/train crews, then he would be able to deduct 80% of his meals instead of the standard 50%. Truck drivers generally can deduct $59/day for meals and incidentals as per diem costs. That deduction is then trimmed to 80% for tax purposes.

What if Ray had a business dinner with his spouse? Would this meal be deductible for tax purposes? In recent court cases, the IRS has taken the stance that business

meals with spouses are not deductible. They're very skeptical when it comes to business activities that have strong personal elements.

This means that if you deduct business meals eaten with your spouse, you should expect a fight with the IRS. You need to protect yourself by having excellent business records to substantiate the business purpose of this expenditure.

You can also deduct expenses incurred for entertainment—such as ball games, other sporting events, movies, or concerts—if they take place before or after substantial, bona fide discussion directly related to the active conduct of your business.

It is advisable to keep additional records, over and above those listed previously. These records could include writing a memo that includes key information such as why you had the meeting with your spouse, what information you gathered from the meeting or hoped to gather, names of referrals obtained, and any business strategies you plan to pursue as a result of the conversation with your spouse.

This memo should then be stapled to the receipt. Be sure to store this information in a safe place where you can retrieve it if needed.

It's very important to protect your receipts, since you must have not only your receipt but also the credit card statement or cancelled check. Unfortunately, many businesses use thermal paper receipts in their cash registers. This means that your receipt will slowly fade away over time and will fade quickly if exposed to direct sunlight.

So how do you protect these valuable receipts? You can copy them onto regular paper or you can scan them. If you

copy or scan them, be sure you have made your notations on the original receipt so it is obvious the notations were made at the time of purchase.

Why do you need both the receipt and your credit card statement or cancelled checks? The receipt shows what was purchased, and the credit card statement or cancelled check shows you paid out the money. It's also a good idea to note business-related meals and entertainment on your calendar as an additional way to substantiate the actual appointment.

Does it make a difference if you pick up the tab or go Dutch treat, where you each pay for your own costs? As long as the activity qualifies as tax-deductible business meals or entertainment, then your costs are deductible regardless of whether you pick up the tab or go Dutch treat.

The important thing to remember is: make sure your activity qualifies as tax-deductible meals or entertainment.

There are instances when the 50% deduction rate does not apply and you are able to deduct 100% of the cost incurred. These instances are:

- meals and entertainment expenses of an employee reimbursed by the employer under an Accountable Plan.
- meals and entertainment expenses reimbursed to a self-employed person who provides adequate records of the expenses to the customer or client. The customer or client is subject to the 50% limitation.
- meals and entertainment provided to the general public for promotional purposes.
- meals and entertainment sold to customers, such as a restaurant providing meals to patrons.

- charitable deductions for meals while traveling for qualified charitable purposes.
- medical expenses for meals as an inpatient.

The following rules apply when deducting meals or entertainment.

- Meals or entertainment incurred for clients or business associates must be both “ordinary” and “necessary.”
- Lavish or extravagant meals and entertainment are not deductible.
- The taxpayer or an employee of the taxpayer must be present when the meals or entertainment are provided to clients and business associates.
- If a group of business acquaintances takes turns picking up each other’s meal or entertainment checks, without regard to whether any business or entertainment are provided to customers or clients, no member of the group can deduct any part of the expense.
- Entertaining customers or clients must be directly related to, or associated with, the active conduct of business, such as discussing business with a client directly before, during, or after the entertainment period, or the reasonable expectation of getting business from a client or customer because of providing the entertainment.
- If business and nonbusiness individuals are entertained at the same event by the taxpayer,

the cost allocable to nonbusiness individuals is not deductible.

- A deduction for the cost of entertainment tickets is limited to the face value of the ticket.
- A deduction for the cost of skyboxes or other private luxury boxes is generally limited to the cost of a non-luxury box seat ticket.

Community Clubs

Self-employed people often get involved with various community clubs. The IRS has taken the stance that amounts paid or incurred for membership in any club organized for business pleasure, recreation, or any other social purpose are not deductible. Examples of these types of clubs include country clubs, golf and athletic clubs, hotel clubs, sporting clubs, airline clubs, and clubs operated to provide meals under circumstances generally considered to be conducive to business discussions.

The good news is there are exceptions to these general rules. Examples of exceptions are boards of trade, business leagues, Chambers of Commerce, civic or public service organizations (such as Lions, Kiwanis, Rotary, and the like), professional organizations (such as bar associations or medical associations), real estate boards, and trade associations. Club dues incurred are generally deductible and are not subject to the nondeductible club rules unless their main purpose is to conduct entertainment activities for members and their guests.

Gift Baskets

Oftentimes members are asked to provide a gift basket as a giveaway at a club meeting or for a community or club event. It's also common for businesses to give gift baskets as gifts, whether during the holiday season or just as a "thank you" to their customers, clients, or patients.

Are these baskets tax deductible? Gift baskets are tax deductible as business gifts/promotion, but have a dollar limitation of only $25. If you have an independent relationship with both the husband and wife, the $25 rule applies separately to each person.

To prove these gift baskets as a deduction, you must record the following facts.

- cost of the gift
- date of the gift
- description of the gift
- business purpose of the gift
- your business relationship with the person to whom you gave the gift

Your business reason for giving the gift may be to foster an ongoing business relationship for future business dealings, or as a means to stimulate referrals, or as a way to thank your top customers or clients, which may move them toward giving you more referrals.

The $25 limit seems to be a very small amount of money in today's economy. This amount is the original limit that was imposed in 1962 and has not been indexed for inflation in all these years. This happens to be one tax law that did not have an automatic inflation adjustment built into the law, which makes this particular law quite unfair. If the $25 amount had been indexed for inflation,

the limit for gifts would be closer to $180 in today's money.

Parties

Earlier I mentioned that Ray holds an annual party for his prospects and clients. Let's look at the specific rules for this type of meals and entertainment.

For Ray to deduct the costs of his annual party, he must be able to prove that his party is directly related to the active conduct of his business, or associated with a directly related discussion that preceded or followed the party.

Ray needs to carefully protect the deductibility of this event. One way he can do this is by not serving cocktails, since the IRS takes the position that the presence of cocktails creates a setting presumed to be social. Also, he may want to hold the party in a location other than his home, as the IRS takes the position that having a party in your home removes the natural business environment of a party in your office or other location.

Therefore Ray should make his party an event that is directly related to the active conduct of his business. He can do this by letting his guests know that the purpose of the party is to build his business. He can display products or information about his business or the properties he has listed. He may want to prepare a display of some of the listings he has.

During the party, he can discuss his various properties or other services he is promoting. This may result in new listings or in referrals. He should have a clear purpose of generating new business rather than promoting goodwill.

If the party is held in Ray's office instead of his home, he automatically meets the business-setting rule.

In addition to thinking about the setting for the party, he must make sure the costs are not lavish or extravagant. He must also meet the "directly related" or "associated" standard for business guests and prospects. This means that his guests must be customers or clients and their spouses or significant others. He needs to be careful about inviting people who are just his friends, since they won't meet this specific criteria and will reduce the deductible amount of the expenditure.

Ray can also invite independent contractors, such as lawn maintenance, plumbers, electricians, handymen, contractors, and so on, along with prospects, clients, and their spouses. There is no difference between the two types of guests as far as the IRS is concerned.

Let's look at the documentation that is required to make this a deductible party. The first thing you need is a guest list. Next, you must have a business discussion directly related to the active conduct of your business. The best way to make this happen is to have a group discussion that will help move your business forward.

It's best to include your active business intention in your invitation. It's also advisable to take pictures of attendees viewing your business presentation. Candid shots are great because they illustrate business action. You may want to make a short speech on how your business can benefit those in attendance. This is a great time to ask for referrals.

If you make your speech from an outline, keep the outline in your file. If you don't use an outline, develop some notes from your speech and file them away.

Summary

- Good record keeping is important to substantiate your expenses.
- Meals and entertainment deductions generally are limited to 50% of the expense incurred (80% if DOT related).
- In recent court cases, the IRS has taken the stance that business meals with spouses are not deductible.
- It's very important to protect your receipts, and you must have not only your receipt but also the credit card statement or cancelled check.
- The receipt shows what was purchased, and the credit card statement or cancelled check shows you paid out the money.
- As long as the activity qualifies as tax-deductible business meals or entertainment, then your costs are deductible regardless of whether you pick up the tab or go Dutch treat.
- Club dues incurred are generally deductible and are not subject to the nondeductible club rules unless their main purpose is to conduct entertainment activities for members and their guests.
- Gift baskets are tax deductible as business gifts/promotion but have a dollar limitation of only $25.
- To deduct the costs of an annual party, you must be able to prove that your party is directly related to the active conduct of your business or associated with a

directly related discussion that preceded or followed the party.

- It’s best to include your active business intention in the invitation for your party.
- Be sure to take pictures throughout the party to substantiate business purpose.

Chapter 7

Planes, Trains, and Automobiles . . . Maximize Your Transportation Deduction!

As I was finishing up tax season, I came across a tax file for Randy, a business coach and public speaker. I'd met Randy at one of my tax-planning seminars.

Eyeing the file, I started thinking about our recent conversation. Randy had been told by his friend that all he had to do was record the odometer reading at the beginning of each year and then do it again at the end of each year. He'd thought this was all he needed to do to be able to deduct his mileage expense on his tax return.

We'd had a lively discussion as to what is required in order to deduct business mileage and other travel expenses. Here is a recap of that conversation.

The IRS separates your miles into three categories: personal miles, commuting miles, and business miles. Commuting and personal miles are not deductible for business purposes. Attaching a sign with your business name on it to your car will not increase your business mileage deduction. You will still be required to account for all your miles in the appropriate categories by using a written mileage log. (You will be able to deduct the cost of the sign for your car as an advertising expense.)

Randy works from his home office, which is a plus when calculating a mileage deduction. Working from home can minimize or even eliminate personal commute miles.

Generally, the miles from your office or primary workplace to a location that has a business purpose are deductible business miles. Examples of this type of miles include meeting a customer or client, attending a meeting, going to the bank or post office for your business, picking up supplies, and attending conferences or other training activities.

The miles from your primary workplace back to your home are considered personal commute miles, and are not deductible. Travel between temporary business stops is deductible. So, if you leave home and make five business stops before returning home, the mileage between your first stop and the last stop is deductible.

The miles from your home to your place of work and back home are considered commute miles, and there is no deduction for these miles. These miles cannot be converted to business miles even by working during the commute. (An example would be returning calls from your cell phone while driving.)

How to Calculate Automotive Mileage and Deductions

To maximize your transportation deduction, first you must calculate your business use percentage (BUP). The IRS gives you four ways to do this.

1. **Brute Force Method:** Record every business mile you drive during the year. Then divide the total business miles by the total miles driven during the year to arrive at your business use percentage (BUP).

2. **90-Day Method:** Record your business miles for a typical 90-day period. Then divide this amount by your total mileage during this period to determine your BUP, and then use this amount for the remainder of the year.
3. **First Week Method:** Record your business miles for the first week of every month. Then divide the business miles by your total miles for that week to determine your BUP, and then use this rate for the remainder of the month.
4. **Simplified Method:** Record your beginning and ending mileage for a 90-day period. Record your personal and commuting miles for that same period. Then assume all the rest of your miles are business miles. Calculate your BUP, and use this rate for the remainder of the year.

Once the BUP has been calculated, you have two ways to calculate your mileage deduction.

1. **Standard Mileage Allowance:** This method utilizes a flat rate per mile for all business miles driven. For 2015, this rate is 57.5 cents/mile. (The IRS adjusts this rate annually, so refer to Pub 463 for the latest rate.) In addition to the flat rate of 57.5 cents/mile, you may also deduct parking, toll costs, BUP interest of your car loan, and BUP of state and local personal property tax on your vehicle. For example, 20,000 miles x $.575 = $11,500 in deduction.
2. **Actual Expenses:** This method also requires a written mileage log to calculate the BUP. It

allows you to deduct your BUP of the following items.

- depreciation
- vehicle loan interest
- lease payments
- insurance
- gas and oil
- car washes
- repairs and maintenance
- tires
- license and registration fees
- personal property tax
- parking and tolls

The Standard Mileage Allowance method eliminates the need to keep track of actual expenses and reduces the amount of recordkeeping that is required. The downside of this method is that most autos cost more than 57.5 cents/mile to operate. Each year AAA researches actual driving costs and publishes a driving cost survey.

According to the 2013 survey, operating costs are as follows.

- small sedan—46.4 cents/mile
- medium sedan—61.0 cents/mile
- large sedan—75.0 cents/mile
- 4WD SUV—77.3 cents/mile
- minivan—65.3 cents/mile

  (These figures assume 15,000 miles/year and $3.49/gallon for gas.)

It’s best to initially calculate both methods to see which one results in the larger deduction. Generally, the Standard Mileage Allowance will result in a larger deduction for

those who drive a lot of miles. This is because this method assumes depreciation in the amount of 14 cents/mile, which can really produce a large deduction. For example, 40,000 business miles/year = $22,400 in deduction.

If you've been taking the Standard Mileage Allowance and you've calculated a higher deduction by utilizing the Actual Expenses method, you can switch methods if you own your car, but not if you lease your car.

Unfortunately, you can't switch from the Actual Expense method to the Standard Mileage Allowance method.

Randy was happy that I had taken the time to explain how to properly record business miles. He didn't want to miss out on this large deduction, since he typically drives approximately 25,000 business miles per year.

Other Travel Deductions

Randy then asked me some questions regarding the other types of traveling he did for his business. During the course of the year, Randy attends several conferences and seminars across the United States. Sometimes these events are for continuing education, and other times he attends as a paid speaker.

These trips become deductible if the "reasonable" standard is met. To meet this standard, the event must benefit your business. This seems like a pretty easy standard to meet.

If the conference is held outside the United States, then the IRS looks at the following factors.

- the purpose of the meeting
- the activities that take place at the meeting
- the purposes and activities of the sponsoring organizations and/or groups
- where the active members of the sponsoring organizations live
- the places at which other meetings of the sponsoring organizations or groups have been or will be held
- other relevant factors that the IRS allows you to present

Before making the decision to attend, it's important to consider whether each out-of-country conference can meet the increased IRS scrutiny.

Ordinary and necessary travel expenses incurred in the course of temporary travel are deductible business expenses. They include:

- airfare
- trains
- buses
- boats
- ferries
- taxis, including tips
- hotel
- valets, including tips
- porters, including tips
- dry cleaning
- parking
- tolls

Be sure to keep all receipts, though the IRS has made it possible to deduct expenses less than $75 without a receipt. The expense must be documented in some fashion.

Self-employed persons may be able to deduct a per diem rate for lodging, meals, and incidentals. The IRS has published per diem rates for all the states and many of the cities within each state. Utilizing per diem rates diminishes the need for receipts.

Cruise Ship Deductions

A question came to mind as I was thinking about Randy's business travel. What if some of his speaking engagements or conferences were on board a cruise ship? Would they still be deductible?

Before answering this question, we need to determine if there are any personal days in the trip or if they are all business days.

The IRS recognizes cruise ships as a bona fide means of tax-deductible business travel, subject to two rules: Luxury Water Limits and the Meal Separation rule. The **Luxury Water Limits** are two times the federal per diem rate for the forty-eight contiguous states. By making sure the cruise ship cost is less than the accumulated daily maximum for the trip, you can deduct the cost of cruise ship travel.

If the cruise ship breaks out the cost of your meals separately (**Meal Separation** rule), you have to account for them just like other business meals. This means they will be reduced by 50%. If the cruise ship doesn't account for them as a separate item, you will be able to deduct 100% of the cruise ship fare, up to the daily limits.

There is one small problem with traveling by cruise ship. The IRS says that deductible cruise ship travel must be on registered U.S. ships. There are only three ocean-worthy ships that fall into this category. They are all operated by Norwegian Cruise Line in Hawaii, under a special exemption from U.S. maritime law.

This means that before you sign up for a cruise ship conference or convention, be sure to check the registry of the ship. If it's not a U.S. registered ship, your costs are not deductible.

If the ship meets the U.S. registry requirement, then it must make all its ports of call in the United States or in U.S. possessions.

You're not home free yet—there is one final rule that must be met: The IRS limits your cruise ship conventions/conferences travel to $2,000 per year.

If you're able to deduct cruise ship travel, you must attach to your tax return a written statement signed by you that includes the following information.

- your total days on the cruise ship
- the hours each day devoted to scheduled business activities
- the program of scheduled activities
- a written statement signed by an officer of the sponsoring organization or group that includes 1) the daily schedule of business activities, and 2) your hours of attendance at the scheduled business activities

Pumped full of the information he needed (and more), Randy left my office.

Summary

- Working from home can minimize or even eliminate personal commute miles.
- Generally, the miles from your office or primary workplace to a location that has a business purpose are deductible business miles.
- Travel between temporary business stops is deductible.
- The IRS separates your miles into three categories: personal miles, commuting miles, and business miles.
- Attaching a sign with your business name on it to your car will not increase your business mileage deduction.
- The IRS gives you four ways to track your miles: Brute Force Method, 90-Day Method, First Week Method, and the Simplified Method.
- There are two ways to calculate your mileage deduction: Actual Expense Method and the Standard Mileage Allowance Method.
- It's best to initially calculate both methods to see which one results in the larger deduction.
- Ordinary and necessary travel expenses incurred in the course of temporary travel are deductible business expenses.
- Self-employed persons may be able to deduct a per diem rate for lodging, meals, and incidentals.

Chapter 8

Understanding the Costs of Healthcare to Your Business

Recently I attended a marketing conference and had the opportunity to visit with a few of the attendees. One such conversation really stood out in my mind.

I was talking with Barb who operates a small business where she provides consulting services to entrepreneurs. I asked her if she normally incurred out-of-pocket medical costs throughout the year.

She answered that she and her family generally incurred between $5,000 and $9,000 per year. This figure included health insurance, out-of-pocket copays, and prescriptions.

My antennae immediately went up, since I could see some potential tax savings for her that were being missed.

Healthcare is a major expense for many people, and its costs continue to rise, even among people who receive little care throughout the year.

The cost of insurance premiums has risen significantly over the past decade. One study from Kaiser shows that premiums have increased by 131% since 1999. In addition to premiums, the cost of treatment is going up as well, and some insurance policies fail to cover all of the treatments required.

With the cost of healthcare increasing faster than the growth of income, many Americans are feeling this expense deep in their wallets.

Fortunately, there are a few ways to reduce some of the financial damage caused by exorbitant healthcare costs. As the government attempts to rein in the rising costs of healthcare through its Affordable Care Act, individual taxpayers can also take advantage of a smart tax strategy to minimize the cost of medical expenses.

I shared with Barb that by understanding tax opportunities for deducting your medical costs, you can find ways to pay for healthcare with pretax dollars, which will help you keep more of your own money in your pocket.

The key to maximizing medical deductions is to find ways to deduct money that you're already spending. By writing off these necessary costs on your taxes, you can shave money off your annual tax bill and free up funds that would otherwise have been sent to the IRS. Utilizing these strategies with other aspects of your proactive tax plan will keep your tax bill as low as possible.

Barb was clearly interested, so I continued to explain how this might work for her.

Every taxpayer is eligible to deduct a portion of his or her healthcare expenses. This itemized deduction can help cover non-reimbursed medical expenses for things like insurance premiums, deductibles, and coinsurance payments. In order to qualify for the deduction, however, your expenses must first exceed 10% of your AGI, (unless you or your spouse are sixty-five or older; then the

percentage is 7.5%), and only expenses over that figure are deductible.

In other words, if you have adjusted gross income of $100,000, you cannot deduct any medical expenses under $10,000. Costs over $10,000 may be deducted.

Obviously, most taxpayers will not pay enough for medical care to claim this deduction every year, but they may qualify in years with medical emergencies or other unusually high costs.

The healthcare deduction can be helpful for many taxpayers, but it's not the only way to save money on your taxes. A small business owner can see substantial tax savings by utilizing a Medical Expense Reimbursement Plan, or MERP.

Even if you don't qualify for a MERP, you may still get a valuable tax break by utilizing a Health Savings Account (HSA).

Medical Expense Reimbursement Plans (MERPs)

Medical Expense Reimbursement Plans are a powerful tool for businesses looking to save money on their taxes while offering medical coverage to their employees. Rather than purchasing a group insurance plan for the company's employees, a MERP allows the employer to reimburse the employees only for the expenses actually incurred throughout the year.

By doing this, employees have the opportunity to choose whatever insurance policy they wish rather than being limited to an employer-provided plan. Best of all, MERPs are 100% tax deductible for the employer, so every cent paid out to employees can be deducted. This creates a

win-win situation for both the employer and the employee, and it's one of the most effective ways to provide high-quality medical care to employees without tremendous overhead.

If you own a business and are providing health insurance to your employees, you should look into a MERP as a more affordable and flexible option. Aside from reimbursing the cost of health insurance premiums, you can also reimburse and deduct many other qualifying medical expenses.

- insurance premiums for major medical, Medicare, and Medigap
- coinsurance, copays, and deductibles
- prescriptions and over-the-counter medications when prescribed by a doctor
- chiropractic, dental, and vision expenses
- fertility treatments
- LASIK surgery
- special schools and therapy

Essentially any doctor-prescribed treatment can be covered by a MERP, including unexpected expenses like hot tubs installed for therapeutic reasons.

Plus, a MERP will cover medical expenses for an employee's spouse and dependents. Because MERPs can cover entire families, they create an additional opportunity for many small business owners.

If you are the owner of a small business, you can cover your own medical expenses by establishing a MERP for yourself or your spouse when one of you is a bona fide employee of the company. This allows you to deduct 100%

of the medical expenses you are already paying out of pocket.

In order to receive benefits under a Medical Expense Reimbursement Plan, an individual must be a bona fide employee of the company. This means that you cannot create a MERP for yourself as a sole proprietor or partner. You can, however, hire your spouse and pay him or her in medical benefits. Because spousal medical expenses are covered by a MERP, your spouse's reimbursements can be used for your own healthcare costs. In effect, this allows you to fully deduct your own medical expenses while staying entirely within the letter of the law.

The way you establish a MERP will vary somewhat, depending on the type of business you own. Some business designations lend themselves more naturally toward this than others. Here are your options.

- If you run the business as a Sole Proprietorship, you can hire your spouse as an employee.
- If you have a Partnership, you can hire your spouse as an employee, as long as that spouse is a limited partner or does not hold an ownership interest in the business.
- In a C Corporation, you can hire yourself as an employee of the company and establish a MERP for yourself that way.
- If you own an S Corporation, however, you cannot establish a MERP for any employee with more than 2% of the business's ownership.

As you can see, an S Corporation is the least tax-advantageous corporate structure for utilizing a MERP.

However, you may still establish a MERP if you open a secondary business with a different designation.

Depending on your business type, you may be able to split your business into two parts and designate the second one under a tax designation that will allow a MERP for yourself or your spouse. For example, if you're a doctor who also publishes papers or speaks at conventions, you might be able to classify these secondary activities as a separate business rather than leaving them as part of your S Corp activities.

This doesn't have to be a daunting process, and you may find other tax benefits from dividing your business activities in this way.

Barb told me she operates her business as a sole proprietor and that she is married. This was looking like a MERP just might work for her situation, but I needed to explain a bit more about how this whole program works.

Although establishing a MERP for your spouse can be a very smart tax decision, it's not something to attempt without the guidance of a tax professional. You will need to be careful to set up the MERP correctly to avoid audits and other potential problems with the IRS.

First, you'll need to carefully document your spouse's work in order to prove that he or she is a bona fide employee of your business. It will not work to designate your spouse as an employee in name only; you need to prove the services your spouse provides are essential to the business and warrant the medical expenses you pay through the MERP.

For example, you might hire your spouse to do your bookkeeping for you, or to act as your assistant by answering phone calls and fielding e-mails. These are legitimate business tasks that can qualify your spouse as an employee. In fact, these are the types of activities that your spouse may already be doing to help with your business without even being officially hired.

To document this work, you'll want to keep track of how many hours of work are completed by the employee and what activities were done during that time. Because it's possible to pay your employee in benefits alone rather than wages, you do not need to establish a payroll or fill out a W-2 for the work. You'll also need to justify why the benefits are fair compensation for the work the employee has done. If your spouse does only a few hours of work for you each year but receives thousands of dollars in medical expense reimbursements, you may run into trouble with the IRS.

Aside from keeping careful records of your spouse's work, you will need to mind a few other rules regarding the maintenance of a MERP. These rules are especially important in businesses with multiple employees.

- Your plan must cover all employees. In other words, you cannot hire your spouse and pay for his or her medical expenses while not paying medical expenses for your other employees. You can, however, exclude part-time employees who work fewer than thirty-five hours per week, employees under the age of twenty-five, and any employee who has worked for you fewer than three years.

- If you own multiple companies, you must provide similar benefits to the employees of both. For example, if you have a business with fifty employees and a secondary business of just your family members, you cannot extend medical benefits to your family without offering the same benefits to the employees of your larger company.
- If your business is affiliated with another business and receives more than 50% of its profit from that business, the two businesses will be treated as one entity as far as MERPs are concerned.

When you set up the Medical Expense Reimbursement Plan, it helps to write out a detailed plan document and summary plan description. This document will explain the type of benefits you will offer and the value of those benefits. You can check with your tax professional for guidance on drafting this document.

As you can see, a MERP is a powerful way to manage the cost of healthcare and provide valuable benefits to your employees. These health plans can get complicated, however, and not every taxpayer will qualify for one.

Health Savings Accounts

I also wanted to make Barb aware of an alternative if the MERP tax strategy didn't work for her. If you don't own your own business or are otherwise unable to take advantage of a MERP, you may wish to look for another way to reduce your healthcare-related tax burden.

A Health Savings Account (HSA) is an excellent tool for setting aside money to cover medical expenses. Anyone can qualify for an HSA, including business owners and employees. You do, however, need to be enrolled in a qualifying high-deductible insurance plan. Once that plan has been established, you simply need to set up a Health Savings Account at the bank of your choice.

The funds you deposit are tax deductible, and the withdrawals from the account are not taxed. This allows you to pay for medical expenses with tax-free dollars, which saves more of your earnings for use on other costs.

An HSA can be used for several purposes.

- copayments, coinsurance, and deductibles
- prescription drugs
- certain necessary over-the-counter drugs
- other qualifying medical expenses

Your contributions to the HSA are capped at $3,350 for an individual policy or $6,650 for a family policy. Taxpayers over age fifty-five can pay an additional $1,000 into the policy each year as a “catch up.” These contributions can roll over to the future years, which allow you to grow your available funds over several years and use them for emergency expenses.

In this way, an HSA is ideal for a healthy worker. After a year or two of consistent tax-deductible contributions, all out-of-pocket deductibles and coinsurance can be paid from the HSA. If you’re not in a position to pay high medical expenses each year, an HSA is a smart way to grow your healthcare savings.

An HSA is not as flexible as a MERP, but it’s a valuable tax-planning tool all the same. In fact, you can

utilize an HSA in conjunction with a MERP for maximum health insurance savings. Here is a practical example.

Say that a family has a taxable income of $100,000 before any medical expenses are deducted. They pay $2,500 annually in insurance premiums for a high-deductible insurance policy. Additionally, they use funds placed in an HSA to cover $6,000 worth of copays, deductibles, and prescription drugs throughout the year.

Because they used the HSA, they can save on regular income tax. Assuming a tax rate of 20%, this amounts to a savings of $1,600 in taxes through using pretax dollars out of the HSA.

If this same couple were to use a MERP, however, they could increase that tax savings by 85%. This is because a MERP reduces FICA as well as regular employment tax. By combining their MERP and HSA, this family can dramatically reduce its tax burden.

Remember that you can also combine an HSA with your standard itemized deductions if your medical expenses for a given year happen to go over the 10% threshold established by the IRS.

For example, if you’re involved in a serious auto accident that results in substantial hospitalization, surgery, or other costly treatments, it’s possible that your healthcare costs can exceed the balance of your HSA before reaching the insurance company’s out-of-pocket maximum. In this case, you can claim a deduction for any medical expense that will not be reimbursed once the expenses total more than 10% of your total AGI.

Barb was surprised at the options for deducting medical expenses. She'd had no idea these tax-saving strategies even existed.

I went on to explain some more information about other types of healthcare deductions. Aside from establishing a MERP, business owners can take advantage of other tax breaks to reduce their total tax burden when they provide health insurance.

Small Business Health Insurance Tax Credit

The Small Business Health Insurance Tax Credit was established to encourage small businesses to provide their employees with insurance in conjunction with the insurance mandate created by the Affordable Care Act. If you choose to purchase a group health insurance policy for your employees rather than a MERP, you can take advantage of this tax credit.

Small businesses with fewer than twenty-five full-time equivalent employees can qualify for a powerful tax credit to offset the cost of providing health insurance. In order to qualify, the average wage for your employees must be below $50,000, and you must pay at least half of the healthcare cost for your employees.

As of 2015, qualifying small businesses can enjoy a 50% tax credit, and nonprofit employers can claim a 35% tax credit.

If you're unable to use the full tax credit in any given year, you can roll it forward to future tax years. You can also amend your previous years' taxes to apply the credit to your returns. This tax credit is frequently overlooked, so it's a good idea to check your previous tax returns to verify

that your tax preparer applied this credit. If not, it might be time to look for a new tax professional.

When considering your insurance options for your employees, look carefully at the difference between setting up a MERP and a group policy. Both options will give you powerful tax incentives, but your employees may have a strong preference for one choice over another.

If you do choose to implement a MERP rather than a group plan, just remember the above-mentioned limitation on discrimination: Whatever benefits you offer to some of your employees must be extended to all of them.

Individual Health Care

Under the Affordable Care Act (ACA), often called "Obamacare," individuals are required to either purchase health insurance or pay a tax penalty. In order to offset the cost of healthcare under this plan, the government offers tax credits. (The lower an individual's income, the higher the tax credit.) These credits begin to phase out at higher incomes, depending on the taxpayer's family size.

Unlike other tax credits, the credits offered by the ACA are not given as refunds at the end of the tax year. Instead, they are offered at the beginning of the year and are applied directly to the insurance policy. In effect, these credits work to reduce the cost of insurance premiums. However, they do not apply toward any out-of-pocket healthcare expenses.

In order to get the best value for your dollar, it makes sense to purchase a high-deductible insurance policy and use any government tax credit you may qualify for with

your income. You can then establish an HSA to cover the remainder of your out-of-pocket healthcare expenses.

If you have a low enough income to qualify for a higher tax credit, you may prefer to purchase a policy with a lower deductible. It's worth investigating your options to make the best choice for you and your family.

Barb was amazed by the options available to business owners. She'd had no idea she could potentially take after-tax dollars that she was already spending and turn them into pretax dollars. She was excited that I shared all this information.

The rising cost of healthcare is something outside of our control. Although the government can attempt to keep costs low through individual mandates and healthcare reforms, there are no guarantees about what will happen to insurance premiums and other medical expenses in the future. A smart tax strategy, however, can help you save your money and provide some security to your family.

The key to proactive tax planning and maximizing medical deductions is to find ways to deduct the expenses you are already paying. There's no point in taking a tax deduction if it requires you to pay more for goods or services, especially if you don't actually need them. By partnering with a Certified Tax Coach (very important for many reasons), you can identify the major expenses in your budget and find a way to write off those expenses on your taxes. A bit of legal, creative accounting can make a huge difference in your tax bill and help put more money in your pocket.

Summary

- Healthcare is a major cost for many people, and its costs continue to rise.
- The key to maximizing medical deductions is to find ways to deduct money you're already spending.
- A Medical Expense Reimbursement Plan (MERP) allows the employer to reimburse the employees for out-of-pocket medical expenses.
- MERPs are 100% deductible by the employer.
- When setting up a MERP, a written, detailed plan document and summary plan description are important.
- A Health Savings Account (HSA) is an excellent tool for setting aside money to cover medical expenses.
- HSA deposits are tax deductible, and the withdrawals are not taxed.
- HSA contributions can be rolled over to future years.
- Small businesses with fewer than twenty-five full-time equivalent employees can qualify for a tax credit to offset the cost of providing health insurance.
- The key to proactive tax planning is to find ways to deduct the expenses you are already paying.

Chapter 9

Real Estate Investments to Boost Your Bottom Line

Monday morning just after nine, the office phone rang. On the other end was my longtime client, Joe. Excitedly he told me, “I just purchased my first investment rental property over the weekend, and I need to see you right away to discuss the tax benefits of my investment.”

“Okay,” I said. “Let’s meet tomorrow morning at ten in my office. I’ll need you to bring a few things: the big package you received when you closed on the purchase of the new property, and in particular the settlement statement that you received from your lender.”

“Great!” Joe said. “See you tomorrow!”

As I hung up the phone, I began to mentally plan our meeting discussion and all the benefits the tax code offers to ownership of investment property.

How to Plant Early Tax-saving Seeds

The next day Joe arrived at my office, eager to discuss his new investment property.

“So, let’s take a look at the settlement statement you brought,” I said.

From the large folder that the mortgage company had given him, he pulled out the lengthy statement and handed it to me.

Skimming through it, I explained, “This document tells us the story about what you’ve just purchased, and it also

contains a wealth of tax-savings-related information that will get you on the right track to all the benefits of your investment property ownership. Ready to review it together?"

At Joe's nod, I continued. "Let's look at the settlement costs or expenses from your Form HUD-1 settlement statement that you were responsible to pay for as the buyer of the property, and how the costs relate to your present and future tax benefits."

From the buyer's column of the HUD-1, we reviewed the numbered rows and columns, and I explained to Joe how each was either a tax benefit to him now, or would be in the future when he sold or disposed of the property.

Table 1

Form HUD-1	Settlement Costs and Expenses	Tax Treatment for Property Buyer
Rows 100 – 600	Real estate taxes city/town/county	Deductible beginning on the date of sale
Rows 100 – 600	Assessments, condo and association fees	Deductible beginning on the date of sale
Rows 700 – 704	Real estate or broker commissions	Amortize over term of the loan
Rows 801 – 802	Loan origination fees or loan discount (points)	Amortize over term of the loan
Rows 803 – 811	Items payable in the connection of the loan, i.e., appraisal, etc.	Amortize over term of the loan
Row 901	Interest	Deductible beginning on the date of sale
Rows 902 – 905	Items required to be paid in advance, such as insurance policies	Deductible beginning on the date of sale
Rows 1000 – 1008	Reserve deposits with lender	Not deductible
Rows 1100 – 1113	Items payable in connection with the title charges	Increase basis and are capitalized

Rows 1200 – 1205	Government recording and transfer charges	Increase basis and are capitalized
Rows 1300 – 1305	Additional settlement charges, i.e., surveys, pest inspections, etc.	Increase basis and are capitalized

I turned the form so Joe could read the numbers I pointed out. “As you can see here, there are quite a few costs and expenses that you’ve paid in connection with your purchase. Some of these we can use now on your present-year tax return, and some will benefit you far into the future when you sell the property.

“I’m sure by now you realize just how important saving this document is, and that it needs to be safely maintained while you own this investment. Sadly, many clients have come to me in the past when they wanted to sell their investment properties, and they haven’t kept their settlement documents from when they purchased their properties. As a result, they lose many of their valuable benefits and ultimately end up paying more in taxes than they needed to.

“Now, are you ready to put your new investment to work for you?”

Joe grinned. “I’m ready!”

So I shared with Joe what I call Property Investment Step 1.

Property Investment Step 1: Setting up the Property for Active and Operational Use

First, Joe and I needed to fill out a Rental Property Setup Worksheet using information from Joe’s settlement statement. In particular, we needed the following.

- property description—for example, “rental condo”
- property location—the address of investment/rental property
- date placed in service—date the property would be available and ready to rent

“This last item is very important, since it will help us in establishing the date to start **depreciating** your new property.”

Joe looked puzzled. He asked, “What is depreciation?”

“According to the United States tax code, depreciation basically provides a way to deduct or reduce the cost of a capital asset—in your case, the investment property you bought—over a specified recovery period expressed in years.

“To depreciate your new investment property correctly, we’ll need to allocate the basis (total costs paid to acquire your investment property)—that is, the cost of the building and the cost of the land, which, by the way, is not depreciable.

“Since we’re on the subject of depreciation, you’ll want to know that, according to the present tax code, the life of your property building is 27.5 years.”

“That’s quite a long time,” Joe said. “I might not even own the property for that many years.”

I said, “Well, in that case, we may want to supercharge your depreciation expenses to get the most benefit right now, by using a technique to separate the ‘real’ property from the ‘personal’ property of your investment. That technique is known as cost segregation.

By using cost segregation, we’re not only following the rules laid out in the tax code, but we’re also reducing the number of years required to depreciate your investment. This

will accelerate your deductions, reduce your current tax liabilities, and increase your present cash flow."

Joe nodded. "Okay, that sounds good to me. When do we start?"

"Well, since the subject of cost segregation can be very complex, we'll have to save the complex details for a later discussion. But for now, let's look on your settlement statement for some of the other expenses and fees you've prepaid that we can use in our worksheet, property taxes paid, prepaid homeowners insurance policies, homeowners association fees, amortization of your loan origination fees, and loan discount points.

"Are you ready to get to the next step?"

"Sure," Joe agreed.

Property Investment Step 2: Your First Year in Operation and Beyond

"For this step, we'll again want to review your settlement statement and Table 1 information for your recurring annual expenses, such as mortgage payments, property taxes, property insurance, and condo and association fees. Joe, do you recall at the beginning of our discussion today, I mentioned the importance of record keeping of all the documents relating to your investment?"

"Yes, I certainly do."

"Well now I'm going to give you a booklet that you can use to record and save all the income and recurring expenses related to your investment. So first let's talk about the income you'll receive as rent or lease payments from your tenants, which you'll report each year as **passive income**."

"Why is it called passive income?"

"It's called passive income since you didn't have to earn it like you would other types of income, such as your wages from employment.

"You'll probably also receive a security deposit payment from your tenants when they first occupy your property, but this payment isn't considered reportable and taxable income to you if it's a refundable payment to your tenants when they complete their lease or rental agreement with you.

"Now, let's talk about the recurring expenses you might have while your property is in service and occupied by your tenants."

Since the categories of expenses can be rather extensive and specific to the type of property, here's a list of typical investment or rental property expenses.

Table 2

	Mortgage Payments		Property Taxes		Insurance
	Management Fees		Utilities		Landscaping
	Wages & Salaries		Advertising		Cleaning & Maintenance
	Commissions		Improvements		Legal & Accounting
	Repairs		Supplies		Depreciation
	Security		Auto & Travel		Pest Control

I said, "Of course, you might not have all of these types of expenses, and you may have others not covered in this list. But we'll determine what to include in this list each year you own the property. The important thing to remember is that you will need to be a good record keeper so that you don't lose any of these valuable deductions."

The tax code gives special attention to **repair** versus **improvement**. In general, the tax code states that **repairs** are expenses we can fully deduct in the year that they occur, whereas an **improvement** may need to be capitalized and deducted (depreciated) over many years, just like a building. We determine these differences each year when we meet to review a property investor's records.

"One final note before we move on to the third and final step in our discussion today. If—after we've included all the income you've derived from the property and deducted all the expenses for the year—if the investment results in a loss, then this loss is subject to the 'passive activities loss rules.'

"The present tax code allows for these losses to offset other **non-passive** income from other sources, such as wages and salaries, within certain limitations. This can be a very valuable and beneficial way to reduce income from other sources, and any tax liabilities you may have from year to year. Of course, as with any tax law, there are exceptions to the **passive activity loss rules** for certain classes of entities and individuals.

"Now, Joe, let's project ourselves for a minute or two into the future, to the day that you want to complete the sale or exchange of your investment property. Are you ready to see what happens then?"

"Ready," he said.

Property Investment Step 3: Final Year in Operation and Tax-saving Benefits of an Investment Sale

"Joe, since you and I have worked together throughout the ownership period of this property, I know that you've kept good records of all the activities with this property. So now it's time to reap your rewards. Let's look at the tax aspects of the property sale.

"We can explore the possibility of a like-kind property exchange and defer any taxes on the sale far into the future, possibly forever. But this subject is just as complex as the subject of cost segregation, so we'll leave that as a topic for a later discussion.

"As you'll recall, we had to originally set up your rental property and establish a basis for depreciation purposes and allocate some of the costs of the purchase to the building and some to the land. Now, as the property seller, you have a final sales price for your property. This is usually located on your seller's settlement statement, just like when you bought the property.

"Next we want to subtract from your sales price the expenses that you incurred to sell your property. When we subtract these selling expenses, we'll then have the **amount realized** from the property sale.

"But before we conclude what taxable gain or loss you may have on the sale, we need to calculate the **adjusted basis** in the property. For that, we'll need to take a look at your original purchase settlement statement for two items. One, the expenses for acquisition—that's the costs we had to capitalize. And two, the list of capital improvements throughout your ownership period.

"Next, we'll account for all those years of depreciation you took and benefitted from as the owner of the property. This will be subtracted from the adjusted basis to arrive at the property's final adjusted basis and the taxable gain or loss on the sale.

"One final note, Joe. If you had any **suspended losses** in the prior years of your ownership due to the passive activity loss limitations, we'll use them to offset any taxable gain that you may have on the sale."

As you can see, it can become quite complex to arrive at that final tax figure on the sale of a property. Employing the help and advice of a tax professional with expert knowledge in real estate transactions can ensure you maximize your ownership benefits, and help you reduce any taxes on the transaction to the lowest levels possible.

When our meeting that day concluded, Joe realized that there was quite a bit more to his property investment than he'd initially thought. With property logbook in hand, he departed the office with a commitment to stay in touch often regarding his new investment.

Summary

- It's very important to always keep a copy of the settlement documents from the purchase of properties.
- Depreciation provides a way to deduct the cost of a capital asset over a specified recovery period expressed in years.
- Employing the help and advice of a tax professional with expert knowledge in real estate transactions can ensure you maximize your ownership benefits, and help

you reduce any taxes on the transaction to the lowest levels possible.

Chapter 10

Hire Your Kids and Lower Your Taxes!

Hiring Your Minor Children

I received an e-mail from Mike who'd watched one of my tax-planning Webinars. He wanted information on one of the tax-planning strategies I'd mentioned during the Webinar. This particular strategy is one where self-employed persons hire their children to work in their businesses.

Why would you want to hire your kids in your business? Most parents pay their children an allowance of some sort to give them some spending money or to help cover some of their extracurricular activities. It's a good idea to pay your children for work they've performed, whether it's around the house or at your place of business.

Paying your children for work they've done teaches them the value of money. It also teaches them how to handle money and gives them an opportunity to contribute to savings accounts. In addition, they feel a sense of pride in what they've accomplished when they've been involved in the process.

I remember when my own daughter was young. She often earned extra money for doing household chores and chores outside, such as cleaning out the barn or the chicken coop. I felt it was important for her to learn the value of money and how to save for things she wanted. I didn't want her to grow up to be someone who always had her hand

out, but rather to grow up to be a responsible citizen with a good work ethic.

Did you know there's a better option than to pay your kids an allowance with after-tax money? If you're able to hire your kids and pay them a reasonable wage from your business, then you're now paying them with pretax money. You will reap the benefits of increased tax deductions and the ability to shift income to a lower tax bracket.

This is also a great strategy to start saving for your child's college education. The wages you pay each of them can be put into a savings account, which can add up to a substantial amount by the time they're ready to attend college. This means that a portion of the money needed for their college education can come from pretax dollars that have been deducted through your business.

Your child can also put the money they earn from your business into a traditional IRA or a ROTH IRA account. If they choose a ROTH IRA account, the money grows tax free. If your child wants to use the money for college, he or she can take the money out of the ROTH IRA account, tax free and penalty free.

If they choose a traditional IRA, you may be able to pay them a higher wage, which, when coupled with an IRA contribution, results in zero tax owed for your child.

Many business owners bring their children to work with them fairly often. My own daughter was at my office after school every day. Many times your children can and do

help with simple tasks around your business, such as shredding, filing, cleaning, deliveries, and more.

Why not make their employment official and hire them to work in your business? This gives you the ability to replace the allowance (paid with after-tax money) with a bona fide paycheck issued to your child (paid with pretax money).

The wages you pay your kids are tax-deductible expenses, since they are actual employees of your business. Therefore, you're saving money by lowering your tax bill. The wages received by your children may not be taxable at all *or* may be taxed at a lower rate than your tax rate.

If the amount of wages you pay them is below the standard deduction— $6,300 for 2015—then there is no tax owed on their wages, and they don't need to file a tax return.

Wages above this amount will be taxed at the 10% rate, which is probably lower than your tax rate. This is a potential $930 tax savings to you if you are taxed at the 15% rate, and $1,550 in tax savings to you if you are taxed at the 25% rate.

You're probably wondering if this is even legal. Fortunately laws regarding child labor are fairly lax when it comes to family businesses. The normal labor laws, such as minimum wage and age requirements, don't apply when a child is employed by his or her parent.

The IRS accepts that children ages seven and older can earn wages. Be sure to check with your state to see if they have any special rules regarding child labor in their parents' businesses. Some states follow IRS guidelines, but others don't, so be sure to find out where your state stands on this issue.

Parents are prohibited from employing their minor children in manufacturing, mining, or in occupations that involve the following activities declared hazardous by the Department of Labor.

- driving a motor vehicle and being an outside helper on a motor vehicle
- storing of explosives
- logging and sawmilling
- working with a power-driven hoisting apparatus
- being exposed to radioactive substances
- meatpacking or meat processing
- manufacturing brick, tile, and related products
- working with power-driven circular saws, band saws, and guillotine shears
- working with power-driven metal-forming, punching, and shearing machines
- working with power-driven paper-product machines, including scrap-paper balers and paper-box compactors
- excavation operations
- roofing operations and all work on or about a roof

- wrecking, demolition, and ship-breaking operations

To be able to deduct your child's wages as a business expense, your child needs to be a bona fide employee of your business. This means he or she needs to be paid for real work and that work must be necessary and ordinary to your business. The job needs to be something that another person could reasonably be paid for.

You must also have them fill out a W-4 form and an I-9 form just like you would any other employee. Each quarter, their wages will be reported to the IRS and to your state, if appropriate. At the end of the year, you will also issue a W-2 form for the wages paid throughout the year.

Each child should also have his or her own bank account or investment account and have money deposited each pay period. You will probably need to set up custodial accounts for each child. This money belongs to your child, not to you or your business.

Most of the time, children work after school or for a few hours on weekends. There are exceptions as children get older and have more hours available to work. As your children grow older, their duties can grow with them. This means you'll be able to hire them for more hours and can pay them higher wages.

Here's a list of jobs your child may be able to do in your business.

- help with mailing projects—affixing labels, stuffing envelopes, stamping envelopes, sorting mail
- filing
- answering phones

- cleaning around your business
- printing reports
- modeling for company advertising and marketing campaigns
- shredding
- waiting on customers
- posting on social media
- updating your Web site
- data entry
- mowing the lawn of a rental property
- cleaning a rental property
- painting a rental property

Be sure to pay your child a fair wage for the work they do for you. As a business owner, you want to pay them as much as possible, but if you go overboard you may garner attention from the IRS or your local state government. It's best to pay them an amount that you would pay someone else with a similar age and skill level to perform the same tasks and duties.

There are Web sites that can help you determine a reasonable rate of pay, or you may want to contact a temp agency to see what other unskilled workers are being paid. This research will help you to audit-proof your tax return when you claim these wages as a business deduction.

Your children aren't the only family members you can hire in your business. If you provide support to other family members, it may be advantageous to see if you can find a place in your business for them to work as well. This could include a parent, grandparent, nephew, niece, or any other family member that you currently support with after-tax dollars.

Earlier I talked about the amount your children can earn before they are taxed on their earnings. For 2015, the standard deduction is $6,300. Earnings above these amounts will be taxed at the 10% tax rate. Some business structures can also avoid paying Social Security, Medicare, and unemployment tax on wages paid to minors.

If you operate your business as a Sole Proprietorship, you are not required to pay Social Security and Medicare tax until your child turns eighteen. You may also avoid paying unemployment tax until he or she turns twenty-one. This same benefit also applies to Partnerships that are wholly owned by a married couple. If your business is structured in any other way, you will still be responsible for paying Social Security and Medicare tax, as well as unemployment taxes on your child's wages.

I'm sure you're wondering if the wages you pay to your children are subject to the **kiddie tax rules**. The kiddie tax rules apply to unearned income received by your minor children in excess of $1,050 (for 2015). Generally, this includes income such as interest and dividends. Fortunately, this tax does not apply to earned income, such as wages.

Hiring Your Adult Children

We've been talking about hiring your minor children, but now I'd like to switch to hiring your grown children. In today's economy it's not uncommon for adult children to move back in with Mom and Dad. Parents often end up supporting these children for extended periods of time.

Hiring your grown children can benefit both of you. You win by having them employed (thus a tax deduction to

your business) and earning part or all of their own support. They win by reducing the amount of after-tax money you must spend for their support. They also benefit by additional work history, which makes it easier for them to find work in the future.

Wages earned by your adult child are taxed at your child's tax rate, which is probably lower than your tax rate. This allows you to reduce your business profit, and it saves income tax on your tax return.

Be sure to have them fill out the appropriate forms, such as a W-4 and an I-9 form, just like you would require for any other employee. Also, be sure they fill out a timesheet so the hours are documented each pay period. It's always a good idea to have a job description, which helps to avoid misconception as to what duties are required of your child. It's important that the tasks match their skill level.

Their wages must be reported on a W-2 form and on appropriate quarterly payroll tax forms throughout the year. Each of your adult children should have their own bank account and deposit their payroll checks each pay period.

It's very important that when you hire your child to work in your business, you have the following five items to protect you in the event of an audit.

1. Proof that the amount paid as wages is reasonable.
2. Proof that you actually paid the money to your child.
3. Proof that the money actually belongs to your child.

4. Actual payroll checks written to your child with the appropriate payroll forms filed.
5. Timesheets that show the hours worked and the tasks performed by your child.

If you're going to hire your child, you must get an employer ID number from the IRS. This can be done online by going to the IRS's Web site, www.IRS.gov. You may also need to apply for an ID number from your state.

Now you're ready to process payroll. I always recommend getting some professional assistance with payroll processing to be sure you're staying in compliance with the payroll rules. An accountant can make sure payroll tax deposits are calculated and deposited correctly. They will also make sure quarterly/annual payroll tax forms are prepared correctly.

You'll need a timesheet that shows the hours worked by your child and the tasks performed. Additional forms, such as a W-4 form and an I-9 form also need to be completed for each child. It's recommended to set up a personnel file, which includes documentation as to the pay rate you're paying your child. Documentation as to how you derived at the hourly pay rate is also advisable for audit purposes.

Be sure to always pay wages by check. This helps to establish a clear audit trail from your business checking account to your child's bank or investment account.

Each quarter you'll be required to file a 941 form, Employer's Quarterly Federal Tax Return, which reports

the amount of federal tax that has been withheld (if any), Social Security, and Medicare taxes.

Payroll quarters run as follows.

1st quarter	January 1 – March 31	reports due by April 30
2nd quarter	April 1 – June 30	reports due by July 31
3rd quarter	July 1 – September 30	reports due by October 31
4th quarter	October 1 – December 31	reports due by December 31

The fourth quarter payroll tax returns include a couple of additional forms, namely the 940 Federal Unemployment form, W-2 forms, and the W-3 form.

Many parents have successfully utilized this tax-saving strategy over the years. It not only decreases your tax bill, but also it offers options to your children, such as saving for college, paying for private school tuition, dance lessons, or even things like football camp with pretax money. It results in a win-win situation for everyone.

Summary

- Paying your children for work they've done teaches them the value of money and how to handle money.
- If you're able to hire your kids and pay them a reasonable wage from your business, then you're now paying them with pretax money. You'll reap the benefits of increased tax deductions and the ability to shift income to a lower tax bracket.

- Your children can put the money they earn from your business into traditional IRA or ROTH IRA accounts.
- Be sure to pay your children fair wages for the jobs they do for you.
- If you operate your business as a Sole Proprietorship, you're not required to pay Social Security and Medicare tax until your child turns eighteen. You may also avoid paying unemployment tax until he or she turns twenty-one.
- Hiring your grown children can benefit both of you: you win by having them employed (thus a tax deduction to your business) and earning part or all of their own support, and they win by reducing the amount of after-tax money you must spend for their support.
- Be sure to have them fill out the appropriate forms, such as a W-4 and an I-9 form, just like you would require for any other employee. Also, be sure they fill out a timesheet so the hours are documented each pay period.
- Their wages must be reported on a W-2 form and on appropriate quarterly payroll tax forms throughout the year.
- If you're going to hire your children, you must get an employer ID number from the IRS.
- Be sure to always pay wages by check. This helps to establish a clear audit trail from your business checking account to your children's bank or investment accounts.

Chapter 11

The Biggest Mistake of All: Failing to Plan!

"There is nothing wrong with a strategy to avoid the payment of taxes. The Internal Revenue Code doesn't prevent that."
—William H. Rehnquist

The first mistake is the biggest mistake of all. It's failing to plan.

It doesn't matter how good you and your tax preparer are with a stack of receipts on April 15. If you didn't know you could write off your child's braces as a business expense, there's nothing we can do.

Remember the last time you drove a car? If you're like most people, you probably sat down in the driver's seat, strapped on your seat belt, turned the ignition, put the car in reverse, then backed up, steering by what you could see out the rearview mirror.

Wait a minute—you mean, that's not how you do it?

Well, that's how most **tax preparers** work. As I shared with you earlier in the book, they spend a lot of time looking back at what you did last year. But they don't spend much time looking forward. They can tell you all about what you did yesterday, but they don't tell you what you should do today, or when you should do it, or how you should do it.

Tax planning, on the other hand, gives business owners two powerful benefits you can't get anywhere else.

Benefit one, it's the key to your financial defense. As a business owner, you have two ways to put cash in your

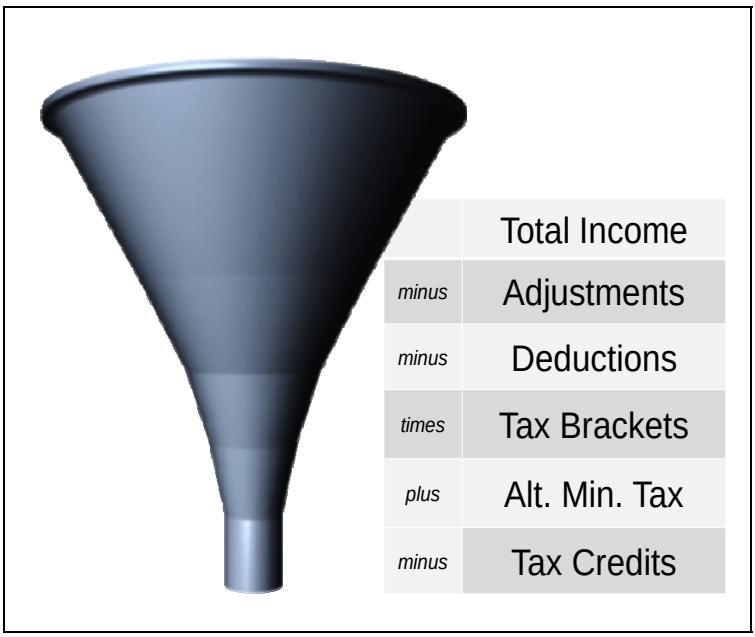
pocket. There's **financial offense**, which means making more. And there's **financial defense**, which means spending less. For most business owners, spending less is easier than making more.

And for most business owners, taxes are your biggest expense. So it makes sense to focus your financial defense where you spend the most.

And benefit two, tax planning guarantees results. You can spend all sorts of time, effort, and money promoting your business, but that still won't guarantee results. *Or* you can set up a Medical Expense Reimbursement Plan, deduct the cost of your teenage daughter's braces, and guarantee savings.

But those guaranteed results start with *planning*. You can't ever deduct money you spend on a Medical Expense Reimbursement Plan if you don't set it up in the first place.

Now that we've reviewed why planning is so important, let's take a quick look at how the tax system works. This will lay a foundation for understanding the specific strategies we'll talk about shortly.



The process starts with **income**. And this includes pretty much everything you'd think the IRS is interested in.

- earned income from wages, salaries, bonuses, and commissions
- profits and losses from your own business
- interest and dividends from bank accounts, stocks, bonds, and mutual funds
- capital gains from sales of property
- income from pensions, IRAs, and annuities
- alimony received
- gambling winnings

Yes, even illegal income is taxable. The IRS doesn't care how you make it. They just want their share!

The good news, if you're operating one of most illegal businesses, is that you can deduct the same expenses as if

you were running a legitimate business. For example, if you're a bookie, you can deduct the cost of the cell phone you use to take bets. The only exceptions include expenses "contrary to public policy" and most businesses involving illegal drugs.

Once you've added up total income, it's time to start subtracting **adjustments to income**. These are a group of special deductions, listed on the first page of Form 1040, that you can take whether you itemize deductions or not.

- IRA contributions
- moving expenses
- half of self-employment tax
- self-employed health insurance
- IRA and self-employed retirement plan contributions
- alimony payments
- student loan interest up to $2,500

Total income minus adjustments to income equals **adjusted gross income** (AGI). Adjustments to income are also called "above the line" deductions, because you take them "above" the line that separates total income from AGI.

Once you've determined your adjusted gross income, you can take a **standard deduction**, which varies according to your filing status. Or you can **itemize deductions**. Obviously, it will pay to take whichever choice gives you greater deductions.

Standard or Itemized Deductions?	
Standard	**Itemize**
• Single $ 6,300 • HOH $ 9,250 • Married/Joint $12,600 • Married/Separate $ 6,300	• Medical/dental • State/local taxes • Foreign taxes • Interest • Casualty/theft losses • Charitable gifts • Miscellaneous
Take *higher* of the two amounts	

Specific itemized deductions include the following.

- medical expenses, to the extent they top 10% of your AGI (7.5% if you're above age sixty-five)
- state and local taxes paid
- foreign taxes paid
- mortgage and investment interest
- casualty and theft losses, to the extent they exceed 10% of your AGI
- charitable gifts
- miscellaneous itemized deductions, to the extent they exceed 2% your AGI

If your total itemized deductions don't add up to more than the standard deduction, just take the standard. For 2015, standard deductions are $6,300 for single taxpayers, $9,250 for heads of households, $12,600 for joint filers, and $6,300 each for married couples filing separately.

Those amounts are high enough that only about a third of taxpayers itemize.

For most of us, itemizing doesn't pay until we buy a home and start substituting deductible mortgage interest and property taxes for nondeductible rent.

Here are the average itemized deductions for the five most common categories, along with the percentage of taxpayers in each group who actually take those deductions.

Itemized Deductions (2011)					
AGI	Medical	Income Taxes	Property Taxes	Mortgage	Charity
$0 – 20,000	$8,494 (4%)	$770 (5%)	$2,991 (5%)	$7,569 (3%)	$1,634 (4%)
$20,001 – 50,000	$7,247 (8%)	$1,500 (20%)	$2,815 (17%)	$7,314 (15%)	$2,281 (15%)
$50,001 – 100,000	$7,352 (12%)	$3,208 (53%)	$3,319 (48%)	$8,645 (44%)	$2,877 (45%)
$100,001 – 200,000	$10,526 (8%)	$6,304 (82%)	$4,713 (78%)	$11,370 (71%)	$3,886 (75%)
$200,001 – 250,000	$18,884 (4%)	$11,526 (93%)	$6,901 (88%)	$15,144 (78%)	$5,726 (87%)
$250,001 – 500,000	$30,133 (2%)	$18,168 (95%)	$9,020 (90%)	$18,790 (77%)	$8,917 (89%)
$500,001 – 1 million	$65,714 (1%)	$40,502 (96%)	$13,870 (91%)	$23,568 (72%)	$18,152 (92%)
$1 million+	$126,198 (<1%)	$203,853 (97%)	$26,329 (92%)	$27,373 (62%)	$134,390 (94%)

Tax deductions reduce your taxable income. If you're in the 15% bracket, an extra dollar of deductions cuts your tax by 15 cents. If you're in the 35% bracket, that same extra dollar of deductions cuts your tax by 35 cents.

You can also deduct a personal exemption of $4,000 for yourself, your spouse, and any dependents.

But, your deductions and personal exemptions start phasing out once your income hits certain levels. For 2015, those levels are $258,250 for singles, and $309,900 for joint filers. The “Pease limit,” named for Ohio Congressman Bob Pease, costs you 3 cents of itemized deduction for every dollar of income above those amounts. (Bob can’t be too happy with that legacy.) And the Personal Exemption Phaseout, or “PEP limit,” costs you $50 of personal exemption for every $2,500 of income above those amounts.

Once you’ve subtracted deductions and personal exemptions, you’ll have your **taxable income**. At that point, you’ll consult the table of tax brackets to see how much to pay.

Tax Brackets (2015)		
Rate	**Single**	**Joint**
10%	0	0
15%	9,225	18,450
25%	37,451	74,901
28%	90,751	151,201
33%	189,301	230,451
35%	411,501	411,501
39.6%	413,201	464,850

If you’re self-employed, and your business is taxed as a Sole Proprietorship or Partnership, you’ll also owe self-

employment tax on your business income. Self-employment tax replaces the Social Security and Medicare you and your employer would pay if you were a regular employee.

Some types of income aren't taxed at the regular rate. For example, tax on "qualified corporate dividends" and most long-term capital gains is capped at 20%. Tax on "unrecaptured Section 1250 gain" (mainly from sales of real estate used in your business) is capped at 25%. And tax on "collectibles" (art, jewelry, and the like) is capped at 28%.

There's also a new 3.8% "unearned income Medicare contribution" on investment income for single taxpayers earning more than $200,000 and joint filers earning more than $250,000. (Doesn't "unearned income Medicare contribution" sound better than "tax"?) For purposes of this new rule, "investment income" includes interest, dividends, capital gains, rental income, royalties, and annuity distributions. You might be in the 35% bracket for regular income, but pay 23.8% on capital gains, even though there's no such thing as a "23.8% bracket," per se.

The bottom line is that tax brackets and tax rates aren't as simple as they might appear. Your actual tax rate on any particular dollar of income can be quite a bit higher or lower than your supposed tax bracket.

Still with me?

Now, here's where it gets really complicated. That's because, after you go through all those steps to calculate your regular tax, you get to start all over again and see if you owe **alternative minimum tax**.

Alternative minimum tax (AMT) is a parallel tax system designed to prevent "the rich" from using regular deductions to avoid tax entirely. In 2009, it hit 4.5 million taxpayers nationwide, primarily in states with high income and property taxes. (This included former IRS Commissioner Mark Everson, who announced in 2004 that he had been hit for the first time.) But the tax wasn't permanently indexed for inflation until the 2013 "fiscal cliff" legislation, and it's become a de facto flat tax for upper-middle-income taxpayers.

The AMT system starts with regular taxable income, then adds back specific **preference items**. These include the following.

- medical expenses between 7.5% and 10% of AGI (for those over sixty-five who would use the lower threshold)
- state and local taxes deductible on Schedule A
- home equity interest *not* used to buy, build, or improve your primary residence
- miscellaneous itemized deductions (entirely)
- investment interest (figured according to special rules)
- part of post-1986 accelerated depreciation
- gains from incentive stock options
- interest from most private-activity municipal bonds

Once you've determined your AMT income (AMTI), you'll subtract an exemption of $83,400 (joint filers), $53,600 (single filers), or $41,700 (separate filers). These exemptions phase out by 25 cents for every dollar of AMTI above $156,500 (joint filers), $117,300 (single filers), or

$78,250 (separate filers). Finally, the tax itself is 26% of AMTI up to $182,500, plus 28% of AMTI above $182,500 (2014).

Okay now, which is higher—your regular tax, or your AMT? Pay that one.

Finally, you'll subtract any available tax credits. These are dollar-for-dollar tax reductions, regardless of your tax bracket. So if you're in the 15% bracket, a dollar's worth of tax credit cuts your tax by a full dollar. If you're in the 35% bracket, an extra dollar's worth of tax credit cuts your tax by the same dollar.

Here are some of the more popular tax credits.

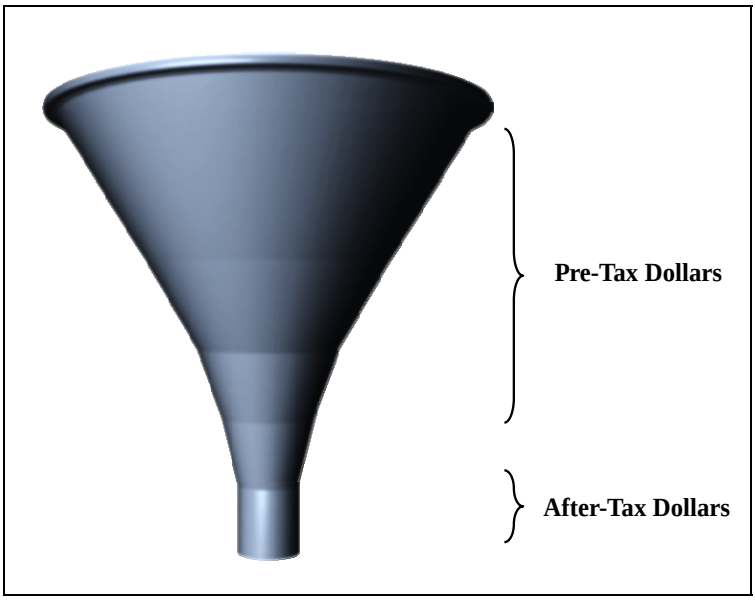
- Child Tax Credit (families with children under seventeen)
- Earned-Income Tax Credit (low-income working families)
- American Opportunity Tax Credit
- Lifetime Learning Tax Credits
- Foreign Tax Credit (That's right, if you pay foreign taxes—or, more likely, if a mutual fund you own pays foreign taxes—you can take a deduction or a credit, whichever saves more. Generally, it's the credit.)
- Business tax credits (from pass-through entities, including Partnerships and S Corporations)

Done! That wasn't so hard, was it?

Ultimately, there are two kinds of dollars in this world: pretax dollars and after-tax dollars.

Pretax dollars are great, because you don't pay any tax on them. Earn a dollar, spend a whole dollar!

And after-tax dollars aren't *bad*. If you go to the grocery store to buy dinner for your family, the checkout clerk won't turn up her nose and say, "Sorry, we can't accept these *after-tax* dollars." But they're not as good as pretax dollars, simply because you don't get to spend the tax you pay on them.



So, here's the bottom line. You lose every time you spend after-tax dollars that could have been pretax dollars.

Summary

- Total income minus adjustments to income equals adjusted gross income (AGI). Adjustments to income are also called "above the line" deductions, because you take them "above" the line that separates total income from AGI.

- Tax deductions reduce your taxable income. If you're in the 15% bracket, an extra dollar of deductions cuts your tax by 15 cents. If you're in the 35% bracket, that same extra dollar of deductions cuts your tax by 35 cents.
- In short, tax brackets and tax rates aren't as simple as they might appear. Your actual tax rate on any particular dollar of income can be quite a bit higher or lower than your supposed tax bracket.
- Ultimately, there are two kinds of dollars in this world: pretax dollars, and after-tax dollars.

Chapter 12

What's Next?

Sincere congratulations on completing the first big step in the tax-planning process—reading this book! I trust you've found value in the information I've shared with you.

If you've gotten this far, I think I know something about who you are. You're likely an entrepreneur or a business owner who is working hard to grow your business. Profits are increasing each year, which is making you nervous about the amount of income tax you're paying. You aren't happy with the amount and want to do something about it.

Up until now, you didn't know what could or should be done to solve this problem. Well, you've come to the right place. Tax planning is a wonderful investment that pays off year after year after year.

You've now been exposed to tax strategies such as:

- ✓ the difference between tax preparation, tax projections, and true tax planning
- ✓ tax strategies for new entrepreneurs
- ✓ how to tell if you're utilizing the right business structure
- ✓ maximize your auto and truck deductions
- ✓ document and maximize your meals and entertainment deductions
- ✓ maximize valuable tax deductions that may be unique for your industry
- ✓ write off your children's braces or other medical costs through your business

- ✓ hire your children and write off private school tuition or start saving for college
- ✓ how to choose the right tax professional

How can you use this information to get the best results for your tax situation? Where do you go for answers to your questions?

Allow me to present to you a simple road map of what you should be doing over the next thirty days to begin the process of taming the tax monster.

Step 1: Stop right now and send me an e-mail at Diane@TaxCoach4You.com to get your gift copy of my survey "How Much Do You Know about Your Taxes?" Take a moment and fill out the survey.

Step 2: Go to my Web site www.TaxCoach4You.com. You can opt in for "Tax Tip Tuesday" and my weekly tax-planning blog, which is filled with entertaining and useful tax-planning information. While you're there, you may want to take a few minutes and watch a few beneficial videos.

Step 3: Opt in for my "Stop Overpaying Your Taxes" bundle of FREE information. Be sure to connect with me on social media. Then read the special reports.

Step 4: Call my office in the next thirty days and schedule a FREE thirty-minute Mini Tax Analysis consultation with me. Send me copies of your last two years' personal and business tax returns at least forty-eight hours ***before*** this session. I'll do my best in the thirty-minute consultation to show you mistakes or missed opportunities on your tax return. (A $250 value.)

Step 5: Please share this important tax-saving information with your friends, family members, and

business associates. My goal is to help thousands of business owners pay less tax legally!

Step 6: Reread this seven-step list and get going! You now have a lot of strategies to start saving income taxes. Pick one or two and get going!

If you want more cash in your pocket, I can't wait for you to sign up and get started on your tax-planning journey. I just know you'll see a major difference in your business once you begin to implement these strategies.

Ask yourself, "What would I do with an additional $12,000, or $31,000, or even $105,000 each year?" Here are some ideas.

- pay for your son's or daughter's college education
- pay for your daughter's wedding
- pay off debt
- take that dream vacation you've always wanted
- buy a new house
- buy a new car
- fund some sort of financial investments
- donate to your favorite charities
- contribute to a retirement plan
- ?????

Step 7: Be sure to call ((800) 841-0212) or e-mail me (Diane@TaxCoach4You.com) with your tax-planning success story.

Questions and Notes

About the Author

Diane Gardner, Your Tax Coach, is a Quilly Award recipient and the best-selling author of *Stand Apart* and *Why Didn't My CPA Tell Me That?* She's been working in the accounting field with small businesses since 1982. Diane is the founder of Adept Business Solutions and Tax Pro Solutions, which meet the needs of her clients by providing accounting and proactive tax-planning services.

Diane is a graduate of San Jose University where she majored in accounting. She is a licensed Enrolled Agent (EA), which allows her to prepare income tax returns and to represent taxpayers in all fifty states.

Diane is also a QuickBooks Pro advisor, an Accredited Tax Preparer (ATP), and a Certified Tax Coach (CTC). Certified Tax Coaches are an elite group of professionals who focus on helping businesses and individuals pay the least amount of tax that is legally possible.

Diane has worked hard to make her businesses stand apart from other accounting and tax professionals by specializing as a tax coach. Her personal goal is to make sure business owners are *not* overpaying their taxes, by utilizing proactive tax planning. Her clients generally realize an average tax savings between $5,000 and $50,000 per year.

Her clients also benefit from her knowledge of marketing, which she shares freely. She writes articles, presents seminars, and offers coaching services to her clients. In addition, she is the leader of the Business Breakthrough Mastermind Group, which meets in her hometown of Rathdrum, Idaho.

When Diane isn't busy working with business owners, she is a devoted wife, mother, and grandmother. Her toddler grandson, Braden, is a very important part of her life, and she is fortunate to be able to spend quite a bit of time with him.

This grandma has now learned more than she ever thought she would know about important things such as backhoes, excavators, front end loaders, and other pieces of heavy equipment. Much of her downtime is spent with a little boy digging in the dirt and making roads.

Diane is quite active in her church and serves on the board of the Twin Lakes Friends Camp, which offers summer camping programs for kids. She is also active in her community and in several local Chambers of Commerce.

For more information about any of the information Diane has presented, you may reach her by calling

(800) 841-0212

or

(208) 687-0508

or by going to her Web sites:

www.AdeptBusiness.biz

www.TaxCoach4You.com

You may also e-mail her at Diane@AdeptBusiness.biz or Diane@TaxCoach4You.com.

Diane receiving her Quilly award.

Diane at a book-signing event.

Go to www.TaxCoach4You.com to claim your FREE “Stop Overpaying Your Taxes” bundle.

While you’re there, you can sign up for “Tax Tip Tuesday” to get my weekly short tax tip e-mailed directly to you. You’ll also receive my weekly tax-planning blog, which is filled with entertaining tax-planning articles.

Here’s what a couple of my satisfied clients are saying about me:

"Diane Gardner helped position my company so that I will be saving about $45,000 in income taxes over the next three years! I didn't know how much tax I was overpaying until I had a tax plan prepared. Diane was wonderful in the way she laid out the various tax strategies, and her firm has been great throughout the implementation process. I will definitely recommend other pro-anglers and business owners to take the time to meet with Diane and her team. I'm confident she can save them money too!"

—Brandon Palaniuk
BMP Fishing
Hayden, Idaho

"My wife and I met with Diane to talk about our need for tax planning. She prepared a customized, written tax plan for our business. As a result of this plan, we anticipate saving about $40,000 a year in taxes. This is a huge savings for us. We can now take that money and invest it back into our business.

Diane suggested ideas that we had previously explored but we hadn't implemented them due to a lack of knowledge of how to do it. Thanks to Diane and her team, the implementation process has been quite simple and effortless on our part.

We would highly recommend tax planning with Diane and her team to small business owners everywhere!"

—Scot & Mary McCauley
R & S Machine Consultants
Hayden, Idaho

STOP OVERPAYING YOUR TAXES

How Much Do You Know About Your Taxes?
Are You Confident You Are Getting Every Available Tax Break?
Is Your Tax Advisor Giving You Proactive Advice To Save You Tax?

Find the hidden business deductions within your business such as:

- Utilizing the correct entity type
- Industry specific write-offs
- Maximizing meals and entertainment write-offs
- Write off healthcare costs through your business
- Save for college and take a tax deduction
- Maximizing auto and truck deductions

The Government Accountability Office estimates that business owners overpay their taxes by $50 billion each year. This is shocking news! Most entrepreneurs overpay their taxes simply because they don't know all the various deductions that are available.

Finally, an easy to read book that will guide you through the maze of self-employed tax deductions.

Diane Gardner, Your Tax Coach, is a Quilly award recipient and a best-selling author who specializes in proactive tax planning for small businesses.

$14.95 Biz Success Publishing

DIANE GARDNER, EA, CTC