

TAX DEDUCTIONS FOR SMALL BUSINESS

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If you email me, please put “SCORE” on the subject line
(Many thanks to Jean Kruse for original composition of majority of
power point slides!)

ORDINARY & NECESSARY

- Whether an expense is ordinary and necessary is based upon the **facts and circumstances** surrounding the expense.
- An expense is **necessary** if it is appropriate and helpful to the taxpayer's business.
- An expense is **ordinary** if it is one that is common and accepted in the particular business activity.

Corporations

- “C” Corporations.
- Advantage is legal protection.
- Disadvantage is double taxation.
- “S” Corporations.
- Advantage is legal protection and taxation only once to owners.
- BUT-restricted to only 100 shareholders.

Sole Proprietors, Partnerships & LLC's

- Sole Proprietor and Partnership are easy to start BUT.....no legal protection.
- LLC can be one or more owners. Taxed the same way as Sole Proprietor (Schedule C) and Partnerships (taxed only once) PLUS legal protection!

ENTITY DIFFERENCES

- Auto expenses
- Office in home
- Salaries to a child under 18
- Self-employment (SE) tax
- Medical insurance & other fringe benefits
- Charitable contributions

Vehicles used in Business

- Corporate owned vehicles: must use ACTUAL expenses; cannot use mileage method
- Personal use portion is NEVER deductible; corporation must add the value of your personal use of corporate vehicle to your W-2 as income to your. IRS has a formula.
- Personally owned vehicle used for corporate business: one way to handle it is for the corporation to pay the vehicle owner the current IRS allowed cents per mile for the business use
- Must keep a Log of the miles on all mixed use vehicles to verify usage. Need odometer reading at beginning of year & end of year

Vehicle used in Business

- Businesses that are not corporations have option of using the “actual method” or the “mileage method” to compute tax return deduction.
- Actual Method requires vehicle be on depreciation schedule. All actual expenses are computed: insurance, gas, oil, repairs, maintenance, tires, license, depreciation. Then business % x actual expenses deduct
- Mileage method still need total miles and business miles, but then deduct business miles x current IRS rate (53.5 cents 2017; 54.5 cents for 2018)
- Total business miles driven, say 1,000, divided by total mileage for year, say 10,000 = 10%

Vehicle used in Business

In addition to both the actual method and mileage method, you can deduct the computed business percentage x interest you paid on the vehicle.

Remember, you must keep a log showing your business miles for ALL methods.

CanNOT go back and forth between methods: must stick with same unless or until you use a different vehicle for business.

Non corporate businesses canNOT use the mileage method if they use more than 4 vehicles in their business.

Office in Home

- Must be a room that is used exclusively and on a regular basis for business purposes.
- Measure the square footage of your entire usable home. [assume 3,000 sq ft]
- Measure the square footage of the room used exclusively for business. [assume 300 sq ft]
- Divide 300 by 3,000 = 10% for business use
- Total actual expenses; records maintained

Office in Home

- Any expense that is for ONLY that room, can be deducted in full—like painting or decorating for that room only. Those expenses should be shown on Schedule C but NOT as an “office in home” expense.
- Regular method (required prior to 2013)
- Simplified Optional method—option for 2013 and later years

Regular Method

- Use Form 8829 to record all expenses; the allowable expenses goes from that form to Schedule C.
- The % of usage (10%) x property tax & mortgage interest will be deducted on this form; the personal % (90%) deducted on Schedule A (itemized).
- Other expenses (insurance, rent, repairs, utilities, depreciation, etc.—10% applied
- Recapture of depreciation on sale of home
- Cannot show a loss because of this expense but loss can be carried forward.

New Simplified Method

- Compute on Schedule C—do not use 8829
- Maximum allowable sq ft for business= 300
- Sq ft for business x \$5 is deductible amount: \$5 x 300 sq ft (max) = \$1,500
- You can use full amount of property tax and interest on Schedule A
- No depreciation deduction; no recapture
- Cannot show a loss because of this expense & loss cannot be carried forward

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Salaries to child under 18

- Only for sole proprietors or 1 owner LLC
- Child must be at least 7 years old
- Salary must be reasonable in relation to services actually provided
- Must keep time sheets + detailed employment records. Check must actually be written to child; can be deposited into a custodial account.
- Child can have an IRA—Roth IRA probably best
- Deductible expense; child *probably* no tax

Self-Employment (SE) Tax

- Paid by sole proprietors, one owner LLCs, & partners—same as social security & medicare tax, but must pay both employee & employer portions, so 15.3% of the profit
- Maximum profit per year on which taxed in 2017-\$127,200; in 2018-\$128,400.
- One-half of the computed tax deductible on page 1 of Form 1040
- Not deducted on Schedule C

Medical Insurance/Fringe Benefits

- Sole proprietors/one owner LLCs/partners/S Corporation owners who are employed by Corp can deduct medical insurance only on page 1 of Form 1040—NOT on Schedule C or E.
- Medical insurance & fringe benefits paid by S Corp, must be added as income on W-2 to owner employee—on W-2 so deductible
- Regular C corporations deduct same as other employees, but cannot discriminate to owners or highly employed

Charitable Contributions

- Regular C corporations deduct on tax Form 1120 but limited to 10% of their taxable income for year; can carryover for 5 years amounts that exceed limitation
- All others deduct on Schedule A (itemized deductions) on personal tax returns
- Must be a “qualified” charity—check on IRS website; documentation (bank record or written statement from charity); over \$250 MUST have acknowledgement from charity

EXPENSES

- Advertising, except advertising to influence legislation is NOT deductible
- Commissions and fees
- Contract Labor
- Business Insurance
- Interest

EXPENSES

- Legal & professional services
- Office expense
- Rent of equipment or facility
- Repairs and maintenance
- Supplies
- Licenses

EXPENSES

- Travel
- Meals and entertainment
- Utilities
- Wages, awards and bonuses
- Dues and subscriptions
- Bank charges & customer credit card chg
- Tools

EXPENSES

- Uniforms, but NOT anything that can be worn for personal use
- Bad debts, but only if accrual accounting
- Collection fees
- Payroll taxes
- Telephone and cell phones

ACCOUNTING SYSTEM

- Must be able to substantiate expenses and income
- Keep business and personal records separate
- Deposit all funds into business bank acct
- Write checks for all business expenses on that business bank account

NOT DEDUCTIBLE

- Penalties and fines
- Personal expenses
- Hobby Losses
- Personal portion of vehicle expenses
- Inventory
- Some types of insurance

BARTERING

- Bartering is the trading of one product or service for another.
- The fair market value of the goods & services exchanged must be reported as income by both parties.
- Taxable in year it is performed for ALL entities.
- Subject to all taxes—income tax, SE tax, sales tax, etc.

New tax law-2018

- Standard deductions go up. May make it unnecessary to itemize deductions.
- Tax rates change.
- Corporate rates drop to around 21%.
- Individual mandate for insurance dropped.

QUESTIONS?

- www.irs.gov – Click on Publications & choose:
- Publication 535, Business Expenses
- Publication 463, Travel, Entertainment, Gift and Car Expenses
- Publication 583, Starting a Business & Keeping Records
- Publication 587, Business use of your home (including use by Day Care Providers)
- To search for one type in: Publ 587 (example)
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- www.scorecr.org to get free mentoring