Small Business

Tax Guide

Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.

— **Judge Learned Hand, HELVERING v. GREGORY, 69 F .2nd 809, 810-11 (2n Cir 1934)**

On my first day of graduate school in the fall of 1993, the instructor opened the class with this quotation. It is the guiding force that has driven me ever since.

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Chapter 1
INTRODUCTION

Objectives: In this chapter we are discussing the difference between a small business and a hobby; general business loss rules; and the definition of a business deduction.

Whether you like it or not, the IRS and state and local taxing authorities are major participants in your business. It's important for you to know to understand that the tax code isn't fair, right, or just. However, if you participate in the system, paying taxes is a fact of life. That being said, this guide can help you determine how much you pay or, more importantly, don't pay.

As a tax professional since 1994, I have learned that the most successful Small Businesses are also the most aggressive in planning and exploiting the thousands of tax deductions that Congress puts into our infernally complicated system.

Every day you make important decisions that determine the success of your Small Businesses. This guide will provide you with quick and easy-to-follow methods, best practices, and insider secrets that will get you the tax savings you need to grow your small business. In addition, it will make you acutely aware of how, from a tax perspective, your daily actions impact your bottom line. You will learn to pay what you owe…but not one penny more.

As a business your income is yours. My job is to show you how to keep it in your pockets instead of in Uncle Sam's. Nothing in this guide is intended to encourage cheating. All I want is for you to do everything you can to keep the money to which you are legally entitled.

Two Tax Systems

As a small business owner, you know that there are two tax systems. The first one, for the wage earner, is designed to take wealth. The second one, for the small-business owner, is designed to create economic growth.

"Why?" The answer is simple. Congress has determined that the country needs small businesses because small businesses are responsible for over 75% of the job growth in this country. As a result, Congress has written and passed tax laws that encourage a small business. Your job as a small business owner is to make certain you take advantage of these laws.

Because you have a small business and the right information, you can deduct part of your house, your child's education, and some of your vacation costs. You can establish a pension plan that makes any government plan seem paltry by comparison. Even better, if your business generates a loss, you can use that loss against any form of income such as your wages, pensions, and rents.

What is a Small Business?

The Small Business Administration (SBA) usually defines a small business by the number of employees. Size standards range from 50 to 1,500 employees, depending on the industry or the SBA program. For tax purposes, however, the answer varies. Sometimes it depends on your revenues and sometimes on the number of employees.

For purposes of this guide, we are defining a small business as one with average annual gross receipts of no more than $10 million in the three prior years. We are concentrating on businesses with less than $ 1,500,000 in average annual gross receipts.

Insider Secret

A hobby is an activity from which you do not expect to make a profit. To qualify as a business, you have to prove your intent to make a profit. If you don't carry on your business activity to make a profit, it will be deemed a hobby and there will be limits on the deductions you can take.

Business vs. Hobby

Most people would prefer to make their living doing things they enjoy. The good news is that I've found that people who enjoy what they do for a living tend to make a lot more money than those who don't. The even better news is that there's nothing in the IRS code that says we have to be miserable in our businesses.

Insider Secret

To qualify as a business, you have to prove your intent to produce a profit. If your goal is to take a loss, you have a hobby. Amazon.com has been losing millions of dollars for years, but since its intent is to make a profit, the IRS recognizes it as a business.

Unfortunately, doing what you enjoy does not a business make. In determining whether or not you are carrying on an activity for profit, the IRS takes into account all of the following factors (no single factor alone is decisive):

- You carry on the activity in a business-like manner
- The time and effort you put into the activity indicate that you intend to make it profitable
- You depend on income from the activity for your livelihood
- Your losses are due to circumstances beyond your control (or are normal in the start-up phase of your type of business)

- You change your methods of operation in an attempt to improve profitability
- You or your advisors have the knowledge needed to carry on the activity as a successful business
- You were successful in making a profit in similar activities in the past
- The activity makes a profit in some years and the amount of profit it makes
- You can expect to make a future profit from the appreciation of the assets used in the activity

Business Losses

The most well-known loss rule says that a business needs to make profit in two of the last five years. While this is a good rule of thumb to live by, the reality is that if you are actively trying to make a profit and you are treating your business as a business, your business never has to make a profit.

The IRS will question you as to why you are pursuing something that isn't making a profit. So if you are continually losing money, it might be time to find a more profitable business venture.

What You Can Deduct

Understanding some of the terminology of the tax code is crucial in creating and keeping records related to reducing your tax liability. The Internal Revenue Code allows you to deduct the "ordinary and necessary" expenses of operating your business. These expenses vary depending on the type of business.

Business expenses are the current operating costs of running your business. To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in your business, trade, or profession. A necessary expense is one that is helpful and appropriate for your business, trade, or profession. An expense does not have to be indispensable to be considered necessary.

Insider Secret

Everything you can spend can be considered deductible. The question is, "Where do you spend your money every day, and how does that spending benefit your business?" By simply paying attention to the details, you can turn most of your daily expenses into business expenses. In addition, what you name your deduction can often determine whether or not it is deductible. In one of his famous hearing, President Clinton coined the phrase, "It depends upon what the meaning of the word 'is'. While we don't want to split hairs with the IRS, by paying attention to the details, we can beat the IRS.

Chapter Questions:

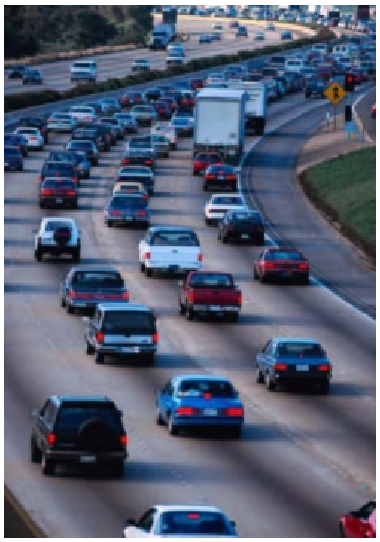
1. The Internal Revenue Code allows you to deduct?
   a. Anything you buy.
   b. Ordinary and necessary expenses
   c. Whatever you want.
   d. None of the above

2. Which of the following is not a primary difference between a business and a hobby?
   a. Intent to make a profit.
   b. Operating in a business-like-manner.
   c. Time and effort spent on the activity shows an intent to make a profit
   d. You depend on income from the activity for your livelihood.
   e. Money spent on the activity will always be more than the money earned from the activity.

Chapter 2

AUTO EXPENSES

Objectives: In this chapter we will discuss how your automobile has become your greatest business asset, and your best small business tax deduction.



Auto expenses are a very important deduction and can be one of your largest personal expenses. If you use your car for business, you can choose from two different methods to deduct business-use charges.

The Mileage Method

The most common method for deducting auto expenses is to deduct the amount per mile that the IRS allows for business travel. In 2018 the rate is $ .545 cents a mile, and in 2019 the rate is $ .58 cents per mile.

Keep your business journal with you and record your mileage every time you get into your car. Is it worth your time? I often challenge my clients to take 100 one-dollar bills and drive down the road throwing one dollar out the window every two miles. This demonstrates how much money you are giving away if you don't record your business miles and take the deduction.

Insider Secret

Wherever you drive, you can turn your mileage into business miles. You may deduct as business mileage the miles driven between two business locations or places of employment. It is critical to establish your home office as your regular workplace if you want to qualify for this great deduction.

Consider this example. If you drive 20,000 business miles a year, you will receive an $11,600 reduction in your income. At the lowest rate, that's a $1,160 tax reduction. At the highest level of taxation, it becomes a $4,292 tax reduction. And this doesn't even account for the savings on self-employment tax. So write it down!

<u>Once you use the mileage method, you must stay with that method until you purchase a new vehicle.</u>

Itemizing

Alternatively, you can itemize; i.e., take a depreciation deduction on the cost of your vehicle and add to that all the costs of running and maintaining your car (gas, oil, parking fees, repairs, insurance premiums, tolls, tires, licenses, and registration fees).

Intent

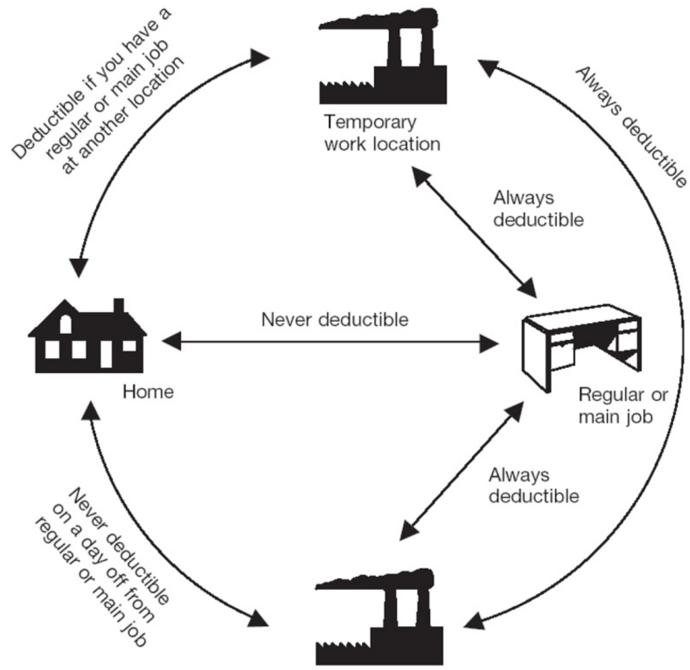
Intent is crucial to get this deduction. The purpose of pointing this out is not to show you how to cheat on your taxes. The purpose is for you to understand the mindset of an entrepreneur and to create tax deductions as you create wealth.

You can create a tax deduction just about every time you get in the car. For example, if you go to Target to purchase an item and, you end up buying office supplies there, your intent does not allow for a business mileage deduction. However, if your intent is to purchase office supplies and you happen to be purchasing other items, then you have a deduction. I recommend that you run a separate receipt for the office supplies.

When Are Transportation Expenses Deductible?

The chart on the next page is a graphic representation of how the mileage method works.

Most employees and self-employed persons can use this chart. (Do not use this chart if your home is your principal place of business.)



Home: The place where you reside. Transportation expenses between your home and your main or regular place of work are personal commuting expenses.

Regular or main job: Your principal place of business. If you have more than one job, you must determine which one is your regular or main job. Consider the time you spend at each, the activity you have at each, and the income you earn at each.

Temporary work location: A place where your work assignment is realistically expected to last (and does in fact last) one year or less. Unless you have a regular place of business, you can only deduct your transportation expenses to a temporary work location outside your metropolitan area.

Second job: If you regularly work at two or more places in one day, whether or not for the same employer, you can deduct your transportation expenses of getting from one workplace to another. You cannot deduct your transportation costs between your home and a second job on a day off from your main job.

Keep Good Records

Regardless of which method you decide to use, you can still deduct all parking fees and tolls while doing business. Since you usually pay this in cash, just write down the date, place, and business event. Now you have a legitimate tax deduction.

Auto Depreciation

Insider Secret

Great news - if you purchased a car in 2009 and want to take the depreciation method, you are entitled to take bonus depreciation not to exceed $ 10,960. the same applies for trucks, vans, and SUV's.

The vehicle you drive is a depreciable asset. When you purchase a vehicle and use it for work, you may depreciate the entire cost, including sales tax, destination charges, and other seller fees. (Registration and license fees do not qualify). The percentage of depreciation depends on the percentage of business use of the vehicle. Although automobiles have a five-year recovery period, they are depreciated over a total of six calendar years. **Very important – if you don't have two cars, then you should not have 100% business use of the auto.**

Depreciation Limits for Passenger Vehicles Placed in Service in 2018 & 2019

1st tax year.............................$ 10,000

2nd tax year......................... $ 16,000

3rd tax year.......................... $ 9,600

Each following year .... $ 5,760

Depreciation Limits for Trucks and Vans Placed in Service in 2018 & 2019

1st tax year.......................... $ 10,000

2nd tax year......................... $ 16,000

3rd tax year.......................... $ 9,600

Each following year .... $ 5,760

Auto Depreciation Table (Using mid-year convention)

Year	200% Declining Balance	150% Declining Balance	Straight Line Method
1	20%	15%	10%
2	32%	25.5%	20%

3	19.2%	17.85%	20%
4	11.5%	16.66%	20%
5	11.5%	16.6%	20%
6	5.76%	8.33%	20%

The highest depreciation starts at 200% DB but will change to straight line by year 4.

Two Cars are Better than One

The Internal Revenue Service requires you to have a good reason to use two cars for business. These are two valid reasons:

- The first vehicle carries more passengers and cargo, while the second gets significantly better gas mileage
- You would like to spread the mileage over two cars so that one vehicle doesn't accumulate too many miles

Let's compare actual versus mileage rate with two cars. Say that Jim owns two vehicles and that he drives 30,000 miles a year for business and 10,000 miles a year for personal needs. Look at his deductions with one car and with two cars.

One Business Car

	Car 1	Car 2
Total Miles	30,000	10,000
Business Miles	30,000	0
Business %	100 %	60 %
Total Costs	$7,500	$3,000
Total Auto Deduction	$7,500	$0

Two Business Cars

	Car 1	Car 2
Total Miles	30,000	10,000
Business Miles	24,000	6,000
Business %	80%	60%
Total Costs	$ 7,500	$ 3,000
Total Auto Deduction	$13,920	$ 3,480

What you see is that if Jim uses two cars for business, he can deduct an additional $ 3,480 a year. To get this deduction, he just needs to keep good records.

Deduct Your Commuting Costs

There is a way you can deduct some of your routine work commutes. Typically you cannot deduct the cost of commuting to and from work. However, if you have a regular place of business, you can deduct the daily transportation costs of traveling to another site where you perform services on an irregular or short-term basis.

For example, a doctor may deduct her daily transportation expenses for traveling between a clinic and a hospital or between her residence and a temporary work location. A salesperson who makes infrequent visits to customers at their offices may also deduct those expenses.

If you have a home office, expenses incurred getting from your home office and other job sites can be deducted. Your "commute" from the bedroom to your home office is the only portion that is not deductible.

Want an Additional Tax Break on Your Vehicle?

You may want to think about trading in your luxury sedan for an SUV.

If you buy a large SUV with a gross loaded weight of 6,000 pounds, you can depreciate the vehicle at a higher rate than you can a smaller vehicle. With a vehicle under 6,000 pounds, you are limited to deducting $3,160 your first year. However, if your vehicle is over 6,000 pounds and you use actual expenses rather than mileage, your deduction climbs to $25,000.

Regardless of how much you spend on luxury cars under 6,000 pounds, the depreciation allowance is capped at $ 10,000 the first year and dwindles to $ 5,760 from the fourth year on. You will probably trade in that vehicle before you have recovered its cost in depreciation.

But since the IRS does not consider SUVs over 6,000 pounds to be "cars," you can fully depreciate an SUV in five years as compared to a luxury car that has a maximum depreciation level of $15,800 over the same five-year period.

Let's look at what can be written off if you buy a $45,000 SUV over 6,000 pounds. You can write off up to $25,000 of the initial cost in the first year as a business-equipment expense. You can write off another $5,000, or 20% of the balance, as depreciation. The next year, you can depreciate 32% of the balance. At the end of five years, you will have written off the entire cost of the vehicle.

If your SUV is not used entirely for business, the deductions are proportional to use. As with any listed property for a business, you should keep usage logs, in this case, mileage. If you are audited and you wrote off a $45,000 vehicle, you can count on there being an audit adjustment. In other words, more tax due.

It's important to note that depreciation rules on company-owned autos for business purposes are usually strict.

Get Back What You Paid for Your Car

If you have a car that you use 75% of the time for business, everything related to that car is 75% deductible. That includes your new DVD player and the Ichiro Bobble-head Doll on your front dash.

Say that you are in the 28% tax bracket and you can convert personal expenses into business expenses. You have, in effect, created a 28% discount on the cost of anything that qualifies as a business expense. Suddenly that item that was too pricey at $100 becomes a bargain at $72 ($100 - $28). The trick, as with many tax strategies, is to get the government to help lower your overall costs.

Frequently Asked Questions about Auto Expenses

We leased an auto for a small business. How much, if any, of the down payment is tax deductible in the year we leased it?

You must spread any advance lease payments over the entire lease period. You cannot deduct any payments you make to buy a car even if the payments are called lease payments. If you lease a car you use in your business, you can deduct the part of each lease payment that is for the use of the car in your business. You cannot deduct any part of a lease payment that is for commuting to your regular job or for any other personal use of the car.

If I buy down the lease (pay a lump sum up front) for a vehicle for my new business, how would this up front payment be treated for tax purposes?

Again, you must spread any advance lease payments over the entire lease period. You cannot deduct any payments you make to buy a car even if the payments are called lease payments.

Chapter Questions:

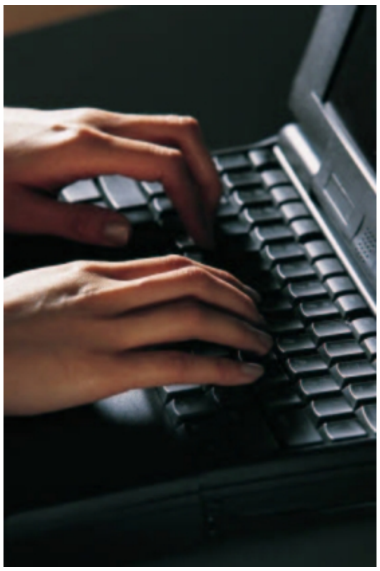
1. If you use the mileage method for deducting your vehicle expenses, you will need to track the following:
   a. Actual miles traveled for business use.
   b. Cost of fuel.
   c. Actual miles traveled for commute and personal vehicle use.
   d. All of the above.

2. You can change the method of automobile expense deduction every year:
   a. True
   b. False

3. Regardless of the method of deduction, I can expense which (2) of the following:
   a. Fuel
   b. Tolls
   c. Parking
   d. Car payments

Chapter 3
ASSETS

Objectives: In this chapter we will discuss the difference between a capital expense and a long-term asset; additionally we will discuss depreciation and the Section 179 expensing of assets.



Long-term assets are things that last for more than one year and are not considered part of inventory. They are completely deductible as capital expenses that you may depreciate over several years. Under Section 179, they may qualify to be deducted in a single year.

Let's say Nora purchased a new computer to keep track of her soaring sales. The computer is not part of her product inventory because she bought it to use in her business, not to resell. Since the computer will last for more than one year, Nora must depreciate it or expense it under Section 179.

Office Furniture and Equipment

Computers, printers, fax machines, desks, chairs, lamps, filing cabinets, couches, and the plants in your office can all be included in your business expenses. If you purchased them prior to starting your business, you can depreciate them over a five or seven-year period.

You get a great deduction when you put your office furniture and equipment on a depreciation schedule. If you buy a leather sofa for $2,000 and put it in your family room, it costs you $2,000. However, if you are in the 35% bracket and you put that same sofa in your home office, the IRS contributes $700 towards the purchase.

In 2018 & 2019, under Section 179, you can deduct up to $1,000,000 worth of business equipment (computers, fax machines, copiers, phone systems, or other fixed assets) as current expenses. If you don't take this deduction, you deduct the cost of the equipment over several years via the tax code's depreciation schedules.

Property eligible for deduction is property other than residential rental property, nonresidential real property, and listed property that is used 50% or less of the time for business. Generally, you must be the first one to have used the property.

Depreciation Period	Type of Property
3 years	Computer software (out of the box is deductible immediately) ▪ Tractor units for over the road use ▪ Any race horse over two years old when placed in service ▪ Any other horse over 12 years old when placed in service
5 years	Automobiles, taxis, buses, and trucks ▪ Computers and peripheral equipment ▪ Office machinery (typewriters, calculators, and copiers) ▪ Any property used in research and experimentation ▪ Breeding cattle and dairy cattle ▪ Appliances, carpets, furniture, and so on
7 years	Office furniture and fixtures, such as desks, files, and safes ▪ Agricultural machinery and equipment ▪ Any property that does not have a class life and has not been designated by law in any other class
10 years	Vessels, barges, tugs, and similar water transportation ▪ Any single purpose horticulture or agricultural structure ▪ Any tree or vine bearing fruits or nuts
15 years	Improvements made directly to land or added to it, such as shrubbery, fences, roads, and bridges ▪ Any retail motor-fuel outlet, such as a convenience store
20 years	Farm buildings (other than single purpose agricultural or horticultural structures)
27.5 years	Residential rental property, for example, an apartment building
39 years	Nonresidential real property, such as a home office, office building, store, or warehouse

Deducting Capital Expenses

Capital expenses are the monies that you invest in your business such as the costs of going into business, business assets, and property improvements. There are two ways to deduct capital expenses:

- You can depreciate them, deducting some of the cost each year over the useful life of the assets
- You can deduct most of the cost in one year using Section 179 of the Internal Revenue Code (IRC)

Using Section 179, you can deduct up to $1,000,000 in long-term assets purchased in the 2018 & 2019 tax years. Due to the size of the deduction and the time-value of money, most businesses no longer need to depreciate long-term assets. This **huge** change in the tax law can benefit you greatly.

Personal Property Converted to Business Use

If you use property in your Business that was used previously for personal purposes, you cannot take a Section 179 deduction for that property. However, you can depreciate it. The method of depreciation you use depends on when you first used the property for personal purposes.

If you began using the property for personal purposes after 1986 and change it to business use in 2019, you can depreciate the property under Modified Accelerated Cost Recovery System (MACRS).

The basis for depreciation of property changed from personal to business use is the lesser of the following:

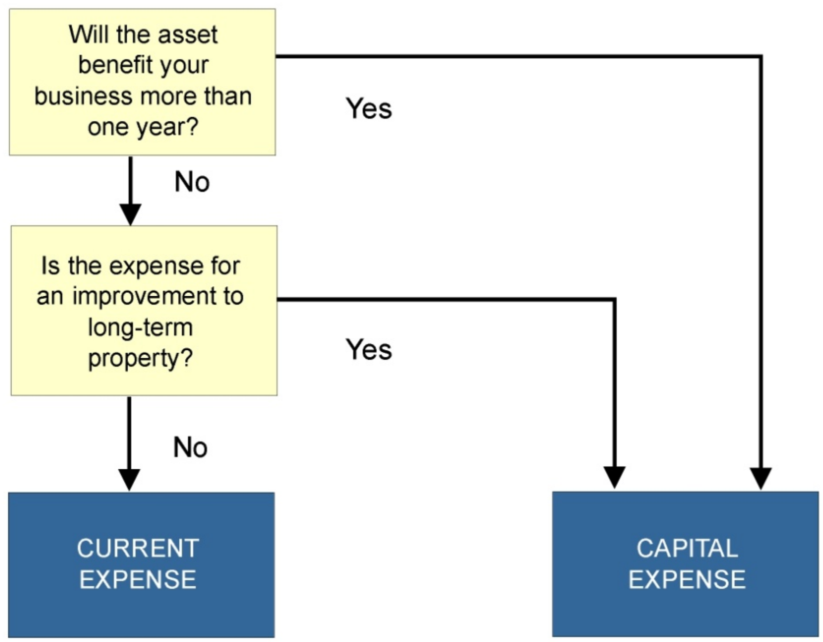
- The adjusted basis of the property on the date of change
- The fair market value of the property on the date of change

An Office Building is NOT Personal Property

This $ 1,000,000 deduction opportunity refers to "personal property." Real estate is not personal property. Non-residential real estate, such as office or industrial property has to be depreciated over 39 years. And only the building qualifies for depreciation; i.e., you cannot depreciate unimproved land.

How Do I Know if an Asset is Capital Expense or Current Expense?

Capital Versus Current Expense



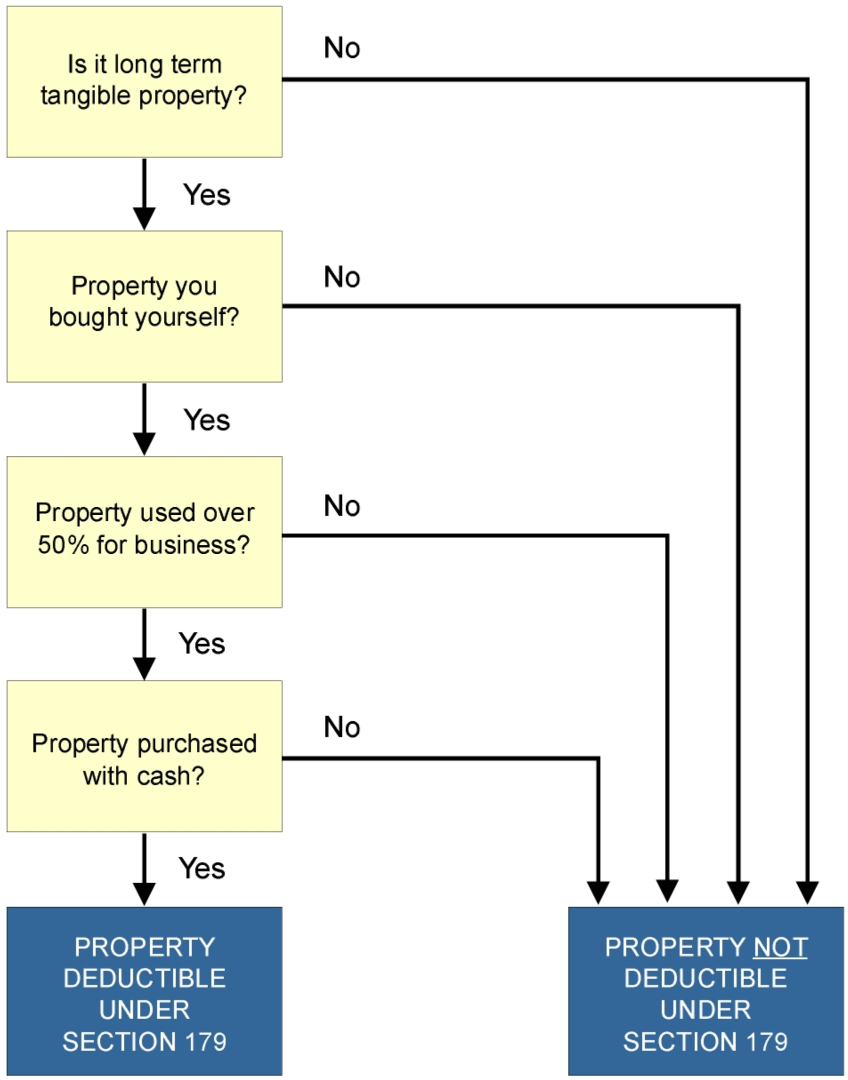
Your Future and Section 179

This is the latest information from the IRS about how Section 179 will affect your future over the next three years.

Current Total Property Limits

Year	Section 179 Deduction Limit	Property Value Limit
2014	$ 500,000	$ 2,000,000
2015	$ 500,000	$ 2,000,000
2016	$ 500,000	$ 2,000,000
2017	$ 500,000	$ 2,000,000
2018	$ 1,000,000	$ 2,500,000
2019	$ 1,000,000	$ 2,500,000

Requirements to Deduct Long-term Property Under Section 179



Frequently Asked Questions about Depreciation

What kinds of property can be depreciated for tax purposes?

Only property used in a trade or business to produce income can be depreciated. Additionally, the property must be something that wears out or becomes obsolete, and must have a determinable useful life substantially beyond the tax year. The kinds of property that can be depreciated include machinery, equipment, buildings, vehicles, and furniture.

Can I deduct the entire acquisition cost of a computer that I purchased for my business as a business expense or do I have to use depreciation?

The computer you purchased for your business is depreciated over a five-year period on Form 4562, Depreciation and Amortization, Part V. If the computer is used for business more than 50% of the time and if the business has taxable income at least as great as the Section 179 deduction claimed, you also have the option to expense it in one year (a Section 179 deduction) on the business portion, Form 4562 Part I.

If I lease office equipment and machinery with the option to buy, when do I depreciate the purchase price?

You must first determine whether your agreement is a lease agreement or a conditional sales contract. Whether the agreement is a conditional sales contract depends on the intent of the parties involved. Intent is based on the facts and circumstances that exist when you make the agreement. In general, an agreement may be considered a conditional sales contract rather than a lease if any one of the following is true:

- The agreement applies part of each payment toward an equity interest that you will receive
- You get title to the property upon the payment of a stated amount required under the contract
- The amount you pay to use therapy property for a short time is a large part of the amount you would have to pay to get title to the property
- You pay much more than the current fair rental value of the property
- You have an option to buy the property at a nominal price relative to the value of the property when you may exercise the option. Determine this value when you make the agreement.

- You have an option to buy the property at a nominal price compared to the total amount you have to pay under the lease
- The lease designates some part of the payments as interest, or parts of the payments are easy to recognize as interest

What all this means is that if, under the agreement, you acquired or will acquire title to or equity in the property, you should treat the agreement as a conditional sales contract. Payments made under a conditional sales contract are not deductible as rent expenses. You have to start depreciating the equipment on the date you acquired the equipment.

Chapter Questions:

1. Computer equipment should be depreciated over a period of:
   a. 5 years.
   b. 3 years.
   c. 7 years.
   d. 10 years.

2. Code section 179 of the internal revenue code allows you to:
   a. Expense the purchase of an office building in the first year.
   b. Expense the cost of tangible personal property in the first year.
   c. Expense your Honda civic in the first year.
   d. Expense the cost of an acre of land in the first year.

3. Business furniture is usual depreciated over
   a. 3 years.
   b. 5 years.
   c. 7 years.
   d. 10 years.

Chapter 4
EXPENSES

Objective: In this chapter we will discuss what is a business deduction, and different types of business expense/deduction categories.

What Qualifies as a Business Deduction?

To qualify as business deductions, your expenses must be:

- Reasonable and customary
- Paid or incurred during the taxable year
- Connected with the conduct of a trade or business

What does Reasonable and Customary Mean?

The meaning of "reasonable and customary" depends on your specific business and business customs in your locale. The expenses don't have to be reasonable and customary to you, only to your particular trade or industry. There are innumerable cases of "hobbies" converted into "businesses" with expenses allowed.

In one case, the expenses a husband and wife incurred for producing, exhibiting, and selling sculptures they had created were considered ordinary and necessary business expenses. In another case, a coal miner operated a kennel for bird dogs. For 11 consecutive years, he lost money. But the courts allowed the deductions and the losses because there was a profit objective. In a more recent case, a high school teacher's golfing activity was declared an activity with a profit motive. As a result, he could legally deduct what once was his "hobby."

So remember, focus on your profit-making motive. It's not what you pay in a tax that counts, it's what you keep.

Separate your Expenses

It is important to separate business expenses from the following expenses:

- Expenses used to figure the cost of goods sold
- Capital expenses
- Personal expenses

The Cost of Goods Sold

If your small business manufactures products or purchases them for resale, some of your expenses may be included in figuring the cost of goods sold. You deduct the cost of goods sold from your gross receipt to figure your gross profit for the year.

If you include an expense to figure the cost of goods sold, you cannot also deduct that expense as a business expense.

The following expenses go into figuring the cost of goods sold:

- The cost of the product or raw materials, including the cost of having them shipped to you
- The cost of storing the products you sell
- Direct labor costs (including contributions to pensions or annuity plans) for workers who produce the products
- Factory overhead expenses

Capital Expenses

There are some costs that you must capitalize rather than deduct. These costs are called capital expenses and are a part of your investment in your business. There are three types of costs you capitalize.

- Going into business
- Business assets
- Property Improvements

Personal Expenses

Generally, you cannot deduct personal, living, or family expenses. However, if you have an expense for something that is used partly for business and partly for personal purposes, divide the total cost between the business and personal parts. You can deduct as a business expense only the business part.

Schedule C and Business Expenses

Advertising

Don't forget these important marketing costs at tax time; they are all deductible business expenses. You can deduct the cost of advertising to sell a particular product or service, to help establish goodwill, or to promote your business. Advertising costs include what you pay for:

- Business cards
- Brochures
- Ads in the local yellow pages
- Newspaper and magazine ads
- Trade publication ads
- Fax blasts
- Catalogs
- Ads on the Internet
- Advertising and public relation agencies
- Press releases or leaflets
- Signs
- Google pay per click

Journal Subscriptions

If you subscribe to a journal for small business or magazines related to your business, you can deduct the annual subscription fee as a business expense.

Car and Truck Expenses

Gas, insurance, repairs, and all costs associated with a vehicle you purchase for your business are deductible. Whether it is by mileage rate or actual costs, the expense can be used to reduce your profits. See Chapter 2.

Samples and Promotional Items

You can deduct the cost of samples you give to your customers and the cost of promotional items such as posters. You cannot deduct the cost of any samples you use personally. This is where you must pay close attention to what you call things. (Remember it depends on the meaning of the word 'is'.)

Commissions

Report the full amount of any commissions you receive as business income. If you pay a bonus, percentage, or other type of commission to agents working under you, you can deduct what you pay as ordinary and necessary business expenses.

Let's look at an example of how that works. Imagine that Alice has her own direct sales business and that she sponsors three agents who report their sales under her. When Alice prepares her return she reports her all of her sales and includes the sales of the agents under her.

Say that in March, each person working under Alice has $600 in sales and that she has $900 in sales of her own. Alice has to report $2,700 ($600 + $600 + $600 + $900) in monthly sales for her group. She will report the entire $2,700 as business income on her tax return. Alice has to pay the three sellers working under her a commission of 50% on their March sales. She pays each of them $300 (50% of $600). She deducts the total, $900, as a business expense on her tax return.

Contract Labor

Contract labor covers individuals or companies you paid but did not withhold for taxes. You must report these payments if the payments are greater than $600. You must also file a 1099-MISC. The cost of the contract labor reduces your profit and taxes.

Depreciation and Section 179 Deduction

Depreciation on equipment, furniture, and materials you are depreciating on MACRS or Section 179, etc. are placed on the form.

You can deduct items you purchased in 2019 for use in your business by using Section 179. Form 4562 is attached to your tax return and is required under the following circumstances:

- You are claiming depreciation on property placed in business during 2019
- You are claiming a Section 179 expense deduction
- You are claiming depreciation on listed property regardless of the date it was placed in service. Listed property generally includes:
  - Passenger automobiles weighing 6,000 pounds or less
  - Any other property used for transportation if the nature of the property lends itself to personal use
  - Any equipment used for entertainment or recreational purposes
  - Cellular telephones or other similar telecommunications equipment
  - Computers or peripheral equipment

Insurance

You can usually deduct the ordinary and necessary cost of insurance as a business expense if it is for your trade, business, or profession.

Insider Secret

If you use a business-only credit card, the interest is deductible.

Interest

Business interest expense is an amount charged for the use of money you borrowed for business activities.

Legal and Professional Fees

Legal and professional fees, such as fees charged by accountants, that are ordinary and necessary expenses directly related to operating your business are deductible business expenses. However, you usually cannot deduct legal fees paid to acquire business assets. Those are added to the basis of the property.

Office Supplies

Insider Secret

Don't maintain inventory. Expense everything as you go.

Keep track of money spent on paper clips, legal pads, pens, toner cartridges, file folders, and all other office supplies. Unless you have deducted the cost in an earlier year, you can generally deduct the cost of materials and supplies actually consumed and used during the tax year. If you keep incidental materials and supplies on hand, you can deduct the cost of the incidental materials and supplies you bought during the tax year if these following requirements are met:

- You don't keep a record of when they are used

- You don't take an inventory of the amount on hand at the beginning and end of the tax year

Rent

Rent is any amount you pay for the use of property you do not own. In general, you can deduct rent as an expense only if the rent is for property you use in your trade or business. If you have or will receive equity in or title to the property, the rent is not deductible.

Repairs and Maintenance

You can deduct the cost of repairs and maintenance for your business, including labor, supplies, and other items that doesn’t add to the value or increase the life of the property. You cannot deduct the value of your own labor or the money spent to restore or replace property. For additional clarification see depreciation.

Office Expenses

All office expenses for the year may be deducted.

Taxes and Licenses

You can deduct various federal, state, local, and foreign taxes directly attributable to your trade or business as business expenses.

License and regulatory fees paid each year to state or local governments are generally deductible business expenses. Some licenses and fees related to starting your business might have to be amortized.

Travel

Expenses for lodging and transportation connected with overnight business travel are deductible. Conventions and meeting are deductible as long as they related to your field of business. So if you have the option of doing C.P.E. at a convention for Realtors in Hawaii, then by all means take the trip and deduct the costs.

Meals

Your total deductible business meal and entertainment expenses are also deductible.

Utilities

You can deduct utility expenses for your trade or business.

Telephone

The telephone is the small business best friend. You will find many deductions if you simply keep track of your expenses. Unfortunately, no matter how much a home phone is used for business calls, the tax law doesn't permit deductions for any part of the basic monthly service charge for the first telephone line into a residence.

However, that prohibition does not apply to optional services on your first line. Thus, charges for such options as caller ID, call waiting, extra directory listings, and equipment rental can be deducted in proportion to your business use.

If you have a second telephone line at home, both basic and optional service charges on the second line can be deducted in proportion to your business usage.

Toll charges on long-distance business calls can be deducted in full.

Cell phones are also deductible, but remember to not deduct the personal portion of the bill.

Wages

You can generally deduct the wages you pay your employees for the services they perform for your business. But it only counts as wages if you are also filing payroll returns. (Form 941, 944, 940, W-2 & W-3) Otherwise the fees that you pay casual labor would be deductible as contract labor.

Bank Service Charges

Review your bank statement to see if you are being charged for operating your business accounts. If you are, you have found a deduction.

Computer

If you use a computer in your business, you can depreciate it. However, if you use it 50% of the time or less in your business, you must use the Alternative Depreciation System (ADS) under MACRS. So make sure the computer is used at least 50% of the time or more for business. Often, investing in a second computer for family use will ensure this is the case.

Home Meetings

If you have business meetings in your home, you can deduct expenses for the meetings only under the following circumstances:

- They meet the rules discussed under Meals and Entertainment in Chapter 9 and if you can prove your expenses
- You meet the rules discussed under Business Use of Your Home in Chapter 5 for deducting the expenses of maintaining your home as a place of business

Say that Barbara and Bill hold bi-weekly meetings in their home for the sales agents who work under them. At those meetings, they discuss selling techniques, solve business problems, and listen to presentations by other business representatives.

Because the meetings are for business, Barbara and Bill can deduct 50% of the cost of the food and beverages they provide at the meetings. To do that, they have to keep a copy of their grocery receipts for the refreshments and record the date, time, and business nature of each meeting. But because they hold the meetings in their living room rather than in a special area set aside only for business, they cannot deduct any of their home expenses for the meetings.

Club Dues and Membership Fees

You usually can't deduct the costs you pay or incur for membership in a club organized for business, pleasure, recreation, or any other social purpose. This category includes country clubs, golf clubs, athletic clubs, hotel clubs, sporting clubs, airline clubs, and clubs operated to provide meals under circumstances generally considered conducive to business discussions. The purpose and activities of a club, not its name, will determine whether or not you can deduct the dues.

There are exceptions. None of the following organizations are treated as a club organized for business, pleasure, recreation, or other social purpose, unless one of its main purposes is to conduct entertainment activities for members or their guests or to provide members or their guests with access to entertainment facilities:

- Boards of trade
- Business leagues
- Chambers of commerce
- Civic or public service organizations

- Professional associations
- Trade associations

Tax Preparation Fees

You can deduct as a trade or business expense the cost of preparing that part of your tax return relating to your business as a sole proprietor.

You can also take a business deduction for the amount you pay or incur in resolving asserted tax deficiencies against your business as a sole proprietor.

Service Charges

You can deduct service charges you pay on orders for goods whether the service charge is a flat charge or is based on other criteria.

Business Gifts

You can also deduct up to $25 for each business-related gift you give to a client or business associate during a tax year. You will need to keep the receipts as proof, but the result can save you money at tax time, particularly if you typically send several gifts each year. For more on business gifts, see Chapter 9.

Internet & E-mail

Don't forget to deduct your monthly bill for your online service providers. If you use those 100% of the time for business, you can take the full deduction. Otherwise you must determine the percentage of usage in relationship to your business and deduct according to that percentage.

Business Use of Your Home

If you use part of your home for business, you may be able to deduct expenses for the business use of your home. These expenses may include mortgage interest, insurance, utilities, repairs, depreciation, security, maintenance, gardeners, maids, and anything else you can think of. Remember, only a portion may be taken for the home office. For more on the business use of your home, see Chapter 5.

Non-Qualifying Expenses

Non-qualifying expenses include:

- Trying to influence government legislation

Chapter Questions:

1. To qualify as a business deduction, the expense must be:
   a. Reasonable and customary.
   b. Paid or incurred during the taxable year.
   c. Connected with the conduct of a trade or business.
   d. All of the above.

2. Which of the following is not deductible as a business expense:
   a. Printing business cards.
   b. Legal fees for the review of a business contract.
   c. Commissions paid to sales reps.
   d. Payments made towards your child’s braces.

3. Payments made to a lobbyist to try and influence a state of federal official are deductible:
   a. False
   b. True

Chapter 5
THE HOME OFFICE

Objectives: In this chapter we will discuss what is a home office, what are the rules that need to be followed in order to qualify as a home office, and what is deductible.

Many people are afraid to take their home office as a deduction because they have heard rumors that doing so creates a red flag with the IRS. The rules on the deductibility of home office expenses are very tight, but understanding them can provide you with wonderful tax write-offs that will pass IRS scrutiny.

In 1999, the rules governing home offices were revised, giving the taxpayer greater flexibility. However, you must still meet specific requirements to deduct expenses related to the business-use of part of your home. Even then, your deductions may be limited. In order to qualify to claim expenses for business-use of your home, you must meet the following requirements.

- Your use of the business part of your home must be exclusive, regular, and for your trade or business.
- The business part of your home must be one of the following
  - Your principal place of business
  - A place where you meet or deal with patients, clients, or customers in the normal course of your trade or business
  - A separate structure not attached to your home that you use in connection with your trade or business

Nowhere does it say that your office has to be a whole room. In fact, it can be part of a room. It can include closet space, garage space, a carport, or a parking pad for your primary business vehicle.

Under the present rules, pretty much everyone who operates a business has a legitimate claim to deducting an office in their home. As a result, the odds of the IRS finding fault with this deduction on a tax return filed after 1999 is very unlikely.

This change potentially entitles the home office deduction to realtors, plumbers, repairmen, contractors, therapists, computer technicians, and other consultants who do their income-producing work outside of the home but who do their billing, scheduling, and other paperwork or administrative/management tasks out of their home office.

Examples of Expenses

Certain expenses are deductible whether or not you use your home for business.:

- Real estate taxes
- Deductible mortgage interest
- Casualty losses

However, if you qualify to claim business-use of the home expenses, you can use the business part of these expenses to figure your business-use of the home deduction. These expenses generally include, but are not limited to the following:

- Depreciation*
- Insurance
- Rent: this can be a major tax break for people don't own their home
- Repairs
- Security system and pest control. You may be able to deduct the costs of vet bills, food, license, etc. for your dog or cat. How is that possible? If you had an office, you'd need both security (Does your dog bark to alert you to someone coming to your home? That is security.) And pest control (Does your cat kill mice around the house? That is pest control.). Well, your home office is no different from an office. You can deduct all of the expenses of maintaining your security system and pest control on a percentage basis of the business use of your home.
- Utilities and services, including gas, electric, water, sewer, and garbage
- Cleaning your office space. This is a great opportunity to hire your children to perform these duties. You will learn more about hiring family members in Chapter 6.
- Computers, fax machines, printers, and phones. Even if you already use and own them, some or all of the expense may be deducted.

*Beware of depreciation. If you sell your home while operating a business out of it, you won't be able to use the new exclusion unless you've used your home for personal purposes for two out of the five years prior to the date of sale. Depreciation will be "recaptured" at 25%.

- Improvements such as painting, wallpaper, carpeting, and drapery
- Desks, sofas, tables, and other furniture
- Landscaping, lawn work, and snow and leaf removal
- Items such as light bulbs, toilet paper, cleaning products, and vacuum cleaner bags

The good news is that there is a loophole. Two years (24 months) before you plan to sell your house, you can convert it back to a personal residence. Then the portion of your home used as an office will qualify for the exclusion, meaning no business capital gains, but depreciation will still be recaptured at 25%.

Indirect Expenses

Indirect expenses are expenses that you will not be able to write off at 100%. They include:

- Rent
- Mortgage interest
- Home insurance
- Utilities
- Lawn care
- General maintenance

The amount you may deduct depends upon the percentage of use of your home in relation to your business.

Insider Secret

Designate as much of your home as your home office as possible. Be sure to include areas such as closets, display tables, and a reasonable area around them. You don't have to designate a complete room. If you don't have a separate office space, designate the desk and area around the desk as your workspace. Make sure you can prove that you've followed the IRS guidelines, and then sit back and watch your deduction climb.

The Business Percentage

To find the business percentage, compare the size of the part of your home that you use for business to the size of your house. Use the resulting percentage to figure the business part of the expenses for operating your entire home. You can use any reasonable method to determine the business percentage. The following are two commonly used methods for figuring the percentage:

- Divide the area (the length multiplied by the width) used for business by the total area of your home

Example:

Your home is 1,200 square feet.
Your office is 240 square feet.
Your office is 20% (240 divided by 1,200) of the total area of your home.
Your business percentage is 20%.

- Divide the number of rooms used for business by the total number of rooms in your home. You can use this method if the rooms in your home are all about the same size.

Example:

You use one room in your home for business.
Your home has four rooms, all of about equal size.
Your office is 25% (1 divided by 4) of the total area of your home.
Your business percentage is 25%.

Additional Information on the Home Office

You can't take the home office deduction if you don't make a profit from your business. However, I encourage you to fill out the paperwork and submit it anyway. This helps establish that you have a business and will give you validation for taking the mileage deduction.

As with all deductions, keeping good records is vital. If you plan to use this deduction, I suggest that you create a business journal and record your times and activities of business every day. Otherwise, if you are audited, you can plan on having your home office deduction discarded.

Insider Secret

Make your home office your first and last business stops of your business day. If you do this, driving to work and back becomes treatment-deductible transportation.

Insider Secret

You can carry over home office deductions to the next year.

New Information on the Home Office

Beginning in tax year 2013 (returns filed in 2014), taxpayers may use a simplified option when figuring the deduction for business use of their home.

Note: This simplified option does not change the criteria for who may claim a home office deduction. It merely simplifies the calculation and recordkeeping requirements of the allowable deduction.

Highlights of the simplified option:

- Standard deduction of $5 per square foot of home used for business (maximum 300 square feet).
- Allowable home-related itemized deductions claimed in full on Schedule A. (For example: Mortgage interest, real estate taxes).
- No home depreciation deduction or later recapture of depreciation for the years the simplified option is used.

Chapter Questions:

1. To qualify for the home office deduction, the part of the home used must be:

   a. Exclusive.

   b. Regular.

   c. Part of your trade or business.

   d. All of the above.

2. Taking the home office deduction can allow you to deduct part of your:

   a. Home Interest.

   b. Home property taxes.

   c. Homeowners insurance.

   d. All of the above.

CHAPTER 6
HIRING YOUR CHILDREN/SPOUSE

Objectives: In this chapter we will discuss the benefits of hiring your spouse and or children to work for your business.

Children who work in their parent's business can earn up to the **standard** deduction for the tax year without owing any federal income tax. In 2018, this amount is $12,000. If your business is unincorporated, you do not have to pay Social Security tax on wages paid to a child under 18.

You can further escape taxation by designating an additional $5,500 of each child's salary for an IRA. The IRS has targeted this amount to be raised in the next few years.

By law, family members must actually earn their salaries and their compensation must be reasonable. Working family members must be at least six years old.

As with all deductions, keep good records. In a recent audit, a client was given a complete deduction of over $ 36,000 for his three children. In the upper tax bracket, that's a savings of over $ 13,320. In the lowest tax bracket, it's a savings of $ 3,600. And there's an additional 15.3% ($ 5,508.) saving on self-employment tax. This is a **huge** deduction.

The Advantages of Hiring Your Children

- You don't have to pay FICA taxes for your children under the age of 18 if your business or partnership is owned solely by you and your spouse.
- You don't have to pay FUTA taxes for children who are under 21 years old.
- In 2018, if there is no unearned income, you will withhold taxes from your children's pay only if that pay exceeds $12,000.
- Your children can earn money by working in your business and pay for their own car, gas, clothing, school expenses, and just about very imaginable expense that you're paying for right now. And it's all deductible!

Insider Secret

Stop giving your kids an allowance. Pay them a salary and get a huge tax break.

What Should You Do?

Start thinking about what your kids can do to earn a salary. Can they clean your office, vacuum the carpets, wash the windows, polish the furniture, or maintain the landscaping outside your office? Whatever a typical office building has to pay in expenses, your children can do. You can pay your daughter to make computer disks, to seal and stamp envelopes, and as she gets older, to help you with various computer tasks.

When hiring your children, establish an hourly wage or weekly salary. Write up responsibilities and other requirements just as you would for any other employee. Establish a fair wage by asking yourself what a typical business would pay for this type of work. Just make sure that your compensation is fair and reasonable and that you record the date, the time, and the work accomplished.

You must file a W-2 form for your children. All you have to do is fill out the form and check exempt in the Social Security and Medicare boxes. You will also have to send in a W-3 form, which is just a summary of all W-2s.

The Advantages of Hiring Your Spouse

If you hire your spouse, you:

- Don't have to pay FUTA taxes if your business is unincorporated
- Can take a tax deduction for the cost of all employee benefits, and your spouse doesn't have to declare the benefit as income
- Can give your spouse health insurance coverage as an employee benefit. For more information on this, see Chapter 7. This is a **huge** savings

Rules for Employing Your Family

- Your child/spouse must be a real employee. The work must be ordinary and necessary for the business, and the pay must be compensation for services actually performed.

- Compensation must be reasonably related to the value of the service performed. As much as you would like to shift the greatest part of your income to your children, who are likely in a lower tax bracket than you are, or to pay your spouse as little as possible since there is no advantage to income shifting, you cannot.
- You have to comply with the legal requirements for employment. You must meet the same legal requirements when you hire your children or spouse as you do when you hire a stranger.

Chapter Questions:

1. When hiring family members to work in your business the primary rules to follow are: (Circle the answers that apply)
   a. Pay them as much as possible.
   b. Family members must actually earn their salaries.
   c. Working family members must be at least 6 years old.
   d. Compensation must be reasonable for the services provided.

2. If your working child is less than 18 years old and your business is organized as a sole proprietorship, then you do not have to pay social security taxes on their wages.
   a. True
   b. False

Chapter 7
BENEFITS

Objectives: in this chapter we will discuss employee/ employer fringe benefits: Health Insurance, HSA accounts, and Retirement Planning.

Health Savings Accounts

If you want to save your taxes, the best deal on the market may very well be a Health Savings Account (HSA). You can use an HSA check (instead of personal check) to pay small or routine medical expenses that you pay yourself.

Insider Secret

You pay no taxes on funds you use from your HAS to pay for medical expenses.

You can establish your HSA with a bank, insurance company, or other financial institution. The contributions you make are tax deductible and you do not have to pay tax on the interest or other money you earn on your account. The money can be withdrawn to pay almost any kind of health-related expense, and there is no tax on these withdrawals.

You'll also need to have a health insurance policy in the event that you or a family member develops a serious health problem. The deductibles are high; they must be at least $ 1,350 for an individual and $ 2,700 for families. However, you can use the money in your HSA to pay the deductible and any co-pays. The HSA can save you money in two ways:

- You will get a tax deduction for the money you deposit in your account.
- Premiums for your high deductible health insurance policy will probably be much lower than those for a traditional comprehensive policy or HMO coverage, thus saving you as much as 40%.

Once you open an HSA account and HSA-qualified health plan, there is no minimum amount you must contribute. However, there are maximum limits. These are the limits in 2019:

- Single: $ 3,500 or your annual deductible, whichever is lower.
- Family: $ 7,000 or the amount of your annual deductible, whichever is lower.

If you are age 55 to 65, you have the option of making catch-up contributions.

YEAR	MAXIMUM CATCH-UP
2006	$700
2007	$800
2008	$900
2009 and later	$1,000

Medical expenses are broadly defined and include dental care. If you believe that opening an HAS might be advantageous to you and your business, check with your local health insurance agent.

A word on health insurance agents verses web buying: both are excellent, and both, by law, cost exactly the same for premiums. But I recommend that you deal with an agent so that if a problem arises you will have an advocate on your side.

Health Insurance

In 2018 and 2019, self-employed individuals can deduct up to 100% of their health insurance payments. In order to deduct legally all insurance plan deductibles and co-pays for medicines and doctor visits, you must:

- Be self-employed and sole proprietor
- Hire your spouse as an employee
- Adopt an employee benefit plan that covers medical insurance for employees and their families
- File for an EIN number
- File a W-2 form

As sole proprietor, you'll have to pay Social Security and Medicare payroll taxes for all family members 18 years old and over. It's important for you to have a written benefits policy that covers all expenses for your employees. And, if you hire anyone other than a family member, you will be required to pay all of these expenses for that person as well.

A group health plan provides medical care to your employees, former employees, or their families. The plan can provide care directly or through insurance, reimbursement, or otherwise.

Frequently Asked Questions about Health Insurance

Can an employer pay the health care costs of an employee as a fringe benefit?

An employer may pay for health care costs of an employee as a nontaxable fringe benefit provided these costs meet certain nondiscrimination rules.

If our business pays our employees' health care costs directly to the medical facility (i.e., not as a reimbursement), is the employee benefit reported on Form W-2 and subject to Social Security withholding?

Provided that they are paid as part of a qualifying accident and health plan, health care costs paid directly to the medical facility are a nontaxable employee benefit. Be very careful with this type of arrangement because it can be very expensive.

If as an employer I pay the health insurance benefits for my employees and their dependents, are both the employees' and dependents' benefits considered income to the employee?

If an employer provides health insurance for an employee, the benefit provided is not taxable (i.e., it isn't considered income) to the employee. An employer can generally deduct the cost of a group health plan (or a self-insured plan) on the "employee benefit programs" line of their business income tax return.

Retirement Plans

Self-employed business owners have a wide variety of retirement plans available to them—Individual Retirement Accounts (IRAs), Simplified Employee Pensions (SEPs), and Keogh accounts. You can deduct contributions made to these plans, and their income is tax deferred. Currently you can place up to $ 56,000 a year in a Keogh or SEP, or 25% of your earned income, whichever is less.

Tax-Deferred Plans for Small and Home-Based Businesses

If you're a small business owner, the decision on what type of retirement plan and how much to contribute is up to you. After all, there is no benefits manager to hand you that nice, descriptive brochure for the company plan and no simple form to sign that will make someone else automatically deduct retirement contributions from your monthly paycheck.

Your best choice for a retirement plan should be determined by the needs of you and your company. Picking the right retirement plan isn't easy. If you work for yourself or you need to save for retirement on your own, you will need to do your homework in order to find the best plan for you.

(401) Keogh Plans

The traditional retirement plan for large businesses is the Keogh plan. Keogh plans can be time-consuming to set up, and require annual filings with the IRS and the Department of Labor. This probably explains why only 42% of the nation's businesses with fewer than 100 employees offer retirement plans to their workers, and why only 11% of businesses with fewer than 25 employees do.

To encourage small businesses to help their employees save for retirement, two new plans, the SEP-IRA and the SIMPLE-IRA, have been designed to streamline the administrative process.

SEP-IRAs

The SEP-IRA is an excellent choice for employers who don't want to be required to put money into a retirement plan every year.

SIMPLE-IRAs

Introduced in 1997, the Savings Incentive Match Plan for Employees (the SIMPLE-IRA) is well named. To be eligible for a SIMPLE-IRA, you must meet only two requirements:

- You must have had no more than 100 employees with compensation of $5,000 or more during the preceding year
- You cannot have maintained a qualified plan during any of the three years preceding the year for which the new plan is established

In 2019, you and any of your employees can contribute up to $ 13,000 or 100% of your income, whichever is less, to a SIMPLE-IRA. The limits on elective deferrals for SIMPLE plans are further increased for taxpayers who are 50 years old or older. The additional catch up amount is:

- $ 2,000 in 2005
- $ 2,500 in 2006 thru 2015

- $ 3,000 in 2016 & 2017

The Traditional IRA

As of 2003, even nonworking spouses can put up to $ 5,000 into an IRA. If you contribute to an IRA, you automatically get the benefit of tax-deferral. The earnings on your investment aren't taxed until you take the money out at retirement. What people find confusing is whether the contributions are tax deductible.

The important thing about planning your own retirement planning is that you do it. After all, retirement plans are some of the best tax shelters around, and the person who benefits is you.

If you haven't started an IRA yet (and millions of people haven't) or if you haven't made a contribution this year to your already established retirement plan, don't fret—there's still time. You have until April 15, 2019 to contribute to a retirement plan for the 2017 tax year.

Frequently Asked Questions about Retirement Plans

I want to establish a traditional IRA for my spouse and me. What is the most I can contribute during the tax year?

If both you and your spouse work and have taxable compensation, each of you can contribute up to $5,500 (or the amount of each IRA owner's compensation, if less than $5,500) to a separate IRA.

Even if one spouse has little or no compensation, you can contribute up to $5,500 to each IRA if your combined compensation is at least equal to the amount contributed to both IRAs and you file a joint return.

Your total contribution to both your IRA and the spousal IRA for this year is limited to $11,000 or your taxable compensation, whichever amount is smaller. You cannot contribute more than $5,500 to either IRA for the year.

Can I take an IRA deduction for the amount I contributed to a 401(k) plan last year?

No. A 401(k) plan is not an IRA. However, the amount you contributed is not included as income in box 1 of your W-2 form so you don't pay tax on that amount.

Chapter Questions:

1. If you would like to fund an HAS account you must have which of the following:
   a. Bank Account
   b. Medical Expenses.
   c. A high deductible health Insurance plan
   d. None of the above.

2. Health Insurance Premiums are fully deductible on the front of the taxpayers' individual tax return:
   a. True
   b. False

Chapter 8
TRAVEL

Objectives: In this chapter we will discuss the methods and strategies that can and will be most beneficial to you for your business travel.

You Can Write Off Your Vacation!

Mixing business with pleasure is the best summer travel tax strategy there is. You can get generous tax deductions even for a trip that feels a lot like a vacation.

If you book business travel flights with a Saturday stay-over to take advantage of the lower airfare, the IRS says that all of your travel costs are deductible—even if you end up spending the entire weekend sightseeing.

To get the greatest tax advantage, spread your business meetings out over the course of a week. This way, the overall trip is considered a business trip even though you've allowed yourself plenty of time for fun.

Insider Secret

If a trip within the US is motivated primarily by business reasons, you can deduct the full cost of travel to and from your destination.

Here's how it works. If you do all of your business on Monday and Tuesday, the IRS will say you should have returned home on Tuesday. But if you have business meetings on Monday, Wednesday, and Friday, you can use the interim days for sightseeing and other vacation activities. The IRS is less likely to say that such a trip is primarily for pleasure. Of course, there are restrictions on your family members' expenses.

Travel and Local Transportation

Travel expenses are generally those business-related expenses for trips that require you to spend the night away from home such as an out-of-town business-related function or convention.

Local transportation expenses are generally those business-related expenses for trips you make in the area of your "tax home" such as the cost of transportation to call on customers in the city where you work.

The IRS looks closely at deductions for travel and transportation. So be sure you can prove your expenses.

Travel

Your tax home is defined as your regular place of business or post of duty, regardless of where you maintain your family home. If you travel away from your tax home on business, you can deduct your ordinary and necessary travel expenses. You cannot deduct lavish or extravagant expenses or those for personal or vacation purposes.

If your trip is entirely business related and you can show that your attendance benefits your business, you can deduct all of your travel expenses, subject to certain limits. This includes expenses for attending seminars, meetings, conventions, and other functions. If your trip was primarily for business and, while at your business destination, you extended your stay for a vacation, made a non-business side trip, or had other non-business activities, you can deduct only your business-related travel expenses. These expenses include the travel costs of getting to and from your business destination and any business-related expenses at your business destination.

Insider Secret

There are several different ways to deduct meal and lodging expenses while you are on the road. I have found it is a much easier and better deduction to use per diem rates when deducting meals. Rates vary depending on the part of the country you are in. See Publication 1524 to find out what those rates are.

Say that Tommy lives and conducts his small business in Austin. He takes a business trip to New Orleans and on his way home, stops in Houston to visit his parents. He spends $830 for transportation, meals, lodging, and other travel expenses during the nine days he is away from home.

If he hadn't stopped in Houston, Tommy would have been gone for only six days, and his total cost would have been only $730. He can deduct only that $730 for his trip, including the cost of round-trip transportation to and from New Orleans. The cost of his meals is subject to the 50% limit on meals.

If your trip is primarily for personal reasons, the entire cost of the trip is a nondeductible personal expense. However, you can deduct any expenses you incur while at your destination if they are directly related to your business.

Tracking Costs

The Basic Method

Most small businesses track costs by saving receipts for food and lodging and then documenting the business purpose of their activities in order to take their deductions.

The Per Diem Method

As the business owner, you can give your employees a per diem allowance. The simplest way of doing this, known as the high-low method, lets you choose from two different rates for meals, lodging, and incidental expenses for business trips within the continental United States.

In most of the country, the per diem rate is $ 149 per day. Per diem allowances can be as much as $ 460 per day in high-cost areas, such as New York, Chicago, Hawaii, and San Francisco. For more details on per-diem rates, go to the IRS web site and search for "per diem rates."

One advantage of the per diem route is that you don't have to keep track of the actual receipts for meals and hotel costs. However, the paperwork burden is not entirely eliminated; you and your employees still have to keep track of the time, place, and purpose of each business expense. **I recommend keeping all receipts.**

If you decide to use the high-low method, you have to use it for all travel for the entire year.

Per Diem for Sole Proprietor

If you are an unincorporated sole proprietor, you also are entitled to take per diem deductions for meals, but not for hotels. You can use the government's meal per diem rates for 2017 (which are $55, $56, $61, $66, $69 or $71, 76, depending on the city), but you cannot use the federal travel-rate method or the high-low method for taking lodging deductions. You'll have to keep track of your actual hotel expenses regardless of whether you use the per diem rates or deduct actual meal expenses.

As sole proprietor, you aren't locked into taking either the per diem deduction or actual meal expenses for the year. You can decide with each trip which method to use for that trip. You do, however, have to be consistent in using only one method per trip.

Foreign Travel Per Diems

Foreign trips are subject to different rules, per diem rates, and requirements. If you happen to have a qualifying business trip overseas, you can check out the foreign per diem possibilities at the State Department site. Search for "foreign per diem rates."

Local Transportation

You can deduct local transportation expenses for your business. Local transportation expense is the cost of getting from:

- One workplace to another in the course of your business when traveling within the general area that is your tax home
- Your home to a temporary work location

Local transportation includes the following kinds of trips you make in the area where you live and work:

- Visiting clients or customers
- Attending business meetings away from your workplace

Transportation expenses include train, bus, and cab fares, care rental fees, and the cost of driving and maintaining your car for business transportation. Meals and lodging are not included in transportation expenses.

Commuting Expenses

You cannot deduct the cost of transportation between your home and your main or regular place of work. The cost of commuting is a nondeductible personal expense, regardless of the distance or whether work is performed during the trip.

Limits on Meal Deductions

Meal expenses are deductible only if your trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Generally, the deduction for non-reimbursed business meals is limited to 50% of the cost of the meal.

Instead of keeping records of your meal expenses and deducting the actual cost, you can deduct a standard meal allowance ranging from $51 to $74 depending on where and when you travel.

Independent Contractors

If you hire individuals as independent contractors and they incur travel, entertainment, and meal expenses, for which you pay, take the deduction. Note that the deductible items are not listed on the 1099-MISC that you file with the IRS to show how much you paid the independent contractor.

Take this example. Dave, an accountant, hires Jerry to drive to another city and audit materials for his client. In the course of the work, Jerry incurs expenses of $500. Jerry brings back an adequate accounting of the expenses and Dave pays Jerry back the $500. Dave can deduct all of the travel and 50% of Jerry's meals and entertainment expenses, but does not include those expenses on Jerry’s 1099 at year end.

Chapter Questions:

1. Travel expenses can include:
   a. Seminars
   b. Conventions
   c. Meetings
   d. All of the above.
2. If your trip is primarily for personal reasons, but you also do a little business on the same trip, then:
   a. All of you expenses are deductible.
   b. None of your expenses are deductible.
   c. Only the expenses directly related to the business portion are deductible.
3. Commuting Expenses are always deductible:
   a. True
   b. False

Chapter 9
Meals, Entertainment

Objectives: In this chapter we will discuss meals and entertainment expenses, how to take the deduction, and how to protect your deduction. In addition we will also discuss business gifts.

IRS rules for business-related meals, entertainment, and gifts allow you substantial opportunities to convert personal expenses into deductions.

You can deduct 50% of ordinary and necessary business expenses for entertaining a client, customer, or employee if it is directly related to your business or associated with your business.

It is essential to keep excellent records for business entertainment expenses. For example, if you take someone out for a meal, be sure to document the date, the amount, the place, the business purpose of the meal, and the business relationship. If you hold a party, keep a copy of the guest list, noting your respective business relationships.

How would you like to get a discount of 5% to nearly 20% on your meals and entertainment expenses? If you are in the 25% tax bracket and your meals and entertainment expenses are deductible, a $100 meal would cost you only $87.50.

Tax laws allow you to deduct half of your meals and entertainment expenses if they are business-related. Any expenses for food and drink provided under circumstances considered favorable to a business discussion, or when a business discussion is held, can be deducted. If you are self-employed, you can deduct the expenses as part of your adjustments to income.

Entertaining Business Clients

When you go out with friends or relatives for a meal or drink, do you ever pick up the check? If they are or could be potential clients or customers for your business, and you discussed business with them, that check would be deductible.

Even if you don't talk business at the meal, the meal is deductible if the meal follows or precedes a business discussion. Recognize that no actual business need come from the meeting as long as business was discussed. Don't hesitate to deduct legitimate expenses, but be careful. If you meet with someone regularly and the two of you take turns picking up the tab, you could face a tremendous penalty for deducting those meals. The IRS will disallow the deduction as a sham, subject to fraud penalties.

Not only can you deduct meals, but you can also deduct business entertainment-expenses. Money spent for entertainment, amusement, or recreation can be deducted if you can show that the expense directly preceded or followed a substantial business discussion or directly related to the active conduct of your trade or business.

Examples of potentially deductible expenses include entertaining guests at nightclubs, theaters, sports games, and even vacation trips. But don't waste energy building up deductible entertainment expenses unless you are prepared to do it right. This area is always a target of audits and is one of the most abused of all expenses. Make sure that each receipt (or notation in your appointment book or business diary) has all five of the following components:

- The amount of each expenditure
- The date of the expenditure
- The name, address or location, and type of expenditure if the information isn't apparent in the name or designation of the place
- The reason for the expenditure, the benefit derived, or the benefit expected to be gained
- Information about the people you entertained, including name, title, or other designation sufficient to establish the business relationship to you

Insider Secret

Keep all receipts no matter what.

You must have a receipt or other documentary evidence for meals or entertainment expenses of $75 or more. Fully acceptable substantiation includes a diary or written planner in which you enter the above descriptive information. If you put this information in your business software records, even in an audit, the entries would be considered complete substantiation under the law.

While most meals or entertainment expenses can only be deducted for half of the cost, certain meal and entertainment expenses remain fully deductible.

- Expenses reimbursed under an "accountable plan"
- Expenses incurred for recreational or social activities provided by the employer for the benefit of its employees, such as a company picnic or holiday party

- Expenses for goods, services, and facilities made available to the general public, such as promotional tickets or customer samples
- Expenses related to the ticket-package costs for sporting events arranged primarily for the purpose of charitable fundraising

The deductions for meals and entertainment allow you substantial opportunities to convert your personal expenditures into business deductions. Don't fail to claim them and don't lose them because of inadequate substantiation. In the 28% tax bracket, $100 worth of entertainment expenses costs you $86. It's worth your time to spend the 20 seconds it takes to note the name of your business clients and the business discussion on the back of your ticket stub or receipt to get $14 in tax savings.

You can deduct entertainment expenses only if they are both ordinary and necessary and meet one of the following tests:

- The directly-related test
- The associated test

The Directly-Related Test

To meet the directly-related test for entertainment expenses (including entertainment-related meals), you must show that:

- You engaged in business with the person during the entertainment period
- The main purpose of the combined business and entertainment was the active conduct of business
- You had more than a general expectation of getting income or some other specific business benefit at some future time

You must consider all the facts, including the nature of the business transacted and the reasons for conducting business during the entertainment. It is not necessary to devote more time to business than to entertainment. However, if the business discussion is only incidental to the entertainment, the entertainment expenses do not meet the directly-related test.

Insider Secret

You don't have to show that business income or other business benefits actually resulted from each entertainment expense.

A Clear Business Setting

If the entertainment takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work. The following situations are examples of entertainment in a clear business setting:

- Entertainment in a hospitality room at a convention where business goodwill is created through the display or discussion of business products
- Entertainment occurring under circumstances where there is no meaningful personal or social relationship between you and the people entertained, such as entertaining business and civic leaders when the purpose is to get business publicity rather than to create or maintain the goodwill of the people you entertained

Expenses not Considered Directly-Related

Entertainment expenses aren't considered directly-related if you aren't there or if there are substantial distractions that prevent you from actively conducting business. The following are examples of situations where there are substantial distractions:

- A meeting or discussion at a nightclub, theater, or sporting event
- A meeting or discussion during what is essentially a social gathering, such as a cocktail party
- A meeting with a group that includes people who are not business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs, or vacation resorts

The Associated Test

If your expenses don't meet the directly-related test, they might meet the associated test. To meet the associated test for entertainment expenses (including entertainment-related meals), you must show that the entertainment is both associated with the active conduct of your trade or business and directly before or after a substantial business discussion.

Associated with Trade or Business

Generally, an expense is associated with the active conduct of your trade or business if you can show that you had a clear business purpose for incurring the expense. The purpose may be to get new business or to encourage the continuation of an already existing business relationship.

Substantial Business Discussion

A business discussion will not be considered substantial unless you can show that actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit.

The meeting does not have to be for any specified length of time, but you must show that the business discussion was substantial in relation to the meal or entertainment. It isn't necessary to devote more time to business than to entertainment, and you don't have to discuss business during the meal or entertainment.

Meetings at Conventions

You are considered to have a substantial business discussion if you attend meetings at a convention or at a trade or business meeting sponsored and conducted by a business or professional organization. However, your reason for attending the convention or meeting must be to further your trade or business. The organization that sponsors the convention or meeting must schedule a program of business activities that is the main activity of the convention or meeting.

Directly Before of After a Business Discussion

If the entertainment is held on the same day as the business discussion, it is considered to be held directly before or after the business discussion.

If the entertainment and the business discussion are not held on the same day, you must consider the facts of each case to see if the associated test has been met. Among the facts to consider are the place, date, and duration of the business discussion. If you or your business associates are from out of town, you must also consider the dates or arrival and departure and the reasons the entertainment and the discussion didn't take place on the same day.

If you entertain out-of-town business guests on the evening before a business discussion or on the evening of the day following a business discussion, the entertainment is considered to be held directly before or after the discussion. The expense meets the associated test.

Expenses for Spouses

You cannot usually deduct the cost of entertainment for your spouse or for the spouse of a customer. However, you can deduct these costs if you can show that you had a clear business purpose, rather than a personal or social purpose, for providing the entertainment.

Let's say that you are entertaining a customer and that the cost for this entertainment is an ordinary and necessary business expense allowed under the entertainment rules. If your customer's spouse joins you because it's impractical to entertain the customer otherwise, you can deduct the cost of entertaining the customer's spouse. If your spouse joins the party because the customer's spouse is present, the cost of the entertainment for your spouse is also deductible.

Club Dues and Membership Fees

You cannot deduct dues (including initiation fees) for membership in any club organized for business, pleasure, recreation, or other social purposes.

This rule applies to any membership organization if one of its principal purposes is to:

- Conduct entertainment activities for members or their guests
- Provide members or their guests with access to entertainment facilities

The purposes and activities of a club, not its name, will determine whether or not you can deduct the dues. You cannot deduct dues paid to:

- Country clubs
- Golf and athletic clubs
- Airline clubs
- Hotel clubs
- Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions

What Entertainment Expenses are Deductible?

Entertainment

Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. Examples include entertaining guests:

- At nightclubs
- At social, athletic, and sporting clubs
- At theaters
- At sporting events
- On yachts
- On hunting, fishing, vacation, and similar trips

Entertainment also may include meeting the personal, living, or family needs of your customers, such as providing them (and their families) with meals, a hotel suite, or a car.

Meals as a Form of Entertainment

Entertainment includes the cost of a meal you provide to a customer or client, whether the meal is a part of other entertainment or by itself. A meal expense includes the cost of food, beverages, taxes, and tip. To deduct an entertainment-related meal, you or your employee must be present when the food or beverages are provided.

Deductions Depend on Your Type of Business

Your kind of business may determine if a particular activity is considered entertainment or ordinary expense. For example, food purchased for an open house event is considered an ordinary expense. Therefore the expense is fully deductible.

Separating Costs

If you have an expense that includes the costs of entertainment and other services such as lodging or transportation, you must allocate that expense between the cost of entertainment and the cost of other services.

For example, you must allocate your expenses if a hotel includes entertainment in its lounge on the same bill with your room charge. You must have a reasonable basis for making this allocation.

Taking Turns Paying for Meals or Entertainment

If a group of business acquaintances takes turns picking up each other's meal or entertainment checks without regard to whether any business purposes are served, no member of the group can deduct any part of the expense.

Lavish or Extravagant Expenses

You cannot deduct expenses for entertainment that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable given the facts and circumstances. In other words, expenses will not be disallowed just because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

Allocating Between Business and Non-Business Expenses

If you entertain business and non-business individuals at the same event, you must divide your entertainment expenses between business and non-business. You can deduct only the business part. If you cannot establish the part of the expense for each person participating, allocate the expense to each participant on a pro rata basis.

If you, for example, entertain a group of individuals that includes yourself, four business prospects, and five social guests, only 50% of the expense qualifies as a business entertainment expense. You cannot deduct the expenses for the five social guests because those costs are non-business expenses.

Trade Association Meetings

You can deduct entertainment expenses that are directly related to and necessary for attending business meetings or conventions of certain exempt organizations if the expenses of your attendance are related to your active trade or business. These organizations include business leagues, chambers of commerce, real estate boards, trade associations, and professional associations.

Entertainment Tickets

If you give a customer tickets to a theater performance or sporting event and you do not go with the customer to the performance or event, you have a choice. You can treat the tickets as a gift or as entertainment, whichever is to your advantage.

If you go with the customer to the event, you must treat the cost of the tickets as an entertainment expense. You cannot choose to treat the tickets as a gift.

You cannot deduct more than the face value of an entertainment ticket, even if you paid a higher price. For example, you cannot deduct service fees you pay to ticket agencies or brokers or any amount over the face value of the tickets you pay to scalpers.

Events that Benefit Charitable Organizations

Different rules apply when the cost of a ticket to a sports event benefits a charitable organization. You can take into account the full cost you pay for the ticket even if it is more than the face value, if all of the following conditions apply:

- The event's main purpose is to benefit a qualified charitable organization
- The entire net proceeds go to the charity
- The event uses volunteers to perform substantially all the event's work

Imagine that you purchase tickets to a college football game through a ticket broker. After having a business discussion, you take a client to the game. Net proceeds from the game go to colleges that qualify as charitable organizations. However, since the colleges also pay individuals to perform services, such as coaching and recruiting, you can use only the face value of the tickets in determining your business deduction.

Imagine, on the other hand, that you purchase tickets to a charitable golf tournament organized by and for the local fire department. The firefighters will run the tournament and all net proceeds will be used to buy new equipment. You can deduct the entire cost of the tickets as a business expense if they otherwise qualify as an entertainment expense.

Skyboxes and Other Private Luxury Boxes

If you rent a skybox or other private luxury box for more than one event, you cannot deduct more than the price of a non-luxury box seat ticket.

To determine whether a skybox has been rented for more than one event, count each game or performance as an event. For example, renting a skybox for a series of playoff games is considered renting it for more than one event. All skyboxes you rent in the same arena, along with any rentals by related parties, are considered in making this determination.

Related parties include:

- Family members (spouses, ancestors, and lineal descendants)
- Parties who have made a reciprocal arrangement involving the sharing of skyboxes
- Related corporations
- A partnership and its principal partners
- A corporation and a partnership with common ownership

Say that you pay $4,000 to rent a 12-seat skybox at Team Stadium for three baseball games and that the cost of regular non-luxury seats at each event is $20 a seat. You can deduct (subject to the 50% limit) $720 (12 seats x $20 each x 3 events).

Food and Beverages in Skybox Seats

If expenses for food and beverages are separately stated, you can deduct these expenses in addition to the amounts allowable for the skybox, subject to the requirements and limits that apply. The amounts separately stated for food and beverages must be reasonable. You cannot inflate the charges for food and beverages to avoid the limited deduction for skybox rentals.

The 50% Limit

In general, you can deduct only 50% of your business-related meal and entertainment expenses. The 50% limit applies to employees or their employers and to self-employed persons (including independent contractors) or their clients, depending on whether their expenses are reimbursed. The 50% limit applies to business meals or entertainment expenses you have while any of the following is true. You are:

- Traveling away from home (whether eating alone or with others) on business
- Entertaining customers at your place of business, a restaurant, or other location

- Attending a business convention or reception, business meeting, or business luncheon at a club

Application of the 50% Limit

The 50% limit on meal and entertainment expenses applies if the expense is otherwise deductible and is not covered by one of the exceptions previously discussed. The 50% limit also applies to certain meal and entertainment expenses that are not business related. It applies to meal and entertainment expenses you have for the production of income, including rental or royalty income. It also applies to the cost of meals included in deductible educational expenses.

Included Expenses

Expenses subject to the 50% limit include:

- Taxes and tips relating to a business meal or entertainment activity
- Cover charges for admission to a nightclub
- Rent paid for a room in which you hold a dinner or cocktail party
- Amounts paid for parking at a sports arena

The cost of transportation to and from a business meal or a business-related entertainment activity is not subject to the 50% limit.

When to Apply the 50% Limit

You apply the 50% limit after determining the amount that would otherwise qualify for a deduction. You first have to determine the amount of meal and entertainment expenses that would be deductible under the other rules discussed in this publication.

For example, you spend $200 for a business-related meal. If $40 of that amount is not allowable because it is lavish and extravagant, the remaining $160 is subject to the 50% limit. Your deduction cannot be more than $80 (50% x $160).

Or say that you purchase two tickets to a rock concert and give them to a client. You purchased the tickets through a ticket agent. You paid $250 for the four tickets, which had a face value of $40 each ($160 total). Your deduction cannot be more than $80 (50% x $160).

Business Gifts and the $25 Limit

If you give gifts in the course of your trade or business, you can deduct all or part of the cost.

You can deduct no more than $25 for business gifts you give directly or indirectly to any one person during your tax year. A gift to the company that is intended for the eventual personal use or benefit of a particular person or a limited class of people will be considered an indirect gift to that particular person or to the individuals within that class of people who receive the gift.

If you give the gift to a member of the customer's family, the gift is considered an indirect gift to the customer. This rule does not apply if you have a bona fide independent business connection with that family member and the gift is not intended for the customer's eventual use.

If you and your spouse both give gifts, the two of you are treated as one taxpayer. It doesn't matter whether you have separate businesses, are separately employed, or have independent connections with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Say that Sam Smith sells land to Home Company. He and his wife, Sue, gave Home Company four cheese boxes to thank them for their business. They paid $ 60 for each package, or $ 240 total. Four of Home Company's executives took the packages home for their families' use. Sam and Sue have no independent business relationship with any of the executive's other family members. Therefore, they can deduct a total of $100 ($ 25 limit x4) for the cheese boxes.

Incidental Costs

Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are generally not included in determining the cost of a gift for purposes of the $ 25 limit.

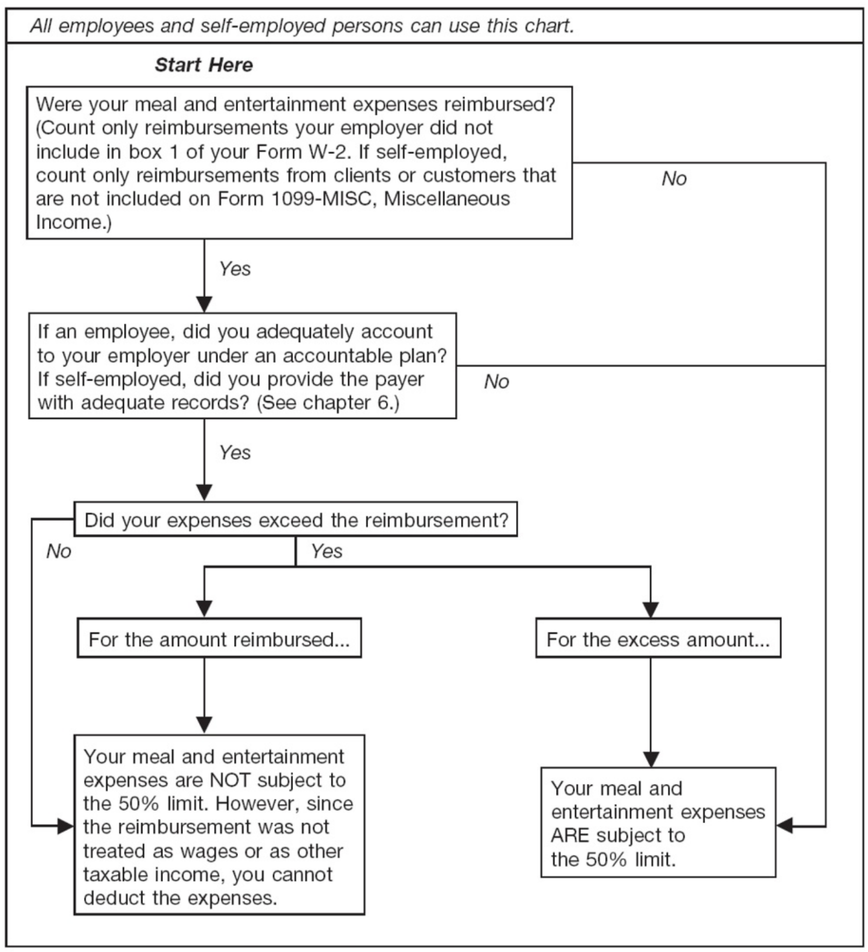
A cost is incidental only if it does not add substantial value to the gift. For example, the cost of gift wrapping is an incidental cost. However, the purchase of an ornamental basket for packaging fruit is not an incidental cost if the value of the basket is substantial relative to the value of the fruit.

For purposes of the $25 limit, the following items are not considered gifts:

- Signs, display racks, or other promotional material to be used on the business premises of the recipient.
- An item that costs $ 4 or less and
  - Has your name clearly and permanently imprinted on the gift, and
  - Is one of a number of identical items you widely distribute, such as pens, desk sets, and plastic bags and cases

The rules and definitions for deducting entertainment expenses are summarized in the table below.

Does the 50% Limit Apply to Your Expenses?



Chapter Questions:

1. When used primarily for business membership fees and dues for social clubs are always deductible:
   a. True
   b. False

2. You attend a business networking lunch every week, the dues and meal for this event are deductible:
   a. True
   b. False

3. Deductible business gifts are limited to $ 25.per person:
   a. True
   b. False

Chapter 10
CONTINUED PROFESSIONAL EDUCATION (CPE)

Objectives: In this chapter we will discuss what educational assistance is, and when it applies; what is continuing education and what can you deduct; and can your trip to Hawaii really be deductible.

Educational Assistance

You can exclude from your income up to $5,250 of qualified employer-provided educational assistance. This is a great benefit to provide for your children that work for you.

You may deduct your expenses for business-related education such as a college course or seminar. You may also deduct the cost of attending a convention or professional meeting as an education expense. In order to qualify for the education deduction, you must be able to show that the education is required by law or regulation to maintain your professional status or maintains or improves skills required in your business. You may also deduct expenses you pay to train or educate yourself and employees.

Allowable expenses include tuition, fees, books, and other learning materials. They also include transportation and travel.

Starting a New Business

Courts have held that you cannot deduct the cost of education expenses if it is for a new profession or business. **So all of the money you paid to a School to qualify for your license or degree is not deductible as a business expense.** However, you may increase your skills in your current field and take the deduction.

In other words, if a CPA decides to go to law school, he cannot deduct the cost of going to law school since the training would qualify for a new business. But if an Enrolled Agent were to seek a Master's degree in taxation, it would qualify as continuing education.

Minimum Educational Requirements

Tax courts have held that you cannot deduct the cost to meet the minimum education requirements for a business or profession. So, if Alice and Barbara decide to change careers, and Alice goes to law school and Barbara goes to medical school, neither woman can deduct her costs.

All of your local transportation expenses to and from a deductible educational activity are deductible. There is no requirement that you have to take your training locally. Many companies and organizations schedule training and education events at major resorts and vacation spots.

C.P.E. Expenses

The transportation from your home or business to the event and back may be deducted. If you drive, you may deduct your actual expenses or use the standard mileage rate for vehicles.

Insider Secret

Don't forget the seminar or conference in Hawaii.

For example, Sunny wanted training in foreclosure processes for her Real Estate continued professional education (CPE). There is a local seminar being held in her city, but the national group, the National Association of Realtor, is offering the same seminar in Maui, Hawaii.

Sunny may go to the training in Hawaii and take the deduction for her trip. Her airfare, parking, taxi, other transportation, and lodging and meals are all deductible travel-related expenses.

Chapter Questions:

1. If I have employees, I can set up a educational assistance plan that will allow me to pay for and deduct up to $ 5,250. Per employee per year:
    a. True
    b. False

2. My professional requires me to complete continuing education every year. A seminar directly related to my profession is available for me to attend next month in Hawaii. If I attend the seminar I can deduct all of the related expenses:
    a. True
    b. False

Glossary of Tax Terms

Accelerated depreciation: A depreciation method that allows larger deductions in the early years of an asset's "life" and smaller deductions at the end of the period. (See "Straight-line depreciation.")

Accrual method (or accrual basis): One of two main accounting methods for determining when a transaction has tax significance. The accrual method says that a transaction is taxed when an obligation to pay or a right to receive payment is created (for example, at the time products are delivered, services rendered, billings sent, etc.). This method is used by all but the smallest businesses. (See "Cash method (or cash basis).")

Adjusted basis: The cost of property (or a substitute figure-see "Basis") with adjustments made to account for depreciation (in the case of business property), improvements (in the case of real estate), withdrawals or reinvestment (in the case of securities, funds, accounts, insurance or annuities), etc. Adjusted basis is part of the computation for determining gain or loss on a sale or exchange and for depreciation.

Adjusted gross income: The amount of income considered actually "available" to be taxed. Adjusted gross income is gross income reduced principally by business expenses incurred to earn the income and other specified reductions (such as alimony).

Alternative minimum tax: An alternative tax system that says: your tax shall not go below this level. The alternative minimum tax works by negating (or minimizing) the effects of tax preferences or loopholes.

Amortization: The write-off of an amount spent for certain capital assets, similar to depreciation. This tax meaning is different from the common meaning of the term that describes, for example, payment schedules of loans.

Applicable Federal Rates (AFRs): Minimum interest rates that must be charged on various transactions that involve payments over a number of years. If the parties to a transaction do not adhere to these rates, the IRS will impute the interest. (See "Imputed interest.")

At-risk rules: Rules that limit an investor's deductible losses from an investment to the amount invested. Complications arise when investors finance their investment through loans that they are not personally on the hook for (nonrecourse financing). Without these rules, investors could raise their deduction limit considerably without being at-risk for the actual loss.

Basis: The starting point for computing gain or loss on a sale or exchange of property or for depreciation. (See "Adjusted basis.") For property that is purchased, basis is its cost. The basis of inherited property is its value at the date of death (or alternative valuation date). The basis of property received as a gift or a nontaxable transaction is based on the adjusted basis of the transferor (with some adjustments). Special rules govern property transferred between corporations and their shareholders, partners and their partnership, etc.

Cafeteria plan: A plan maintained by an employer that allows employees to select from a menu of taxable and nontaxable benefits.

Capital expenditures: Amounts spent to acquire or improve assets with useful lives of more than one year. These expenditures may not be deducted, but are added to the basis of the property (See "Adjusted basis.") and, for business property, may be converted into deductions through depreciation or amortization.

Capital gain or loss: Gain or loss from the sale or exchange of investment property, personal property (such as a home) or other "capital asset," which is often entitled to preferential tax treatment.

Carrybacks and carryforwards: Deductions that may be transferred to a year other than the current year because they exceeded certain limits. These deductions are typically carried back to earlier years first and, if they exceed the limits for those years, are then carried forward to later years until the deduction is used up. Charitable contributions and net operating losses are examples of deductions that may be carried back or forward.

Cash method (or cash basis): One of two main accounting methods for determining when a transaction has tax significance. The cash method says that a transaction is taxed when payment is made. This method is used by most individuals. (See "Accrual method (or accrual basis).")

Community property: A system governing spousal ownership of property and income that is the law in certain western and southern states and Wisconsin. The differences between community property and "common law" can change how federal tax law applies to spouses. For example: married taxpayers filing separately in a common law state do not have to report income earned by the other spouse. They do have to report income earned in a community property state.

Deferred compensation: An arrangement that allows an employee to receive part of a year's pay in a later year and not be taxed in the year the money was earned.

Depletion: A system similar to depreciation that allows the owner of natural resources (for example: a coal mine or an oil well) to deduct a portion of the cost of the asset during each year of its presumed productive life.

Depreciation: A system that allows a business or individual to deduct a portion of the cost of an asset ("recover its cost") during each year of its predetermined "life" (or "recovery period").

Earned income: Income earned by working for it. Interest, dividends and other kinds of profits are examples of unearned income.

Earned income credit: A tax credit available to individuals with low earned income. An individual is entitled to the full amount of this credit even if it exceeds the amount of tax otherwise due.

Employee stock ownership plan (ESOP): A type of profit-sharing plan in which benefits come in the form of stock in the employer.

Estimated tax: Quarterly down payments on a year's taxes that are required (on April 15, June 15, September 15, and January 15) if the total year's taxes will exceed $1,000 and the amount is not covered by withholding.

Federal Insurance Contributions Act (FICA): Social security taxes (for both old-age, survivors and disability insurance-OASDI-and Medicare).

Federal Unemployment Tax Act (FUTA): Unemployment taxes.

Filing status:. One of four tax ranks determined by your marital status, your dependents and the way you file your tax return: (1) single, (2) married filing jointly, (3) married filing separately and (4) head of household. Filing status determines your tax rates and your eligibility for various tax benefits (for example: alimony deduction, IRA deduction, standard deduction, etc.).

First-in, first-out (FIFO): A rule that applies to the sale of part of a group of similar items (such as inventory, shares of the same stock, etc.) that assumes the first ones acquired were the first ones sold. This is important if the items in the group were acquired or manufactured at different times or for different costs. The rule may be overridden by identifying the specific item sold, if possible. (See "Last-in, first-out (LIFO).")

Generation-skipping transfer tax: An extra tax on gifts or on-death transfers of money or property that would otherwise escape the once-per-generation transfer taxes that apply to gifts and estates. For example: a gift from a grandfather to a granddaughter skips a generation and might be subject to this tax.

Golden parachutes: Bonuses payable to key executives in the event control of their corporation changes, as in the case of a takeover. "Excess" golden parachute payments are subject to tax penalties.

Gross income: All income that might be subject to tax. Most "realized" increases in wealth are considered income. The main exceptions for individuals are gifts, inheritances, increases in value of property prior to sale, loan repayments and some personal injury awards. For businesses, investments in their capital are not considered income.

Head of household: A filing status available to qualifying single parents (or others supporting certain dependents) that allows lower taxes than the normal rates for singles.

Imputed interest: A portion of a future payment that is treated as interest if parties to the transaction do not provide a stated amount of interest at a rate acceptable to the IRS. (See "Applicable Federal Rates (AFRs).") This prevents improper use of certain tax advantages (capital gains rates or tax deferral). For example: if a business sells an asset on the installment basis, part of all future payments is treated as interest whether the transaction states it or not.

Incentive stock option: A stock option that may be granted to an employee under tax-favored terms.

Itemized deductions: Personal deductions that may be taken if they total more than the standard deduction. (See "Standard deduction.") The following deductions are then itemized or listed on Schedule A of Form 1040: medical expenses, charitable contributions, state and local taxes, home mortgage interest, real estate taxes, casualty losses, unreimbursed employee expenses, investment expenses and others.

Investment credit: A credit against tax available for investment in a limited range of business property. The general investment credit was repealed in 1986, but this type of credit has been enacted and repealed repeatedly throughout history.

Involuntary conversion: The conversion of property into money under circumstances beyond the control of the owner. For example: (1) property that is destroyed and "converted" into an insurance settlement or (2) property that is seized by the government and "converted" into a condemnation award. Owners may avoid tax on any gain that may result (if the insurance settlement or condemnation award exceeds the adjusted basis of the property) by reinvesting in similar property within certain time limits.

Joint return: An optional filing status available to married taxpayers that offers generally (but not always) lower taxes than "married filing separately."

Keogh plan: A retirement plan available to self-employed individuals.

Last-in, first-out (LIFO): A rule that applies to the sale of part of a group of similar items in an inventory that assumes the last ones acquired were the first ones sold. This is important if the items in the group were acquired or manufactured at different times or for different costs. (See "First-in, first-out (FIFO).")

Like-kind exchanges: Tax-free swaps of investment property. Commonly used for real estate.

Limited liability company (LLC): A legal structure that allows a business to be taxed like a partnership but function generally like a corporation. An LLC offers members (among other things) protection against liability for claims against the business that is not available in a partnership.

Listed property: Property listed in the tax code or by the IRS that must comply with special rules before depreciation may be claimed. Cars and personal computers are examples of listed property. The special rules are designed to prevent deductions where the property is used for personal rather than business purposes.

Medical Spending Accounts (MSAs): An investment fund similar to an IRA that can be used to pay more routine medical expenses, when used in conjunction with "high-deductible" health insurance, which pays the big bills. Only 750,000 of these MSAs are available nationwide under a pilot program that runs through the year 2000. To qualify, you have to be self-employed or employed by a small employer that offers the program.

Modified Accelerated Cost Recovery System (MACRS): The system for computing depreciation for most business assets.

Net operating loss: The excess of business expenses over income. A business may apply a net operating loss to get a refund of past taxes (or a reduction of future taxes) by carrying it back to profitable years as an additional deduction (or by carrying it forward as a deduction to future years).

Original issue discount (OID): The purchase discount offered on some bonds (and similar obligations) in lieu of interest. For example: zero-coupon bonds. OID is generally treated as interest income to the holder rather than as a capital gain.

Passive activity loss (PAL): Loss on an investment that is deductible only up to the limit of gains from similar investments. The limit mainly affects tax shelters and does not apply to stocks, bonds or investments in businesses in which the investor materially participates. Special rules apply to investments in real estate.

Qualified plan: A retirement or profit-sharing plan that meets requirements about who must be covered, the amount of benefits that are paid, information that must be given to plan participants, etc. Qualified plans are entitled to tax benefits unavailable to nonqualified plans.

Real estate investment trust (REIT): A kind of "mutual fund" that invests in real estate rather than stocks and bonds.

Real estate mortgage investment conduit (REMIC): A kind of "mutual fund" that invests in real estate mortgages rather than stocks and bonds.

Recapture: The undoing of a tax benefit if certain requirements are not met in future years. For example: (1) The low-income housing credit may be recaptured or added back to tax if the credit property ceases to be used as low-income housing for a minimum number of years. (2) The alimony deduction may be retroactively lost or recaptured if payments do not continue at the requisite level for a minimum number of years.

Regulated investment company (RIC): A mutual fund.

Rollover: The tax-free termination of one investment and reinvestment of the proceeds. For example: An individual may roll over a lump-sum distribution from an employer's retirement plan into an IRA.

S corporation: A corporation with no more than 100 shareholders that is not taxed, but treated similarly to a partnership, if other requirements are met.

Savings Incentive Match Plan for Employees (SIMPLE plans): A simplified retirement arrangement for small businesses that comes in two varieties: one similar to a 401(k) plan and one that funds IRAs for employees.

Standard deduction: A deduction allowed individuals instead of listing or itemizing deductible personal expenses. (See "Itemized deductions.") The amount depends on the individual's filing status. Additional amounts are available for taxpayers who are blind or are age 65 or over. Individuals may deduct either their standard deduction or the total of their itemized deductions, whichever is greater.

Straight-line depreciation: A depreciation method that allows equal deductions in each year of an asset's "life" or recovery period. (See "Accelerated depreciation.")

Swaps, tax-free: (1) Exchanges of like-kind property that result in no capital gains tax (commonly used for real estate). (2) Sales and repurchases of stock (or other securities) designed to realize a tax loss without discontinuing the investment. Transactions must comply with the wash sale rules to be effective. (See "Wash sales.")

Taxable income: What is left after all deductions are taken. This is the amount upon which tax is computed.

Taxpayer identification number (TIN): In the case of an individual, the Social Security number. In the case of a business (even an individual in business), the employer identification number.

Top-heavy plan: An employee retirement or profit-sharing plan that disproportionately benefits top executives.

Uniform capitalization rules (Unicap): A set of uniform rules for computing the cost of goods produced by a business that prevents current deductions for costs that must be capitalized (See "Capital expenditures.") or added to inventory.

Wash sales: Simultaneous or near-simultaneous purchases and sales of the same property, usually stocks or bonds, made to generate deductible tax losses without discontinuing the investment. Losses on the transactions are ignored for tax purposes, however, unless a 30-day waiting period is observed between them.

Withholding allowances: Adjustments made to assure correct withholding on wages for individuals who may have unusually large deductions or who may be subject to other special circumstances.

Self Employed Expenses Deductions

The purpose of this worksheet is to help you organize your tax deductible business expenses. In order for an expense to be deductible, it must be considered an "ordinary and necessary" expense. You may include other applicable expenses. Do not include expenses for which you have been reimbursed, expect to be reimbursed, or are reimbursable.

Operating Expenses	
Advertising	
Bank Charges	
Business Cards	
Catalogues	
Cleaning & Maintenance	
Commissions	
Demos	
Depreciation & Sect. 179	
Employee Benefits	
Freight	
Gifts	
Interest	
Map Books	
Office Expense	
Pension/Profit Sharing	
Postage/Delivery Expenses	
Printing	
Refunds	
Rent (Machinery/Equip)	
Rent (Other)	
Repairs	
Sales	
Samples & Promotional	
Seminars & Trade Shows	
Service Charges	
Software	
Storage Fees	
Supplies	
Taxes	
Tools	
Utilities	
Wages	
Other ____________	
Other ____________	
Other ____________	
Other ____________	
Total	

Vehicle & Travel

See Vehicle, Travel & Entertainment Worksheet

Cost Of Goods	
Cost of Items for Personal Use	
Cost of Labor	
Inventory at Beginning of Year	
Inventory at End of Year	
Materials and Supplies	
Outside Service	
Purchases	
Other ____________	
Other ____________	
Total	

Equipment	
Equipment	
Furniture	
Other ____________	
Total	

Professional	
Dues	
Insurance	
Legal & Professional	
License	
Publications	
Other ____________	
Other ____________	
Total	

Telephone	
Cellular Phone	
Long Distance	
Pay Phone	
Other ____________	
Total	

Other Information

____

____

Vehicle, Travel & Entertainment Expense

Vehicle Expense	
Description of vehicle	
Date placed in service	
Odometer reading beginning of year	
Odometer reading end of year	
Total miles	
Business miles	
Commute miles	
Daily average round-trip commute	
Personal miles	
Is car leased?	Yes ______ No ______
Is car owned (or financed)	Yes ______ No ______
Was this vehicle depreciated in a prior year?	Yes ______ No ______
Gas, lube, oil	
Repairs & Maintenance	
Tires	
Towing	

Vehicle Expense	
Insurance	
Auto license/reg	
Personal property tax	
Lease payments	
Interest	
Auto club	
Warranty	
Smog Certificate	
Other ______________	
Other ______________	
Total	

Travel & Entertainment Expense	
Airfare, train	
Car rental & gas	
Parking, tolls	
Taxi, bus, shuttles	
Lodging	
Meals	
Entertainment	
Tips	
Telephone	
Dry Cleaning	
Number of days out of town	
Other ______________	
Other ______________	
Total	

Notes:

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