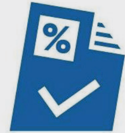
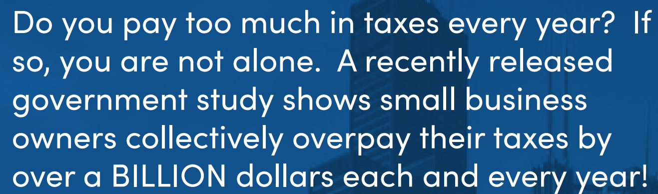


BOTTOM LINE TAX SOLUTIONS

TAX RESOLUTION AND TAX PLANNING

10 Tax Mistakes

Small Business Owners Make That Cost Them Thousands Each and Every Year!



Do you pay too much in taxes every year? If so, you are not alone. A recently released government study shows small business owners collectively overpay their taxes by over a BILLION dollars each and every year!

Often, taxes are one of the biggest expenses business owners face. We could all stand to pay less taxes, right? To do just that, I have put together the top 10 mistakes that cost small business owners when they file their taxes.

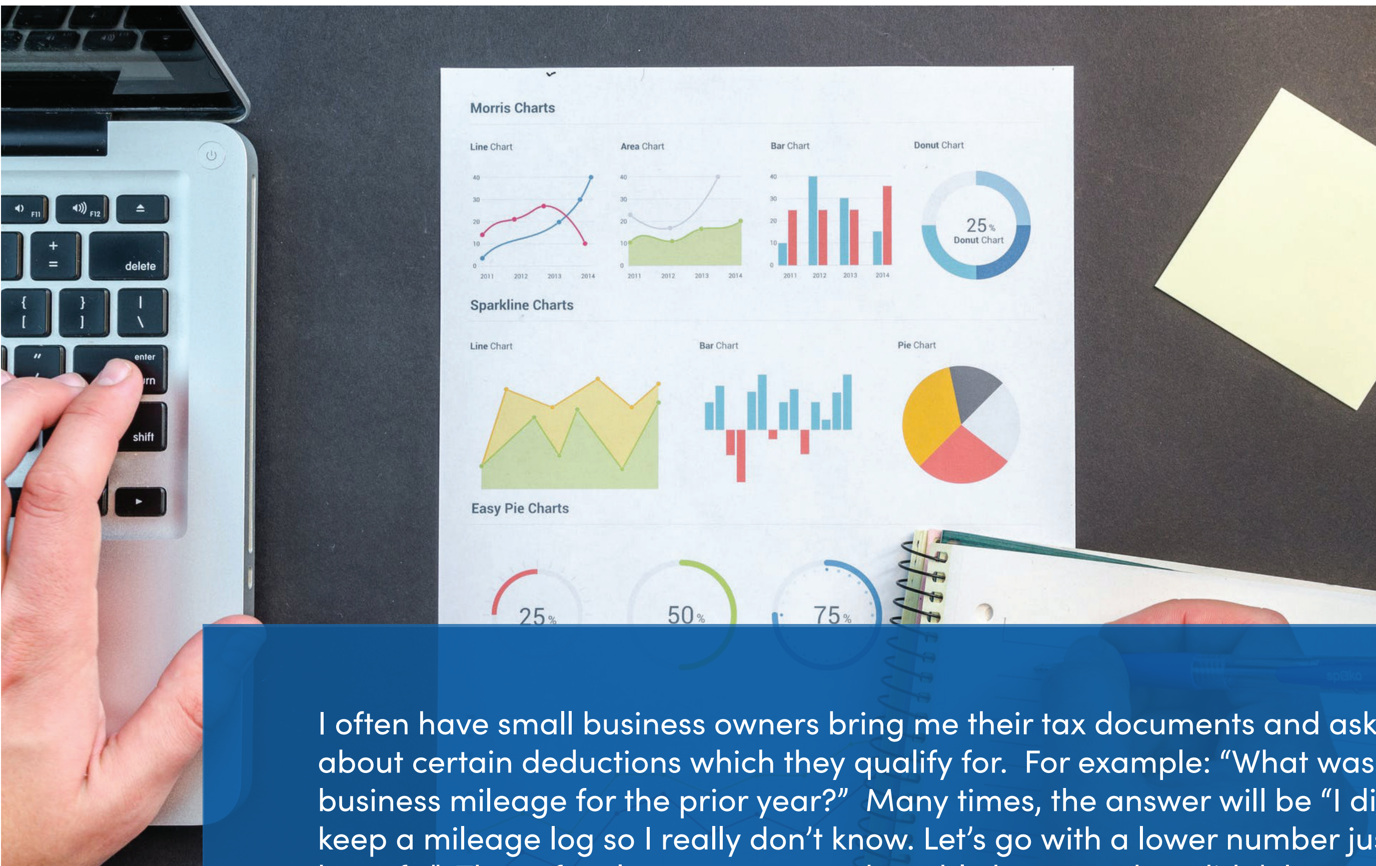
01

FAILING TO PLAN

We have all heard the saying that "Failing to Plan is Planning to Fail". This is never truer than when it comes to income taxes. Often, small business owners will wait until tax time, throw receipts in a shoebox, drop them off at their accountant's office and hope for the best! The problem is, by tax time, it is too late to change your tax situation! You may dig up a few more receipts, but if you did not know that you could potentially write off your kid's braces as a business deduction, it is just too late! (See #7 for more info on medical reimbursement). If you really want to reduce your taxes, you need a plan. You need proactive strategies that can reduce your tax liability without raising red flags or going into "gray" areas. This is where tax planning comes into play. A proactive tax plan can save you THOUSANDS at tax time by utilizing legal strategies that are written within the IRS tax code.

02

FAILING TO KEEP GOOD RECORDS



I often have small business owners bring me their tax documents and ask them about certain deductions which they qualify for. For example: “What was your business mileage for the prior year?” Many times, the answer will be “I didn’t keep a mileage log so I really don’t know. Let’s go with a lower number just to be safe.” They often leave money on the table because they didn’t keep good records. All business owners know you don’t leave money on the table, right? Poor record keeping means missed tax deductions and missed tax deductions mean overpaying your taxes. I advise my clients to invest the time and money into a good recordkeeping system. This includes setting up a separate bank account for your business income and expenses. If you use a credit card for business purchases, use a separate card for personal charges. Don’t pay cash for business expenses. Use an online accounting system or App to download your business checking and credit card information to have easy access to totals. Also, there are several inexpensive Apps that will track your business mileage right from your phone! These things help ensure that deductions are not missed come tax time; a key step to minimize the amount of taxes paid! A little time and money spent now will pay off at tax time!

03

NOT MAKING ESTIMATED TAX PAYMENTS

As a self-employed taxpayer, the IRS requires you to estimate your tax liability each quarter and submit estimated tax payments toward the balance due. Failure to do so can result in penalties being assessed on your tax return which increases the amount you have to pay. It is easier on cash flow to "pay as you go" as opposed to having a large payment to make at year end. It also helps avoid penalties that can add up quickly. Mistakes #1 and #2 also come into play here as well; tax planning and good record keeping! Each are key components to calculating your estimated tax payments. We want to pay in enough to cover the taxes but not too much so the IRS is holding your money all year without paying you interest.

04

CHOOSING THE WRONG BUSINESS ENTITY

There are several choices of entity that business owners can use to operate their business under. These include sole proprietorship, partnership, limited liability company, S corporation and C Corporation. The entity type that you choose determines how much personal liability protection you have as the business owner and how you pay your taxes. There are different tax considerations for each type of entity. Entity choice dictates which set of “rules” you must play under when it comes to taxes. It is important that you understand the rules for your entity type to maximize your ability to take certain tax deductions.

Note: there is no “one size fits all” when choosing the type of entity to operate under. It really depends on each individual situation. What may be the best entity choice today may not be the best choice tomorrow.   Evaluating entity selection is a key component in tax planning. Sometimes just changing the type of entity can save a taxpayer thousands of dollars. Entity selection is always a consideration when it comes to minimizing taxes.

NOT UTILIZING RETIREMENT PLANS

Another key consideration when it comes to tax planning is utilizing retirement plan strategies. Retirement plans are one of the few tax saving strategies that allow you to get a tax benefit for money that you technically get to keep. (You just have to set it aside for the future). Business owners have several options available for retirement plan vehicles outside of just a traditional IRA. These include Simple IRA's, 401(k)'s and SEP plans. These plans can help reduce your liability by allowing you to defer paying taxes on contributions. But wait, it gets better! Earnings grow tax deferred as well; you pay the tax when you draw the money out of the plan at retirement.

06

MISSING FAMILY EMPLOYMENT OPPORTUNTIES

If you have children at home or help support other relatives, you may get a tax deduction by hiring your family member to work for you in your business. This strategy can allow you to shift income from your current tax rate into a potentially lower tax rate (in many cases a ZERO tax rate). To use this strategy, the family member must actually work in the business. There are several "I's to dot and T's to cross" that must be done to make this strategy pass IRS scrutiny. However, it can be a powerful strategy to lower your tax liability and get tax deductions for things you already spend money on. Now you can deduct your child's football camp or car insurance – pay them to work (lower tax bracket) and that pay pays for their expenses (money you would have spent anyway).

And paying your child gives them earned income which then would allow them to put money into a ROTH IRA and build TAX FREE wealth for their future!!

There are also possible benefits to hiring your spouse to help you in your business. (See #7 for more on this).

07

MISSING OPPORTUNITIES TO DEDUCT MEDICAL EXPENSES

Under the current tax law, it is hard for most taxpayers to get a deduction for medical expenses. Taxpayers must itemize deductions, and since the current standard deduction was raised, most taxpayers no longer itemize. If they do itemize, they can only deduct medical expenses that are over 7.5% of their Adjusted Gross Income. For example, if a married couple has $100,000 in income, they could only deduct out of medical expenses over $7,500 for the year. However, certain business owners may be able to take advantage of a loophole in the tax law called a **Me**dical **E**xpense **R**eimbursement **P**lan. **MERP**s allow a business deduction for out of pocket medical expenses. Married business owners who file their taxes as a Sole Proprietorship with no other employees can take advantage of this by hiring their spouse to help them in their business. This is also an option for business owners (married or single) who operate their business as a C Corporation. Note that like hiring family members, there are also certain steps that you must take to assure audit proof medical expense deductions. In certain cases, this can be a big tax benefit. Also, health insurance paid by the business can possibly be deductible as a business expense which can increase the tax benefit as well.

08

NOT FULLY UTILIZING AUTO DEDUCTIONS

Most business owners use their vehicle in the course of running their business. There are two options available when calculating business automobile deductions: standard mileage or actual expenses.

Standard mileage is easy to calculate, take the number of business miles driven and multiply it by the allowable rate set by the IRS for the tax year. Taking the standard deduction allows for a couple of additional auto expenses that can be deducted along with the mileage. These include parking and tolls, and the business percentage of interest paid (financed vehicles). These deductions are often missed on tax returns, even those prepared by tax professionals.

Actual expense calculations are a little more detailed. Take the number of business miles driven for the year and divide it by the total miles driven in the vehicle for the year. That gives you the business use percentage. You can then deduct that percentage of the gas, insurance, repair and maintenance costs, etc. spent for the year. You also can take a depreciation deduction to get some tax benefit on the cost of the vehicle.

Both options require taxpayers to keep a mileage log. However, in my 27 years of practice I have found that only a small percentage of business owners actually do that. This is important for two reasons. First, business owners who don't keep a mileage log tend to use a low estimate of their business miles when they file their taxes. This results in taking a deduction lower that they are entitled to. Second, it is often the item that the IRS will review in case of audit. So, keeping track of your mileage will not only assure that you are taking the full deduction you are entitled to, but also protect you in case the IRS questions the deduction. There are several Apps available for your phone that make mileage tracking easy.

Another mistake that small business owners make when it comes to automobile expenses is not comparing the standard mileage rate against the actual expense deduction. Which way gives the best outcome? Depending on the type of vehicle driven, the costs to operate can sometimes be more than the standard mileage rate. In this case, actual expenses can be a higher deduction that standard mileage. Note: once you decide to take actual expenses on a vehicle you are locked into taking actual expenses in the years to follow as long as you own that vehicle.

09

SKIPPING THE HOME OFFICE DEDUCTION

Do you have a home office that is used regularly and exclusively for your business? Do you claim the office in home deduction on your tax return? Many business owners qualify for this deduction, but they don't report it on their tax return. Why is that? Many have heard that the Office In Home deduction can raise a red flag on their return and could cause the IRS to choose their return for audit.

The home office deduction is one of the most misunderstood deductions available to small business owners. The reason for that is the rules for claiming the deduction have changed several times over the years. To qualify, you must have an area in your home that is used **regularly and exclusively** for administrative or management activities for your trade or business and you have **no other fixed location** where you conduct substantial administrative or management activities. This is true even if you have another office, so long as you don't use it more than occasionally for administrative or management activities

Like automobile expenses, there are two methods available to calculate the home office deduction. Actual expense method or the simplified method. With the actual expense method, you take the square footage of your office space and divide it by the total square footage of your home. That gives you the business use percentage. Then you can deduct that percentage of your home costs such as your mortgage interest, property taxes, insurance, repairs and maintenance and utility costs. You will also depreciate the business use percentage of the cost of your home. Note that when you sell your home, you will have to recapture depreciation that you claimed; but you can still use the tax-free exclusion if you qualify.

The simplified method allows you to take a set $5.00 per square foot for up to 300 square feet of eligible office space. With this method, there is no depreciation recapture upon sale. This method is certainly easier than the actual expense method. However, it often results in a lower deduction that using the actual method. We advise clients to look at both options to see where the get the biggest deduction.

Another advantage to having a home office is it can also boost your automobile deduction; because it can minimize or eliminate commuting miles that would otherwise not be deductible.

EXAMPLE: Let's say you operate a plumbing business and you DON"T have a home office. You get up in the morning and go to your first appointment. The IRS says that this mileage is commuting mileage and therefore is not deductible. You leave your first appointment and go to 2 more. The mileage between appointments is considered business mileage and therefore is deductible. You leave your last stop for the day and head back home. This is also considered commuting mileage and not deductible. Now, let's assume that you have an office in your home. You begin your day in your home office. (your commute is downstairs to your office). You leave your home office and go to your first appointment. The drive now is considered deductible business mileage. The same is true for the mileage from your last stop back to your home if you go back to your home office at the end of the day.

As you can see, taking the Office In Home deduction can be a powerful way to not only get a tax deduction for expenses you are already paying such as your mortgage and utilities, but it also can significantly increase your business mileage deduction as well.

10

NOT WORKING WITH A TAX PLANNER

Now you might be thinking "I already have a CPA, why do I need to work with a tax planner?" Ask yourself this, when is the last time your accountant gave you an idea that saved you money on your taxes? Most accountant's do a great job preparing your tax return. They put the right numbers in the right box on the right form, but then they call it a day. Their time is spent recording history, the history that you give them. The question is, is that all you want?

If you are serious about reducing the amount of taxes that you pay, you ***MUST*** be **PROACTIVE**. (This carries us full circle back to mistake #1). Look forward to the road ahead and not in the rear-view mirror!

In the course of reading this report, you may have found some things that you aren't doing effectively as you could be. Maybe you are operating your business under the wrong entity or you are missing out on automobile or home office deductions. If that is the case, then it is time to work with a tax planner! In most cases, the tax savings from a comprehensive tax plan will more than pay for the tax planning engagement. Keep in mind, savings from a tax plan can continue year after year (if your numbers stay relatively the same). Why wouldn't you want to take advantage of what a certified tax planner can do for you?

About the Author

Hi there! My name is Jacqueline Sheldon, EA, and for the last 27 years I have worked with small business owners to help them keep more of what they make through proactive tax planning.

I am a Certified Tax Coach that specializes in working with small business owners. I am also licensed by the IRS as an Enrolled Agent, which means that I can represent taxpayers and fight for them before the IRS.

If you feel like you are paying too much in taxes, I may be able to help. I offer a FREE tax review to see if I can uncover tax strategies that could reduce your tax liability. Give me a call to schedule your free consultation.

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