

Wayne Davies Answers 19 of Your Most Pressing Small Business Tax Deduction Questions

For Small Business Owners,
Self-Employed People,
Home-Based Business Owners,
Entrepreneurs,
and
Independent Contractors

by
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QUESTION #1:

I've heard there are hundreds of tax deductions, but which ones make the most sense?

ANSWER:

You are right. There are hundreds of legal tax deductions! I've even got a book on my shelf entitled: "422 Tax Deductions for Business & Self-Employed Individuals."

And we should have a good understanding of every single one! But my experience is this: there are certain deductions that are worth far more than others (in terms of actual tax savings), and so we should learn as much as we can about those first.

That's why I've identified what I call the "Top 10" Small Business Tax Deductions, and those are the ones I'm focusing on now.

I think this is another application of the 80/20 rule – i.e. 80% of the tax savings are found in only 20% of the available tax deductions. The challenge, of course, is to identify which deductions fall into the 20% group. That's what I'm doing by drawing special attention to 10 deductions that I believe are head and shoulders above the rest.

QUESTION #2:

People want a simple way to do their bookkeeping; otherwise, all the info about tax deductions won't matter!

ANSWER:

I agree. A simple bookkeeping system is the foundation of any successful business, and it's also the key to an effective tax reduction plan.

Here's an article I wrote about that very topic:

<http://ezinearticles.com/?Small-Business-Taxes---What-is-the-1-Reason-You-Pay-Too-Much-Tax?&id=1848199>

QUESTION #3:

What are the most often ignored/overlooked tax deductions? Even CPA's and other registered tax preparers seem to miss out on ways to help their clients pay less tax.

ANSWER:

Thanks so much for writing.

You really hit the nail on the head!

I agree -- there are many tax deductions that folks never hear about because their tax preparers either

- 1) Don't know about them. (how sad is that?)
- 2) Don't have the time or the desire to tell people about them, especially during tax season, when they are so busy doing tax returns they don't have time (or the desire) to do anything else. (in my opinion, that's also a sad situation).

I believe that I'm here to not only "do the returns", but to help every client pay the least amount of tax allowed by law, and not a penny more.

And so I must be proactive and make tax saving recommendations to my clients. I love helping the average small business owner find out what those deductions are that their tax preparer never told them about.

I think 2 of the most ignored/overlooked deductions are 1) incorporating and 2) deducting medical expenses.

QUESTION #4:

How do I write off prior year losses?

ANSWER:

As a sole proprietor, your losses from a prior year should have been reported on that particular year's personal tax return via Schedule C. If the loss was large enough, this could have created what is called a "Net Operating Loss" (NOL), and NOL's can either be carried back or carried forward (to offset income in other years).

For an S Corp or a partnership, if you have a loss, it gets passed thru the corporation/partnership to the owner's personal income tax return, and then the same carryback and/or carryforward rules apply as mentioned in the paragraph above.

I will have a section in the coaching program on the tax reporting responsibilities of sole proprietors (Schedule C), S Corporations (Form 1120S), and partnerships (Form 1065) and we can certainly address the NOL issue in that lesson.

Plus, the coaching program will have email and phone support -- so I can interact with folks 1-on-1 and go into detail on any particular question that you want and need to know more about.

QUESTION #5:

I tried running my business as a corporation, but it was too much hassle. I prefer the simplicity of a sole proprietorship.

ANSWER:

I'm sympathetic to your aversion to red tape. But I must ask you this: It really wasn't worth it?

Example: (and this example is "real" - I've encountered it numerous times in my 21-year career as a tax pro). I'm a sole proprietor. If I incorporate, I'll save \$6,000/year in taxes. I must pay an accountant and a lawyer about \$1,500/year (for tax returns and legal stuff), and I must spend about 4 hours each year doing some additional paperwork (like signing & mailing payroll tax returns, or whatever).

It's really not worth spending 4 hours a year to save \$4,500?

Here's an article I wrote about this very issue:

<http://ezinearticles.com/?Small-Business-Taxes---What-is-Your-Biggest-Obstacle-to-Paying-Less-Tax?&id=1876858>

QUESTION #6:

Where do I find your "Top 10" list of small business tax deductions?

ANSWER:

There are 2 blog posts that provide an overview of my "Top 10" small biz tax deductions:

<http://selfemployedtaxdeductionstoday.com/5-fabulous-small-business-tax-deductions/>

<http://selfemployedtaxdeductionstoday.com/5-more-fabulous-small-business-tax-deductions/>

QUESTION #7:

I've been wondering whether I should incorporate and I really want to understand this issue better.

ANSWER:

"Should I incorporate?" is one of the most common questions I get from small biz owners and self-employed people. This is a question that really can't be answered responsibly in an email. Sorry! But it is a critical question, one that you must spend some time getting an answer to. Thousands of dollars in tax savings can be at stake. Plus there's the issue of liability protection; if you're not incorporated, you run the risk of unlimited liability.

QUESTION #8:

You've done a great job in your blog of explaining the major points in your "Top 10" list!

When are you going to start the coaching program? I definitely don't want to miss it!
Thanks! A DEVOTED FAN

ANSWER:

Thanks for writing, and thanks for the kind words :-)

Since you're on my email list, I'll keep you posted on when the new tax deduction coaching program will begin, in case you'd like to be a part of that. Look for an email with details in the next few days.

Blogs are good, but folks can only learn a certain amount from a blog, right?

QUESTION #9:

How do you know what legal entity to form?

ANSWER:

"Should I incorporate?" and "What type of entity should I form" are 2 of the most common questions I get from small business owners. And rightly so -- thousands of dollars in tax savings can be at stake, plus there's the issue of asset protection.

My tax coaching program will devote at least 2 lessons (probably 3) to these questions. Plus I'll go into detail on how to make sure you know how to comply with all the tax reporting requirements that go along with forming the various entities.

QUESTION #10:

This is a great list of tax deductions. I would simply want to know more about each one. And I would want to know not only "what" they are, but "how to" implement them.

ANSWER:

I agree. Knowing "the what" isn't enough. Folks must also know the "how to".

That's why I think most small biz owners should be working with a tax professional to learn as much as possible about the wild and wacky world of tax deductions. When it comes to being a Do-It-Your-Self-er, there are certainly some disadvantages to flying solo when it comes to taxes.

You're trying to run a successful business. That's a massive undertaking in and of itself. Trying to keep up with all the ever-changing tax code can be a full-time job. Why run the risk of missing out on tax deduction strategies that you just don't have the time to keep track of by yourself?

QUESTION #11

Over the past month, I've been researching 8 of the 10 deductions in your list. So I guess I don't really have any specific questions. I would just like to learn more about each one.

ANSWER:

Thank you for writing. I'm impressed that you've been researching 8 of the 10 deductions already! Are you psychic? Or just a very tax-savvy small business owner?

For a more in-depth explanation of each deduction, I've been writing a more "meaty" one-page article on each one. Here are the 5 I've written thus far. I'll be posting the other 5 in next week's ezine issue -- so be on the lookout for that, ok?

Incorporate Your Small Business

<http://selfemployedtaxdeductionstoday.com/4-great-reasons-incorporate-your-sole-proprietorship/>

Pay Yourself Reasonable Compensation

<http://selfemployedtaxdeductionstoday.com/4-critical-steps-paying-yourself-reasonable-compensation/>

Contribute to Your IRA or Retirement Plan Every Year

<http://selfemployedtaxdeductionstoday.com/3-reasons-contribute-ira-year/>

Maximize Your Vehicle Deductions

<http://selfemployedtaxdeductionstoday.com/5-easy-steps-irs-mileage-rate-deduction/>

Set Up A Medical Reimbursement Plan (aka How to Write Off All Your Medical Expenses As A Business Deduction)

<http://selfemployedtaxdeductionstoday.com/small-business-tax-deductions-deduct-medical-expenses/>

Of course, reading an article about a tax deduction is one thing. Actually implementing it can be something else altogether. Some of these deductions are fairly straightforward (like keeping track of your mileage). Others are a bit more complex (like incorporating your business).

So, you will really need to get some help to "put it all together", i.e. get a more thorough understanding of the best tax deductions available to your small business, and to track them and deduct them on your income tax returns.

QUESTION #12:

Please explain the medical expense deduction.

ANSWER:

Here's an article I wrote that explains how to write off all your medical expenses as a business deduction --

<http://selfemployedtaxdeductionstoday.com/small-business-tax-deductions-deduct-medical-expenses/>

Let me know what you think, ok? And please let me know if you have any more questions.

QUESTION #13:

I would like to know more about gifting.

ANSWER:

When you say "gifting" -- are you referring to one person gifting an asset to another person? Example -- an elderly parent gifting his stock portfolio to his children?

Currently, people can give up to \$13,000 per year per recipient without incurring the gift tax and without having to file a gift tax return.

This is probably not an area that I'll be covering in my new tax coaching program, because it really isn't directly related to small business tax deductions.

But it is a great question! And an area that most folks don't know much about.

I'm sure you can find some good articles on this topic at <http://taxes.about.com/>

William Perez does a great job there.

Got any questions about small biz tax deductions?

QUESTION #14:

Please explain what deductions are available specifically for S corps with single owners. Everything I have read seems to be more focused toward S corps that have several employees.

ANSWER:

Great question.

Often the #1 "tax perk" for a single-owner S Corp is the ability to reduce self-employment tax. This results from paying yourself "reasonable compensation" as an employee of the corporation, and only these wages are subject to payroll tax while the S Corp profits are not.

There are certainly many other deductions available to S Corps -- the same ones that are available to sole proprietors, partnerships, and C Corporations.

QUESTION #15:

This is not a tax deduction question: What is the best way to record the minutes for a LLC meeting when there is only one owner? Are there sample forms to follow?

ANSWER:

Good question. Any decent attorney can do those minutes for you, once a year, at minimal cost. If you're a do-it-yourself-er, there are plenty of good resources available with "fill in the blank" forms -- just google "LLC minutes" and I'm sure you can find plenty of resources.

I've always like Nolo Press. Their books are top notch.

Here's one of their products that does only what you're asking about.

<http://www.nolo.com/products/minutes-of-llc-meeting-PR078.html>

For a few dollars more, I'm sure you can get one of their books that contains alot more than just that one form.

One more suggestion -- check your local public library. They often have these kind of books, and you sure can't beat their prices :-)

Hope that helps.

QUESTION #16:

I've been an S Corporation for a while. When does it make sense to switch back to being a C Corporation? Is there a certain income level that is better for a C Corp than an S Corp? Also, I've heard that health insurance and other employee benefits are better in a C Corp than an S Corp.

ANSWER:

That's a great question. Re: an income threshold, I don't think there is a "magic number". Like many tax questions, the only responsible short answer I can give you via email is "it depends". Believe me, I wish there was an easy answer.

I think the best advice I can give you is to sit down with your tax pro and "crunch the numbers". Certainly it makes sense to at least do that. You've done well to realize the different tax treatment of benefits for C Corps and S Corps.

Sorry I couldn't give you more specific advice.

QUESTION #17:

I'm a sole proprietor. How do you deduct medical expenses?

ANSWER:

Re: medical expenses -- as a sole proprietor, you've got a couple options:

1. Employ your spouse in your business and set up a Medical Reimbursement Plan (MRP)
2. Set up a Health Savings Account (HSA)

These 2 strategies can be used together. Or you can use just one of them.

I just posted an article to my blog about the MRP (getting lots of questions today about that!) <http://selfemployedtaxdeductiontoday.com/small-business-tax-deductions-deduct-medical-expenses/>

IRS Pub 969 has details on the HSA
<http://www.irs.gov/pub/irs-pdf/p969.pdf>

Hope that helps.

QUESTION #18:

I'm self-employed. I only have one phone (my cell phone); no land line. How much of the cell phone cost is deductible? I use my cell phone for both business and personal calls.

ANSWER:

Re: the cell phone -- I would advise you to take a deduction based on the business-use percentage of the phone. You should identify which calls are personal and which are business, and do an allocation accordingly. You can get this info from your cell phone company. If you use the cell phone 75% for business, you can deduct 75% of the cell phone expense. Fair enough?

QUESTION #19:

I find it very difficult to keep a mileage log. Any suggestions on how to make that task easier?

ANSWER:

Here's a good article on that:

<http://selfemployeditaxdeductionstoday.com/5-easy-steps-irs-mileage-rate-deduction/>

Take special note of Step #3. I think you'll like what I say about those who complain about keeping a log!