

10 Most Expensive Tax Mistakes That Cost Business Owners Thousands

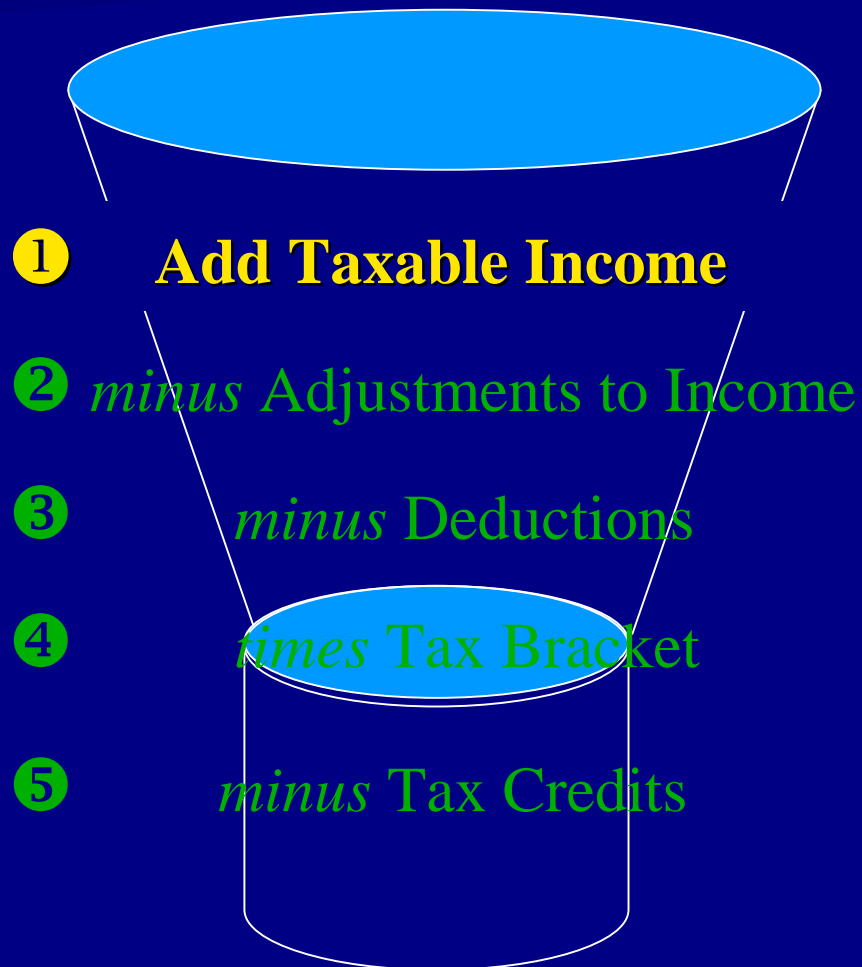
#1: Failing to Plan

“There is nothing wrong with a strategy to avoid the payment of taxes. The Internal Revenue Code doesn’t prevent that.”

William H. Rehnquist

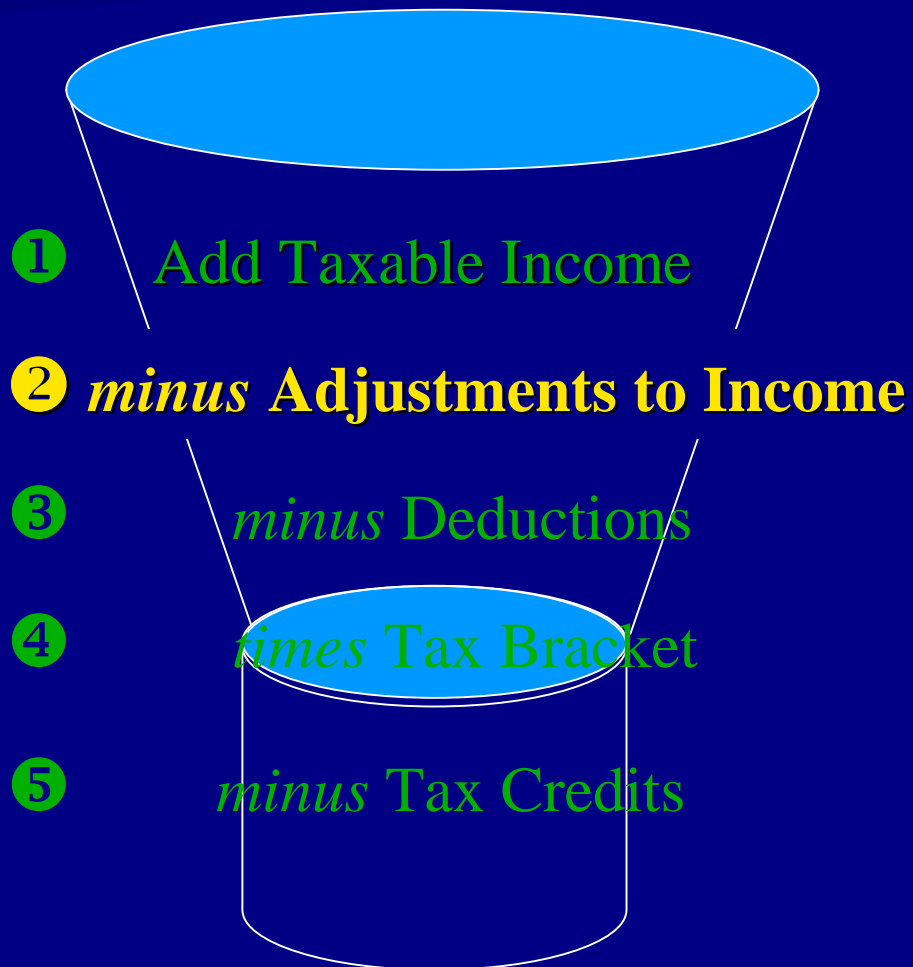
1. Tax planning is financial defense
2. Tax planning guarantees results

Taxable Income



- Earned income
- Interest/dividends
- Capital gains
- Pension/IRA/Annuity
- Rent/royalty
- Alimony
- Gambling winnings
- Illegal income

Adjustments to Income



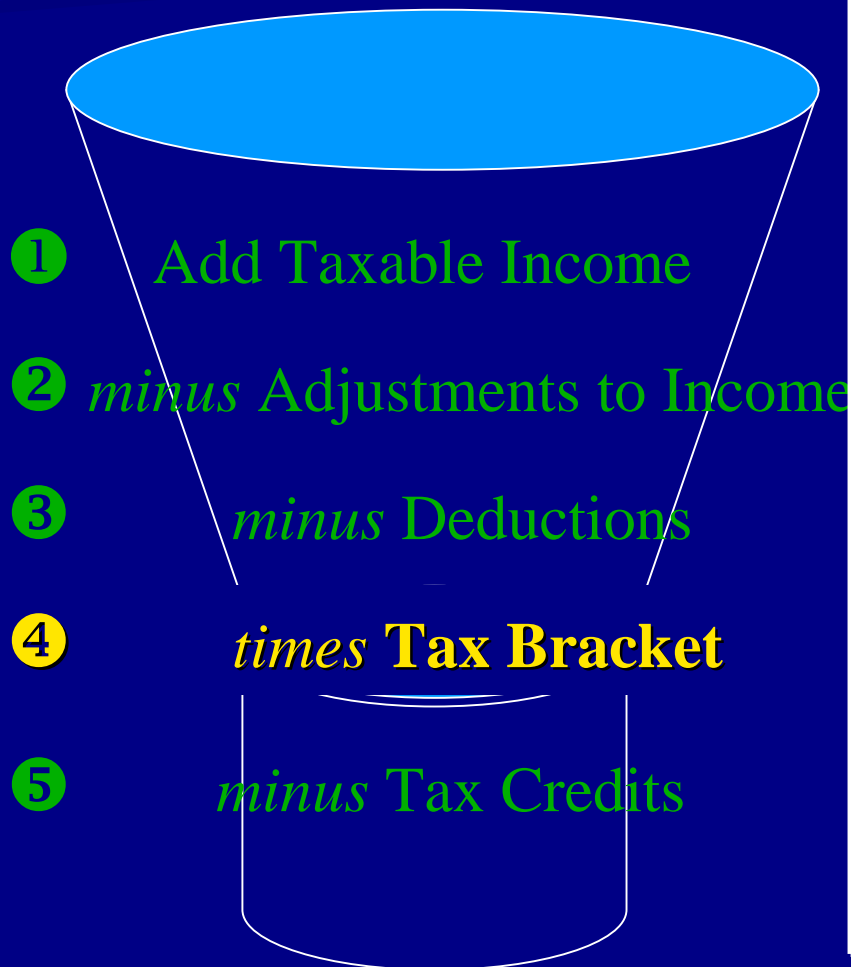
- IRA contributions
- Moving expenses
- ½ SE tax
- SE health insurance
- Keogh/SEP
- Alimony
- Student loan interest

Deductions/Exemptions

-
- ① Add Taxable Income
 - ② *minus* Adjustments to Income
 - ③ *minus* **Deductions/Exemptions**
 - ④ *times* Tax Bracket
 - ⑤ *minus* Tax Credits

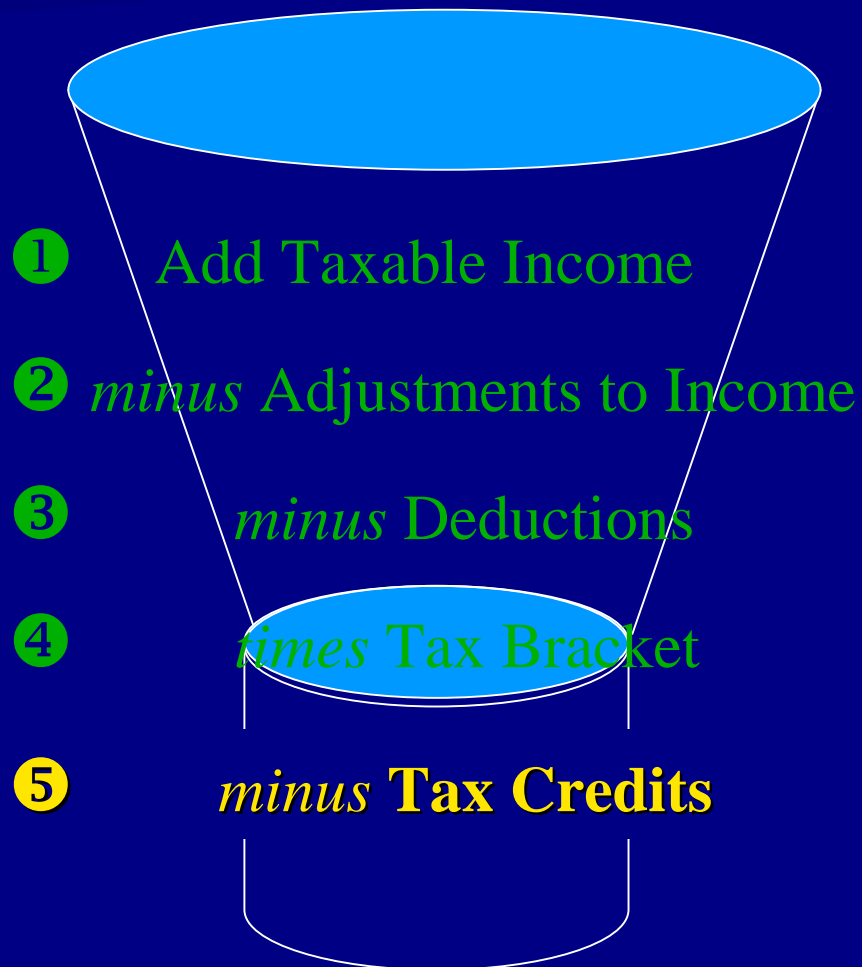
- Medical/dental
- State/local taxes
- Foreign taxes
- Interest
- Casualty/theft losses
- Charitable gifts
- Miscellaneous itemized deductions

Tax Brackets



Rate	Single	HoH	Joint
10%	0	0	0
15%	8,026	16,051	16,051
25%	32,551	43,651	65,101
28%	78,851	112,651	131,451
33%	164,551	182,401	200,301
35%	357,701	357,701	357,701

Tax Credits



- Family credits
- Education credits
- Foreign tax
- General business
- Low-income housing
- Renovation

Two Kinds of Dollars

-
- ① Add Taxable Income
 - ② *minus* Adjustments to Income
 - ③ *minus* Deductions
 - ④ *times* Tax Bracket
 - ⑤ *minus* Tax Credits

Pre-Tax Dollars

After-Tax Dollars

Keys to Cutting Tax

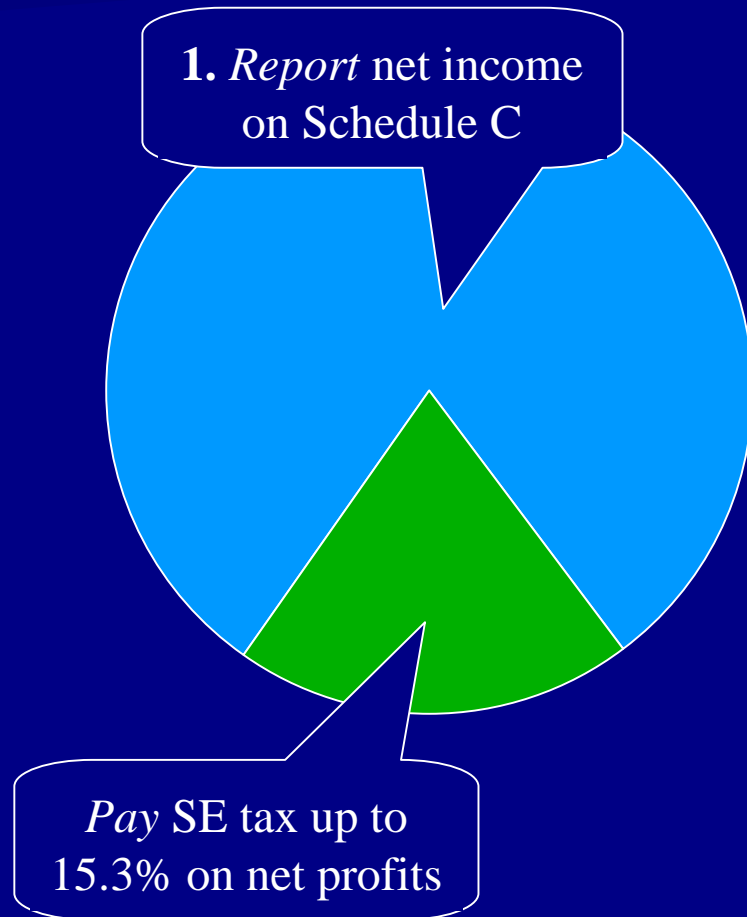
“You lose every time you spend after-tax dollars that could have been pre-tax dollars.”

1. Earn as much nontaxable income as possible
2. Make the most of adjustments/deductions/credits
3. Shift income to later years and lower-brackets

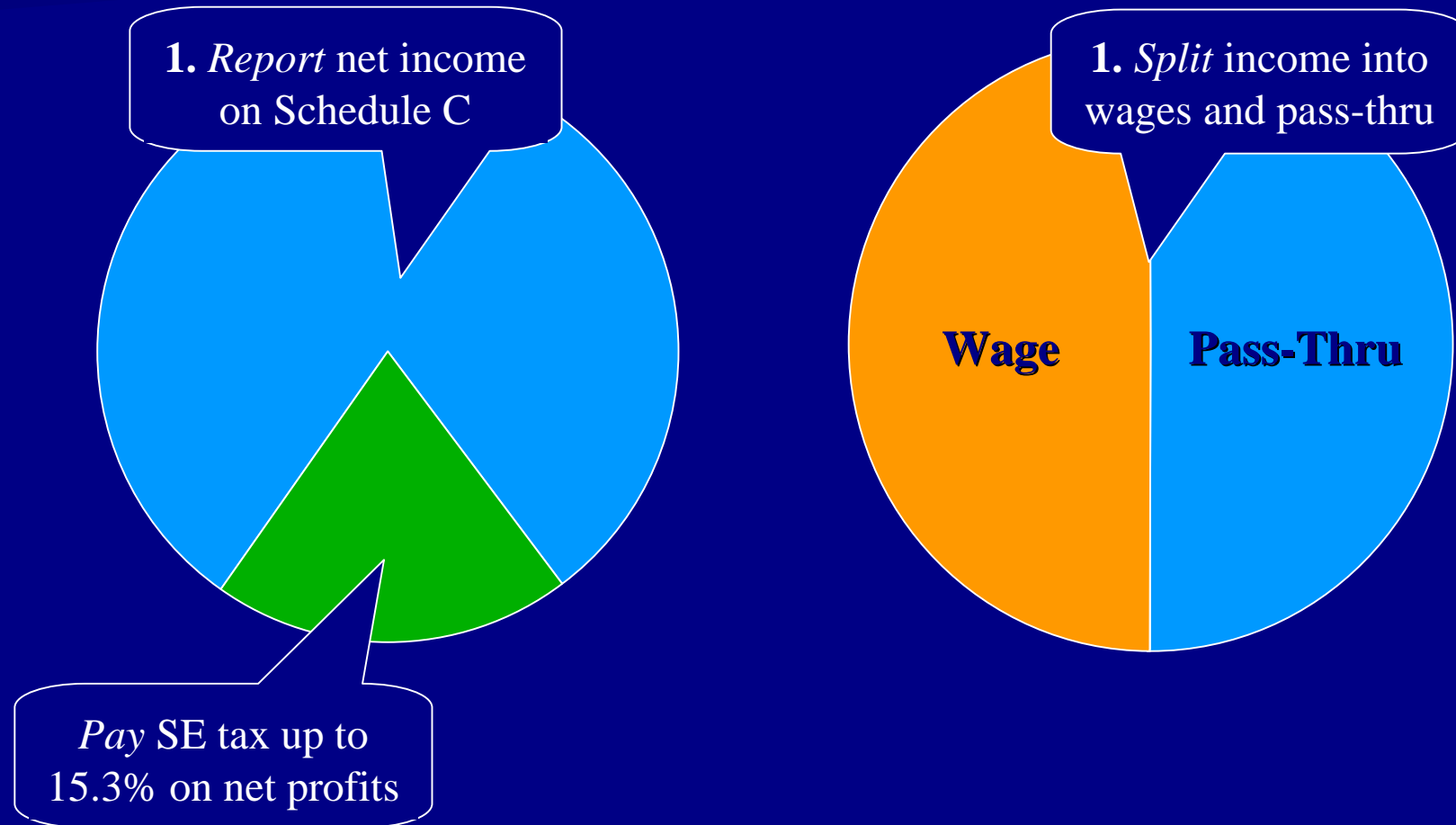
#2: Misunderstanding Audit Odds

Filer	FY 2004	FY 2005	FY 2006
Form 1040 (by Income)			
\$ 0 – 24,999	1.25%	1.46%	1.49%
\$ 25,000 – 49,999	0.43%	0.60%	0.62%
\$ 50,000 – 99,000	0.44%	0.57%	0.62%
\$100,000 +	1.39%	1.41%	1.29%
\$1,000,000+	N/A	5.2%	N/A
Schedule C (by Gross Receipts)			
\$ 0 – 24,999	3.15%	3.88%	3.78%
\$ 25,000 – 99,000	1.47%	3.31%	2.09%
\$100,000 +	1.86%	3.85%	3.90%
S Corp (Form 1120S)	0.19%	0.30%	0.38%
LLC/Partnership (Form 1065)	0.26%	0.33%	0.35%

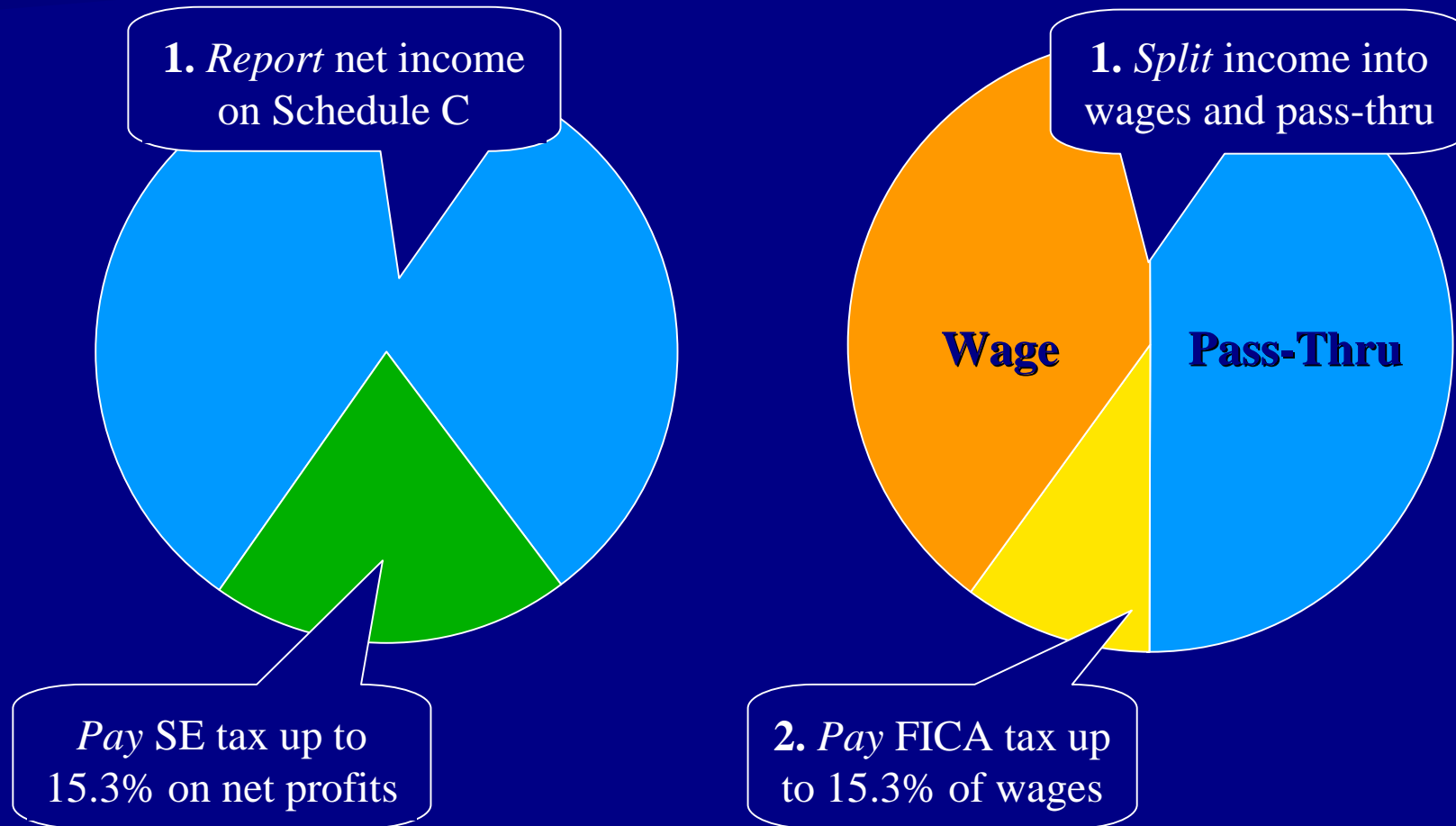
#3: Too Much SE Tax



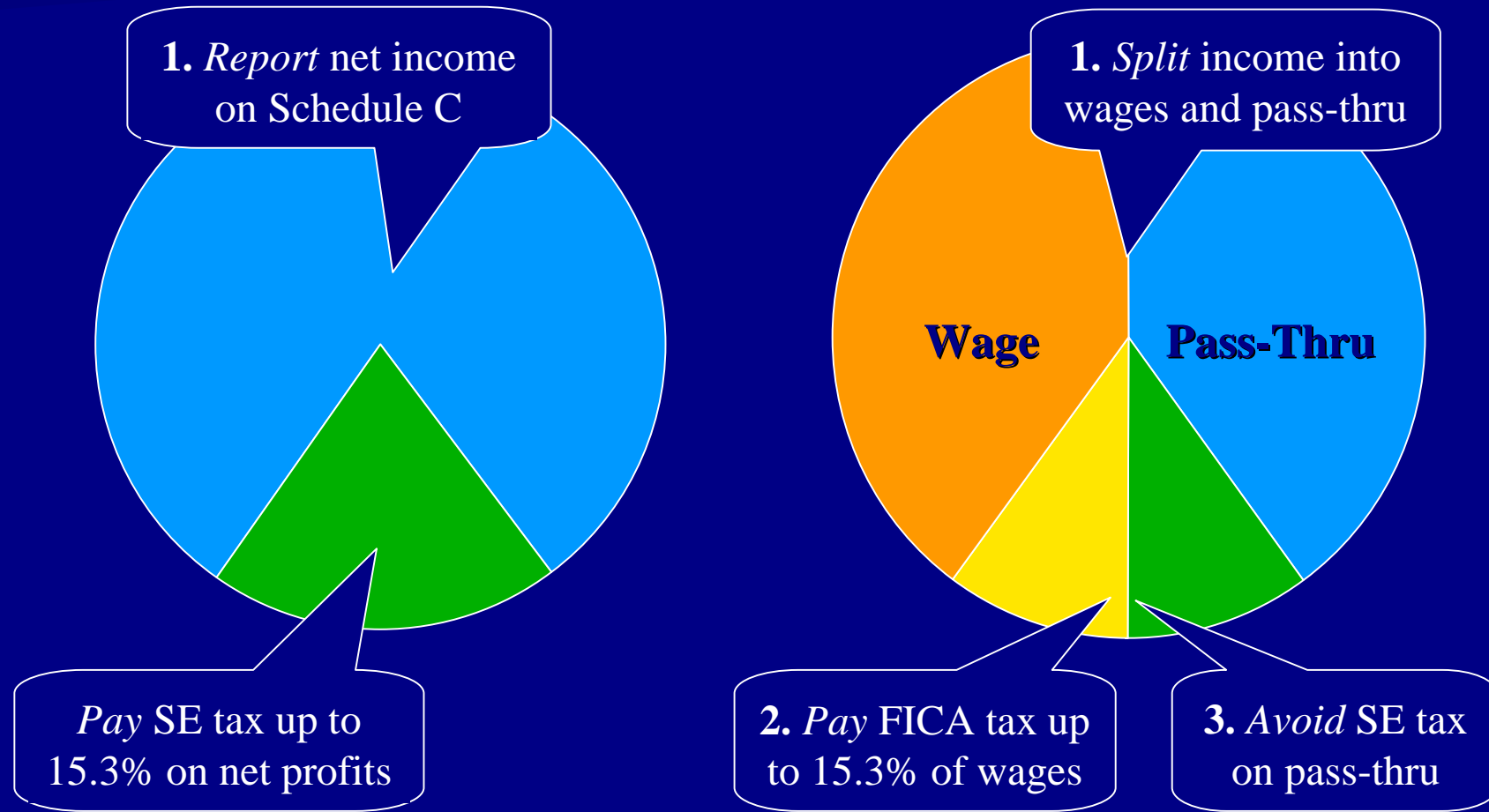
Proprietorship vs. S Corp



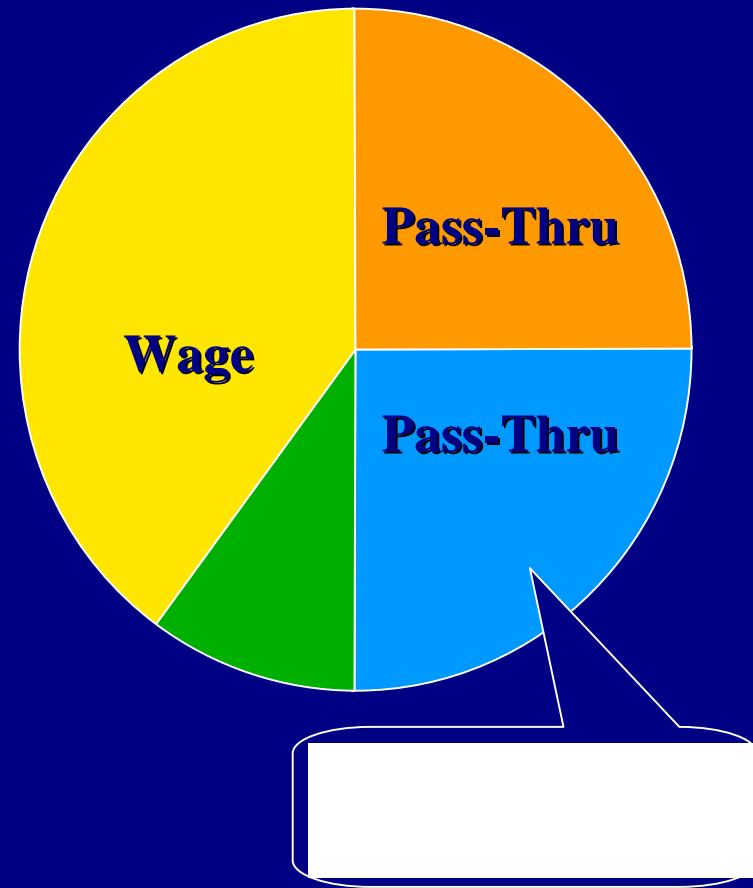
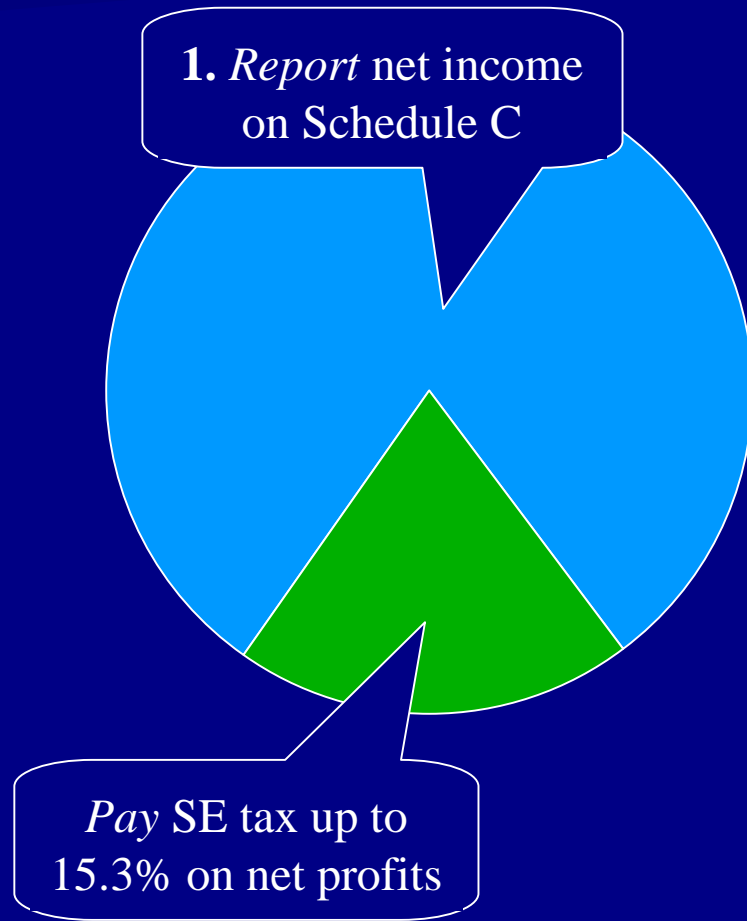
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Proprietorship vs. S Corp



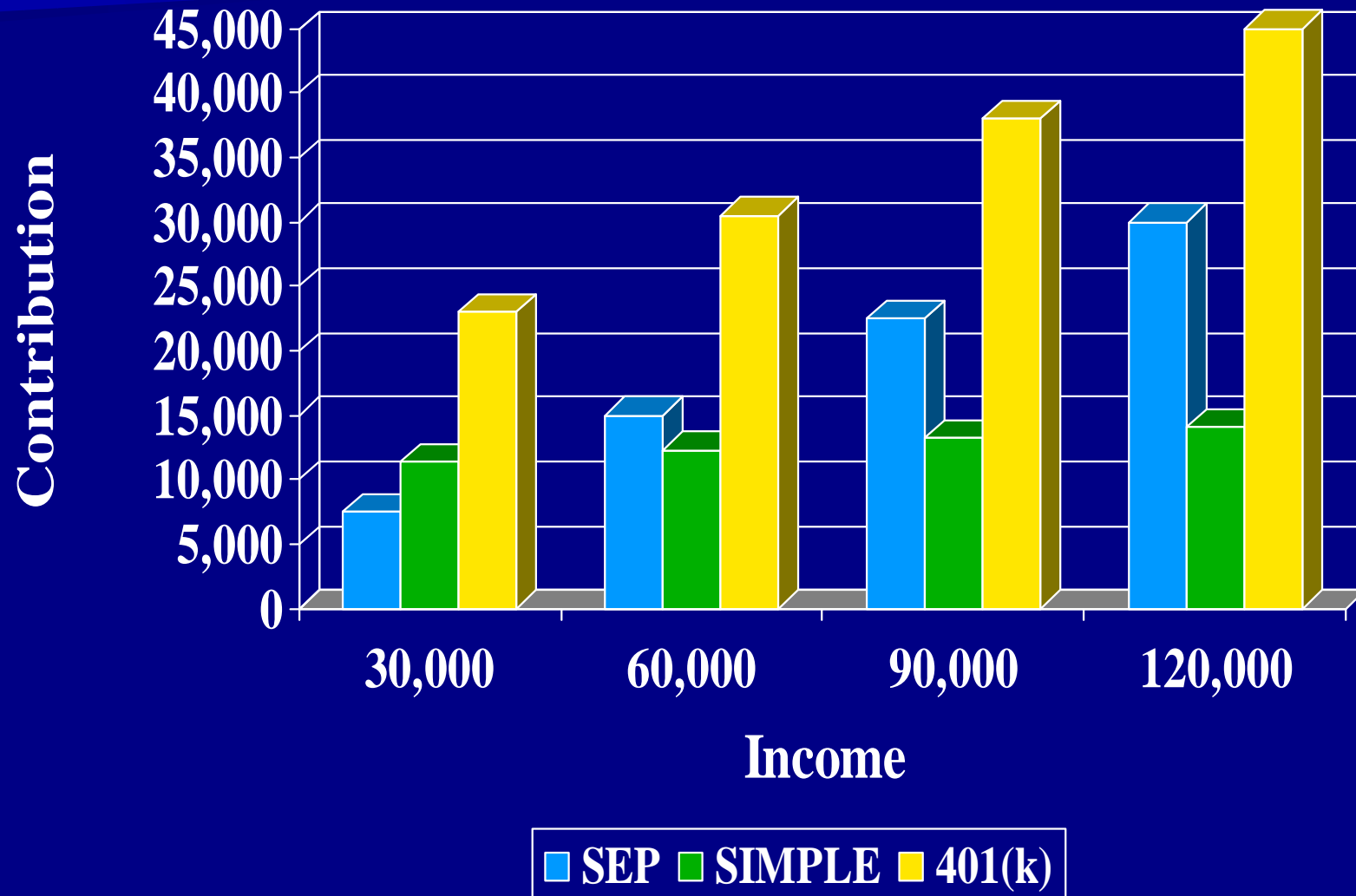
Proprietorship vs. S Corp



Entity Comparison

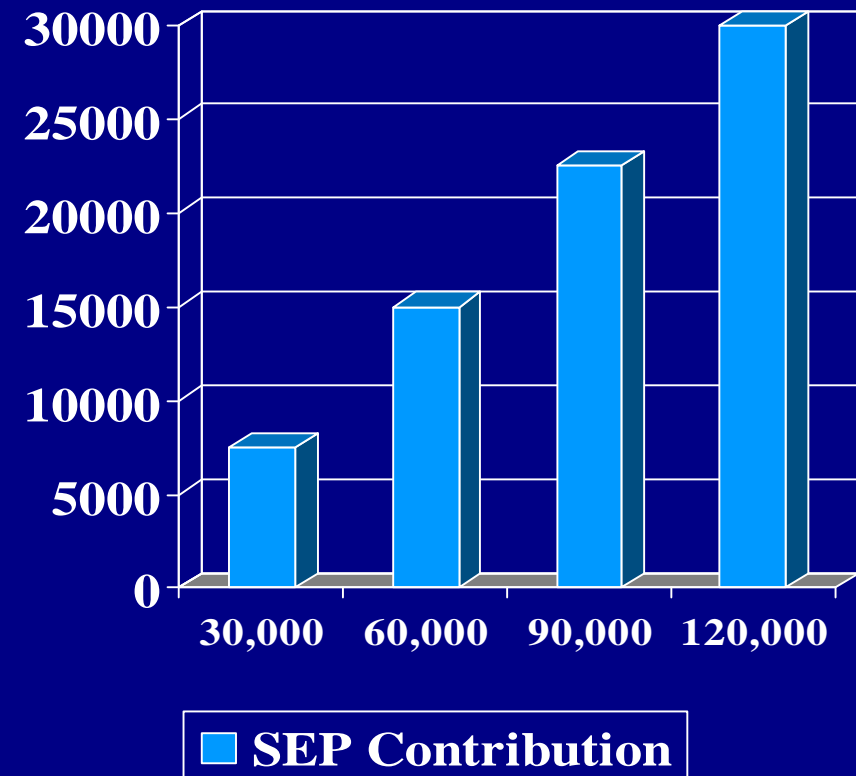
	Proprietor	S Corp
State Filing	None	Articles
IRS Filing	None	EIN/S Election
Meetings	None	Annual
Owner Payroll	None	FICA, UC, WC
SE Tax	Net income	Salary Only
File	Schedule C	1120S + K1
Income Split?	No	Yes

#4: Wrong Retirement Plan



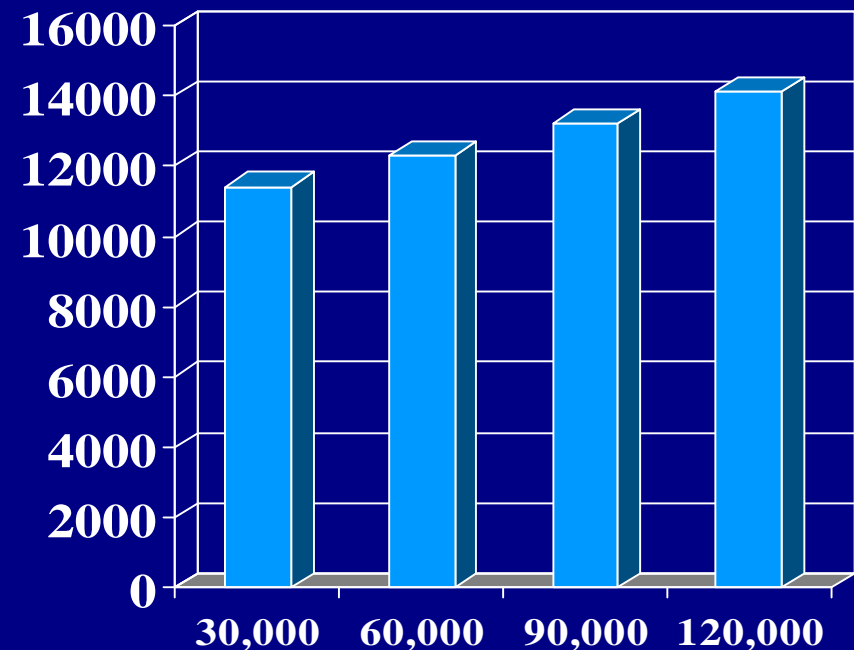
Simplified Employee Pension

- “Turbocharged” IRA
- Self-employed contribute up to 25% of “net SE income”
- Corporations contribute up to 25% of “covered comp”
- Max. contribution: \$46,000
- Must contribute for all eligible employees
- Contributions directed to employee IRAs
- No annual administration



SIMPLE IRA

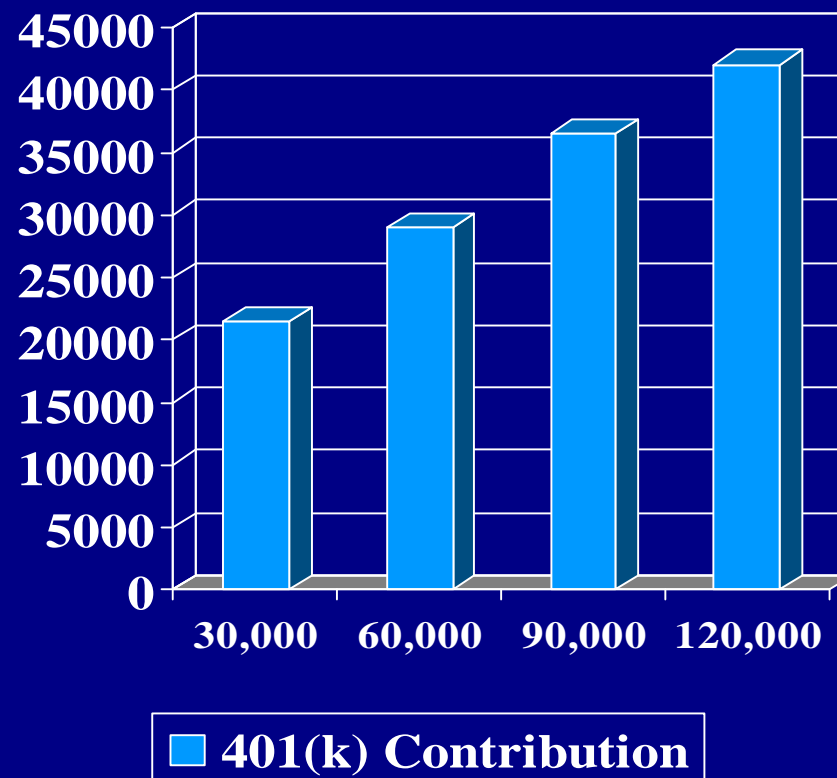
- Employees defer up to 100% of income or \$10,500
- Employees age 50+ can add \$2,000 “catch up”
- Business “match” or “PS”
 - Match \$-for-\$ up to 3%
 - Profit share = 2% of income
- Contribute to SIMPLE- IRAs
- No annual administration



■ SIMPLE Contribution

401(k)

- Employees defer 100% of income up to \$15,500
- Employees age 50+ can add \$5,000 “catch up”
- Employer contributes up to 25% of “covered comp”
- Max. contribution: \$45,000
- Loans, hardship withdrawals, rollovers, etc.
- Simplified administration for “individual” 401(k)



Defined Benefit Plan

- Guarantee up to \$175,000 annual retirement income
- Calculate contributions according to current age, retirement age, and salary
- Required annual contributions
- “412(i)” fully-insured plan
- “Dual” plans for more flexibility

Age	Regular	412(i)
45	\$80,278	\$164,970
50	\$133,131	\$258,019
55	\$211,448	\$395,634
60	\$236,910	\$450,112

Projections based on retirement at age 62 with \$165,000 annual pretax income.

#5: Missing Family Employment

- Children age 7+
- First \$5,450 tax-free
- Next \$8,025 taxed at 10%
- “Reasonable” wages
- Written job description, timesheet, check
- Account in child’s name
- FICA/FUTA savings

#5: Missing Family Employment

- Children age 7+
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- Account in child’s name
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#6: Missing Medical Benefits

- Employee benefit plan
 - Married: Hire spouse (no salary necessary)
 - Not married: C-corp
- Reimburse *employee* for medical expenses incurred for self, spouse, and dependents
- Works with any insurance
 - Use your own insurance
 - Supplement spouse's coverage

MERP/105 Plan

- Major medical, LTC, Medicare, “Medigap”
- Co-pays, deductibles, prescriptions
- Dental, vision, and chiropractic
- Braces, fertility treatments, special schools
- Nonprescription medications and supplies

MERP/105 Plan

- Written plan document
- No pre-funding required
 - Reimburse employee
 - Pay provider directly
- Bypass 7.5% floor
- Minimize self-employment tax

Health Savings Account

1. “High deductible health plan”

- \$1,950+ deductible (individual coverage)
- \$3,850+ deductible (family coverage)

Plus

2. Tax-deductible “Health Savings Account”

- Contribute & deduct up to \$2,900/\$5,800 per year
- Account grows tax-free
- Tax-free withdrawals for qualified expenses

Example

Owner/spouse/2 children
31% federal/state tax
15.3% self-employment tax

Before

\$900/month premium

- no deductible/out-of-pocket
- \$15 co-pays
- \$10/\$20/\$40 drug card

\$10,800 *minimum/year*

- \$2,700 federal savings
- \$ 0 SE tax savings

\$ 8,100 after-tax cost

After

\$265/month premium

- \$5000 out-of-pocket max
- 80/20 drug co-pay
- 100% after o-o-p max

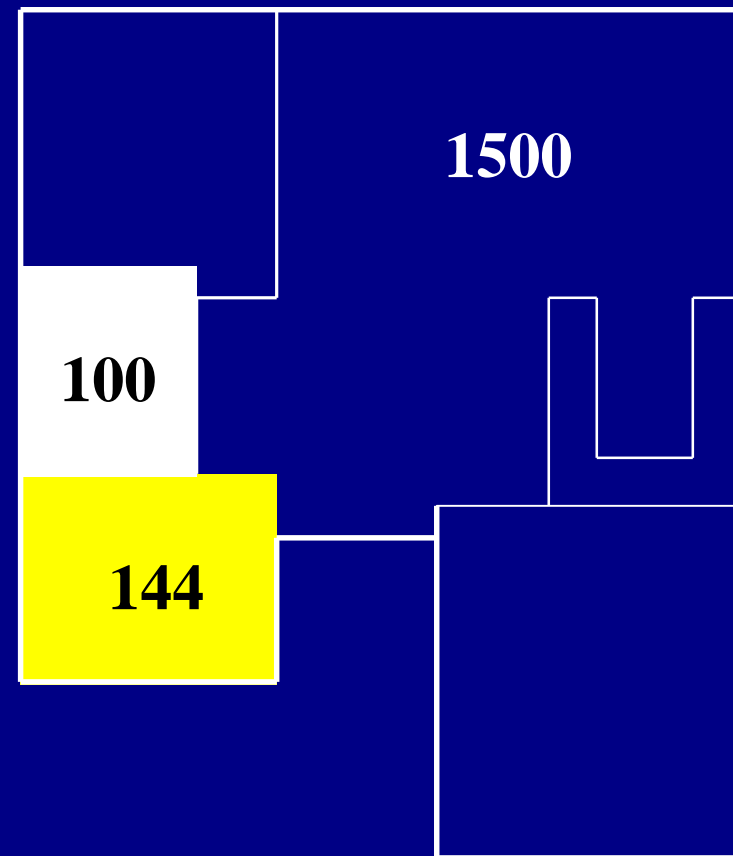
\$8,180 *maximum/year*

- \$2,045 federal tax savings
- \$1,156 SE tax savings

\$4,979 after-tax cost

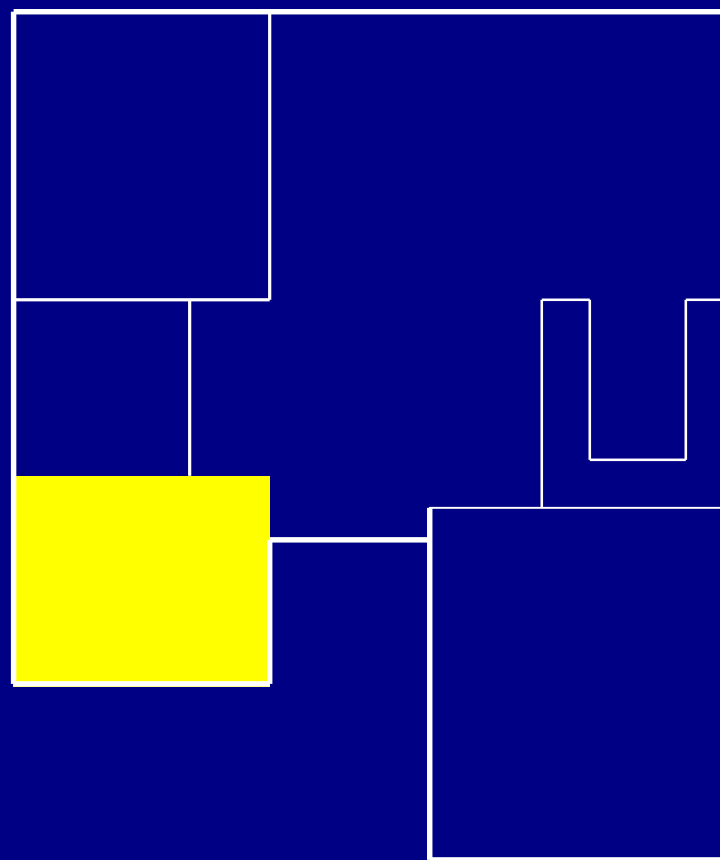
#7: Missing A Home Office

- Determine “BUP” of home
 - Divide by rooms
 - Square footage
 - Eliminate “common areas”



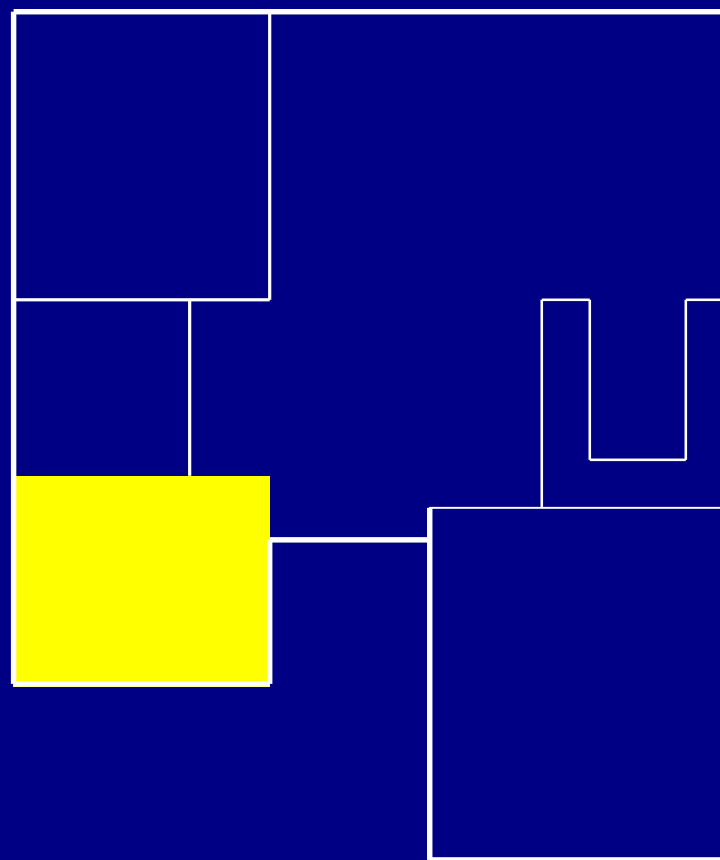
#7: Missing A Home Office

- Deduct “BUP” of expenses:
 - Mortgage/property taxes (better than Schedule A)
 - Utilities/security/cleaning
 - Office furniture/decor
 - Depreciation (39 years)
- “Footie pajama” commute



#7: Missing A Home Office

- When you sell:
 - Recapture depreciation
 - *Keep* tax-free exclusion



#8: Missing Car/Truck Expenses

AAA Driving Costs Survey (2007)

Vehicle	Cents/Mile
Small Sedan	41.4
Medium Sedan	52.5
Large Sedan	62.5
4WD SUV	66.6
Minivan	57.6

Figures assume 15,000 miles/year; \$2.256/gallon gas

#9: Missing Meals/Entertainment

- *Bona fide* business discussion
 - Clients
 - Prospects
 - Referral Sources
 - Business colleagues
- 50% of most expenses
- Home entertainment
- Associated entertainment
- How much?
- When?
- Where?
- Business purpose?
- Business relationship?

#10: Missing Tax Coaching Service

- *True Tax Planning*
- *Written Tax Plan*
 - Family, Home, and Job
 - Business
 - Investments
- *Review Returns*