TaxTips

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Substantiating Business Expenses

Don't forget to save those receipts

As a business owner, one of the most important things you should do is keep good records. Without them, the IRS may disallow some of the expenses you incur if it chooses your return for a closer look. Maintaining good records should be done throughout the year. Keeping receipts, credit card statements, bank statements, and canceled checks is a must. Set aside a spot in your office for expenses and sort through them periodically. Group similar expenses together and total them. Keep receipts for large purchases, such as equipment or capital improvements, separate because they are reported differently on your tax return. Staying organized will give you a better idea of the expenses you are incurring and what your bottom line will be. An added benefit is that when it comes time to file your tax return, you'll be more prepared.

Leasing Assets to Your Corporation

A simple strategy may save you money on taxes

A business doesn't have to own all its operating assets. Leasing your personally owned property, such as a building, vehicle, or equipment, to your incorporated business may be a good tax-savings strategy. Similarly, another corporation, a partnership, or a family business in which you have an ownership interest may lease assets to your corporation. In addition to possible tax savings, you may not want your corporation to own a lot of assets if you are in a business where lawsuits are common. Leasing instead of owning is one way to insulate assets from potential creditors.

To avoid potential problems with the IRS, lease terms between you and your corporation must be fair to both sides. The contract should be legally binding and the payments should be set at the same rate you would charge anyone else. Lease payments are deductible expenses to the corporation, while lease income is taxable to you. In turn, you'll get to deduct costs of ownership, such as mortgage interest, maintenance, repairs, depreciation, acquisition interest, insurance and administrative costs.

Employer Identification Numbers

When do you need one?

There are several instances when you will need to apply for a federal employer identification number (EIN). The most common instance is when you are operating a business and you have employees. If you are operating a sole proprietorship and you do not have any employees, your social security number is typically all you need.

If you are a sole proprietor and you have an EIN, you'll need to get a new one if you convert to a partnership or corporation. If you convert to a limited liability company, you'll only need a new EIN if you choose to be taxed as a corporation or partnership.

You won't need a new EIN if you only change the name or location of your business, or if you operate at more than one business location.

Selling Your Business

Know the tax consequences beforehand

The tax consequences of selling a business depend on whether you operate as a sole proprietor or a corporation. As a sole proprietor, selling your business means you are selling the individual assets of the business. The sale of a business is not usually a sale of one asset. Instead, some or all of the business's assets are sold. When this occurs, each asset is treated as being sold separately for determining the treatment of gain or loss.

If you are incorporated, you can either sell your stock to another individual, or the corporation can sell the assets. If the assets are sold, the corporation pays the tax on any gain. You, as a shareholder of the corporation, do not have a tax consequence unless the corporation liquidates and distributes the proceeds of the sale to you in exchange for your stock.

In any case, if you sell your business, you may need to complete additional tax forms with your annual tax return. When sold, these assets must be classified as capital assets, depreciable property used in the business, real property used in the business, or property held for sale to customers, such as inventory. The sale of capital assets results in capital gain or loss. The sale of inventory results in ordinary income or loss.

It's important to determine what the potential tax consequences are prior to signing the sales contract. If you want to defer the gain on the sale, an installment agreement might be an option. Let me help you understand your options so we can discuss the tax consequences before you sell.

Business Owners Beware

Scammers are after your data

For years, we have heard stories about how identity thieves hack into computers and steal personal information. We have been assaulted with phishing scams where thieves impersonate IRS employees and intimidate innocent taxpayers into paying large sums of money for taxes they don't owe. No one is immune to this threat. Individuals in all 50 states have been targeted.

Now the thieves are targeting business owners. To put things into perspective, through June 1, 2017, the IRS identified approximately 10,000 business returns as potentially theft-related compared to about 4,000 for calendar year 2016 and 350 for calendar year 2015.

This coming filing season, the IRS will be asking tax professionals to gather more information on their business clients. All the data being collected assists the IRS in authenticating that the tax return being submitted is the legitimate return and not an identity theft return. Some of the new information people may be asked to provide when filing their business, trust or estate client returns include:

- The name and social security number of the individual authorized to sign the business return. Is the person signing the return authorized to do so?
- Were estimated tax payments made? If yes, when were they made, how were they made, and how much was paid?
- Is there a parent company? If yes, what is its name?
- Additional information based on deductions claimed.
- Has the business filed Form(s) 940, 941 or other business-related tax forms?

Now is a good time to determine if you need an employer identification number. If you are required to have one, the IRS will ask for it.

Automobile Expenses

Which is better, deducting the standard mileage rate or claiming actual expenses?

With the standard mileage at 53.5 cents per mile for 2017, it might be time to revisit what yields the more substantial deduction—the standard mileage rate for each business mile, or your actual car expenses. If this is the first year you have business use of an automobile, you don't have to decide which method yields the better result until you file your return. If this is not the first year you have business use of an automobile, you cannot switch to the standard mileage rate in a later year if you started with deducting the actual expenses. On the other hand, if you started with deducting automobile expenses using the standard mileage rate, you can switch to the actual expense method.

Admittedly, claiming the standard mileage rate is a lot easier for most of us. All we have to do is keep track of our business miles and multiply them by the current rate. In addition, you may also deduct your costs for parking and tolls and, if you are self-employed, the interest on your car loan. Claiming actual expenses requires a bit more diligence in your recordkeeping. Doing so, however, may pay off in the end by giving you a larger deduction.

First, you must keep receipts for all your gasoline and oil, repairs, tires, licensing and registration fees, insurance, garage rent, lease fees, parking, tolls, and rental fees. If you are self-employed, you may also take the business portion of any interest you are paying on a car loan. Luxury and sales taxes are not deductible under any circumstance, although the amounts you pay can be added to your cost and recovered through depreciation.

Regardless of the method you choose, the expenses are limited to your business-use percentage. This percentage is calculated by dividing your total business miles by your total miles driven for the year. It's wise to make note of your odometer reading on January 1 and again on December 31.

Working with Your Spouse

Is your spouse your employee?

One of the advantages of operating your own business is hiring family members. However, the employment tax requirements for family employees can vary from those that apply to other employees. There are a couple of different ways a married couple can operate a business together.

If you operate a sole proprietorship and you hire your spouse as an employee, you have an employee/employer relationship. This means one spouse substantially controls the business in terms of management decisions and the other spouse is under his or her direction and control. If such a relationship exists, then the nonowner spouse is an employee subject to income tax withholding, social security and Medicare tax, but not to FUTA tax. If this type of arrangement exists, you can provide benefits to your spouse and deduct them on your business return. One of these benefits can be health insurance. If your spouse is a bona fide employee and is paid a reasonable wage for the services that he or she performs, you can provide health insurance to your spouse with a policy that covers both of you. This way you are allowed a deduction for the coverage on your business return and, in turn, reduce your self-employment tax. You can also provide retirement benefits to your spouse.

On the other hand, if your spouse has an equal say in the business affairs, provides substantially equal services to the business, and contributes capital to the business, then a partnership relationship exists and the business's income should be reported on Form 1065. When spouses carry on a business together and share in the profits and losses, they are partners in a partnership regardless of whether they have a formal partnership agreement. They should not report the income on a Form 1040, Schedule C, in the name of one spouse as a sole proprietor nor should they file a joint Schedule C. In a partnership, each spouse reports their separate share of the partnership income and pays their own self-employment tax. This generally does not increase the total tax on the return, but it does give each spouse credit for social security earnings on which retirement benefits are based.