DISCLAIMER: We are not professional tax advisors, nor are we Certified Public Accountants. Information provided here is for educational purposes only.

TAX TIPS

The one question that every business owner has asked is "How do I get to keep more of my hard-earned business money before the government taxes it away?"

The answer is: **DEDUCTIONS**

As a small business owner, you work, try to grow your business, and hope to make a profit. What you can keep from that profit depends in part on the income tax you pay.

You are not taxed on all the income you bring in by way of sales, fees, commissions, or other payments. Instead, you are essentially taxed on what you keep after paying off the expenses of making the sales that are the heart of your business.

The next question small business owners ask is "What can I deduct?" There are more deductions than what can be covered here and what you can deduct depends entirely on every individual's situation. Although the IRS allows theses deductions, they do put strict limitations on them.

1. TRAVEL & ENTERTAINMENT
   - As a general rule, the costs of commuting between your home and workplace are not deductible. However, if you can prove that your home office is your "principal" place of business, the cost of travelling from your home to your customers is deductible.
   - If you travel away from your "tax-home" for more than one day, all business-related expenses are fully deductible—airfare, taxi, parking, lodging, entertainment, and incidentals, EXCEPT meals, which is 50% deductible. You must be able to prove it was business-related and bookkeeping records must indicate the length of stay, city & state where you traveled, and reason for travel. And, it must be within reason. I must note that the "standard" daily meal allowance here in Wisconsin is $34/day. The meal allowance varies between different cities in different states. (Your bookkeeper and accountant will need to know the detailed information, if you use a bookkeeper and an accountant.)
   - For Travel to Conventions—If the convention is related to the active conduct of your business, meals are 100% deductible.
   - For tax purposes, Travel & Entertainment expenses are recorded on Schedule C of the IRS tax forms.

2. CAR EXPENSES
   - You can choose between two methods for deducting business-related expenses of a car:

1. Actual Expense
2. Standard Mileage Allowance (36.5¢/mi. 2002)

- You must make the decision in the first year you own the car or place the car in service for business.
- If you choose to use the Actual Expense method in the first year, you can not use the standard mileage expense in later years.
- The Actual Expense method allows you to deduct all of your out-of-pocket costs for operating your car for business, plus an allowance for depreciation if you own your car.
- Actual expenses include:

Depreciation	Licenses	Tolls
Garage Rent	Oil	Towing
Gas	Parking Fees	Lease Fees
Insurance	Repairs	Tires

- If you are self-employed, the interest on your car loan is also deductible if used more than 50% for business, if you elect to use actual expenses.
- The Standard Mileage Allowance also includes deductions for:

Parking Fees	Towing	Tolls

- It is VERY important that you record the number of miles driven for business, the date of each trip, the designation for the travel, and the reason. You must also keep track of the total number of miles driven each year.
- For tax purposes, Car Expenses for the business are recorded on Schedule C of the IRS tax forms and the mileage breakdown is recorded on IRS Form 2106.

3. RENT OR MORTGAGE PAYMENTS

(THIS IS A TRICKY ONE-and the only one I will explain in-depth)

- To claim a rental deduction, you must use the portion of your home as the "principal" place of business activity conducted at home and as a place for meeting or dealing with clients in the ordinary course of your business. Your home office will qualify as your principal place of business if you spend most of your working time there and most of your business income is attributable to your activities there.
- It must be regularly and exclusively used for this purpose.
  (1998 EXCLUSIVE: No one else uses that portion of your home for any other purpose. No children's computer games, no novelty books or other un-business-related merchandise or activity is to be near or around that portion of your home. And, it must be sectioned off from the other areas of your home if it is not a separate room.)
- The IRS uses their "theory of relativity" when it comes to qualifying your home office deduction. They use 2 steps to determine whether a home office is the principal place of business:
  1. The importance of activity at that location and
  2. The time spent at that location
- In 1998 the IRS did not consider administrative or management activities as qualifying evidence. HOWEVER, in 1999 the IRS loosened up the reigns it has on us small business owners. A home office will meet the principal place of business test if it is used "exclusively" (there's that word again) and regularly to conduct administrative or management activities and you can show that there is no other fixed location where

you conduct substantial administrative or managerial activities for your business [J.K. Lasser's *Your Income Tax 2002* – This book is "our bible" and I and my accountant friends highly recommend it.]

- Lastly, the amount of your home office deduction must be directly proportionate to the total square footage of your home and cannot exceed gross income derived from the home office activity. If it exceeds this limit, the excess can be carried forward into the next year, if there is sufficient gross income in that year.

  EXAMPLE:
  1. Figure the square footage percentage.
     1,500 total sq. ft./1 rm. is 10 X 11 (110 sq. ft.)
     The room uses 8% of the total square footage.
     This percentage then becomes the basis of indirect expenses you can also deduct: homeowners/renters insurance/security systems/repairs/maintenance, etc.
  2. Figure the home office deduction based on the percentage derived in step #1.
     $2,400 annual rent X 8% = Home Ofc. Exp.
  3. Say you gross $30,000 – and annual home office deduction is $2,400 – you can deduct all of the home office deduction.
- For tax purposes, business use of home is computed on IRS form 8829 and the deductible portion is recorded on the IRS Schedule C.
- NOTE: If you are a homeowner you may not want to use the home office deduction. If you do, there will be a capital gain assessed on the percentage of the sale of the home. (The same percentage you used to calculate your home office deduction.) Please consult with an accountant.

4. SELF-EMPLOYMENT TAX EXPENSE

- Owners of businesses organized other than as a corporation are not employees of their businesses. As such, they are personally responsible for paying Social Security and Medicare taxes (called "Self-employment tax.")
- Owners of unincorporated businesses pay self-employment tax on NET earnings from self-employment.
- ½ of Self Employment tax is deductible as an adjustment to gross income on your personal tax returns.
- For tax purposes, self-employment tax is computed on Form SE and is recorded on Schedule C and Form 1040.

5. INTEREST & TAXES (some examples of deductions)

- Business Credit Card interest is fully deductible.
- Interest on loans on business-related computer equipment.
- For tax purposes, interest & taxes are recorded on IRS Schedule C.

6. DEPRECIATION (some examples of depreciable assets)

- Furniture & Fixtures (desks, chairs, file cabinets, etc.)
- Computer Hardware & Software, Calculators, Typewriters

- Phone & Fax
- Automobiles using Actual Expense method
- For tax purposes, depreciation is recorded on IRS Form 4562.

There are many different ways to depreciate – please consult with your bookkeeper or accountant for the method best for your taxation purposes.

7. ADVERTISING & PROMOTION (some examples of deductions)
- Costs of brochures purchased (either of your product or of your services.)
- Costs of business cards.
- Costs of newspaper advertisements.
- For tax purposes, Advertising & Promotion is recorded on IRS Schedule C.

8. MORTGAGE & REAL ESTATE TAXES

9. UTILITIES & TELEPHONE
- As in the mileage expense, you must keep a record or diary of business calls to support your deductions if you do not have a separate phone line installed for your business phone.
- You may not deduct any part of the standard monthly charge for the first telephone line into your home. After deducting the standard monthly charge, only the percentages of telephone usage directly related to your business is deductible, except business-related long-distance calls.

10. MEDICAL INSURANCE
- 60% deduction (2002)

Your goal should be to claim all the deductions to which you are entitled in order to minimize your business income. At the same time, you want to “audit-proof” your return to avoid confrontations with the IRS.

Here are some more tips:

KEEP GOOD RECORDS! You have to be able to back up your deductions with proof of when the expense was paid or incurred, the amount of the expense, and the reason why it is deductible. Using a computer to keep your books and records can simplify both recordkeeping requirements and tax return preparation.

FILL OUT ALL FORMS AND SCHEDULES REQUIRED!

FILE ON TIME!