10 Most Expensive Tax Mistakes That Cost Business Owners Thousands

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#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
Why Tax Planning?

1. Key to financial *defense*
2. Guarantee results
# Taxable Income

![Diagram of taxable income]

<table>
<thead>
<tr>
<th>Total Income</th>
<th>minus Adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>minus</td>
<td>Deductions</td>
</tr>
<tr>
<td>times</td>
<td>Tax Brackets</td>
</tr>
<tr>
<td>plus</td>
<td>Alt. Min. Tax</td>
</tr>
<tr>
<td>minus</td>
<td>Tax Credits</td>
</tr>
</tbody>
</table>
Adjustments to Income

- IRA Contributions
- Moving Expenses
- ½ SE Tax
- SE Health Ins
- Retirement
- Alimony
- Student loan
<table>
<thead>
<tr>
<th>Standard</th>
<th>Itemize</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Single</td>
<td>• Medical/dental</td>
</tr>
<tr>
<td>$ 6,300</td>
<td>• State/local taxes</td>
</tr>
<tr>
<td>• HoH</td>
<td>• Foreign taxes</td>
</tr>
<tr>
<td>$ 9,250</td>
<td>• Interest</td>
</tr>
<tr>
<td>• Married/Joint</td>
<td>• Casualty/theft losses</td>
</tr>
<tr>
<td>$12,600</td>
<td>• Charitable gifts</td>
</tr>
<tr>
<td>• Married/Separate</td>
<td>• Miscellaneous</td>
</tr>
<tr>
<td>$ 6,300</td>
<td></td>
</tr>
</tbody>
</table>

Take *higher* of the two amounts
## Tax Brackets (2015)

<table>
<thead>
<tr>
<th>Rate</th>
<th>Single</th>
<th>Joint</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>15%</td>
<td>9,226</td>
<td>18,451</td>
</tr>
<tr>
<td>25%</td>
<td>37,451</td>
<td>74,901</td>
</tr>
<tr>
<td>28%</td>
<td>90,751</td>
<td>151,201</td>
</tr>
<tr>
<td>33%</td>
<td>189,301</td>
<td>230,451</td>
</tr>
<tr>
<td>35%</td>
<td>411,501</td>
<td>411,501</td>
</tr>
<tr>
<td>39.6%</td>
<td>413,201</td>
<td>464,851</td>
</tr>
</tbody>
</table>
Tax Credits

- Family Credits
- Education Credits
- Foreign Tax
- General Business
- Renovation
Two Kinds of Dollars

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 nontaxable income
2. Maximize deductions and credits
3. Shift income: later years, lower brackets
#2: “Audit Paranoia”

<table>
<thead>
<tr>
<th>Schedule C: $0-24,999</th>
<th>1.20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule C: $25,000-99,999</td>
<td>2.40%</td>
</tr>
<tr>
<td>Schedule C: $100,000+</td>
<td>3.60%</td>
</tr>
<tr>
<td>Partnership</td>
<td>0.50%</td>
</tr>
<tr>
<td>S-Corp</td>
<td>0.50%</td>
</tr>
</tbody>
</table>
#3: Wrong Business Entity

- C-Corp?
- S-Corp?
- Partnership?
- Sole Prop?
Sole Proprietorship

Report net income on Schedule C

Pay SE tax up to 15.3% on income

Pay income tax on net income
S-Corporation

Split proceeds into “salary” and “income”

Pay FICA up to 15.3% on salary

Avoid FICA/SE tax on income

Pay income tax on salary and income
Employment Tax Comparison

<table>
<thead>
<tr>
<th>S-Corp FICA</th>
<th>Proprietorship SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>Income</td>
</tr>
<tr>
<td>$40,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>FICA</td>
<td>SE Tax</td>
</tr>
<tr>
<td>$6,120</td>
<td>$11,304</td>
</tr>
<tr>
<td>Net</td>
<td>Net</td>
</tr>
<tr>
<td>$73,880</td>
<td>$68,696</td>
</tr>
</tbody>
</table>

S-Corp Saves $5,184
#4: Wrong Retirement Plan

![Bar chart showing contributions for different income levels for SEP, SIMPLE, and 401(k) plans.]
Simplified Employee Pension

- “Turbocharged” IRA
- Contribute up to 25% of income
- Max. contribution: $53,000
- Must contribute for all eligible employees
- Contributions directed to employee IRAs
- No annual administration
SIMPLE IRA

- Defer 100% of income up to $12,500
- Age 50+ add $2,500 “catch up”
- Business “match” or “PS”
- Contribute to IRAs
- No annual administration
401(k)

- Defer 100% of income up to $18,000
- Age 50+ add $5,500 “catch up”
- Employer contributes up to 25% of “covered comp”
- Max. contribution: $53,000
- Loans, hardship withdrawals, rollovers, etc.
- Simplified administration for “individual” 401(k)
Defined Benefit Plan

- Guarantee up to $185,000
- Contribute according to age and salary
- Required contributions
- “412(i)” insured plan
- “Dual” plans

<table>
<thead>
<tr>
<th>Age</th>
<th>Regular</th>
<th>412(i)</th>
</tr>
</thead>
<tbody>
<tr>
<td>45</td>
<td>$80,278</td>
<td>$164,970</td>
</tr>
<tr>
<td>50</td>
<td>$133,131</td>
<td>$258,019</td>
</tr>
<tr>
<td>55</td>
<td>$211,448</td>
<td>$395,634</td>
</tr>
<tr>
<td>60</td>
<td>$236,910</td>
<td>$450,112</td>
</tr>
</tbody>
</table>

Projections based on retirement at age 62 with $165,000 annual pretax income.
#5: Missing Family Employment

- Children age 7+
- First $6,300 tax-free
- Next $9,225 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+
- First $6,300 tax-free
- Next $9,225 taxed at 10%
- “Reasonable” wages
- Written job description, timesheet, check
- Account in child’s name
- FICA/FUTA savings
#6: Missing Medical Benefits
## “Employee” Benefit Plan

<table>
<thead>
<tr>
<th>Business Entity</th>
<th>How to Qualify</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proprietorship</td>
<td>Hire Spouse</td>
</tr>
<tr>
<td>Partnership</td>
<td>Hire Spouse (if &lt;5% owner)</td>
</tr>
<tr>
<td>S-Corporation</td>
<td>&gt;2% Shareholders ineligible</td>
</tr>
<tr>
<td>C-Corporation</td>
<td>Hire Self</td>
</tr>
</tbody>
</table>
The “Fine Print”

Nondiscrimination:
- Must cover all eligible employees
- However, you can exclude:
  - Under age 25
  - less than 35 hours/week
  - less than 9 months/year
  - less than 3 years service

- Controlled group rules
- Affiliated service groups
The Benefit

- Reimburse medical expenses incurred for:
  - self
  - spouse
  - dependents
- Not subject to 10% floor
- Avoid self-employment tax
- Supplement spouse’s coverage
Eligible Expenses

- Major medical, LTC, Medicare, “Medigap”
- Co-pays, deductibles, prescriptions
- Dental, vision, and chiropractic
- Braces, LASIK, fertility, special schools
- OTC medications (by prescription)
The “Paperwork”

- Written plan document
- Benefits are “reasonable compensation”
- Verify bona fide employment
- Document payments
- Certification
- PCORI fee
Health Savings Account

1. “High deductible health plan”
   - $1,300+ deductible (individual coverage)
   - $2,600+ deductible (family coverage)

   Plus

2. Tax-deductible “Health Savings Account”
   - Contribute & deduct up to $3,350/$6,650 per year
   - Account grows tax-free
   - Tax-free withdrawals for qualified expenses
#7: Missing A Home Office
Qualifying Home Office

“Principal place of business”:

1. “exclusively and regularly for administrative or management activities of your trade or business”

2. “you have no other fixed location where you conduct substantial administrative or management activities of your trade or business.”

Source: IRS Publication 587
#7: Missing Home Office

- Determine “BUP” of home
  - Divide by rooms
  - Square footage
  - Eliminate “common areas”
#7: Missing Home Office

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

- Increase business miles
#7: Missing Home Office

- When you sell:
  - Recapture depreciation
  - *Keep* tax-free exclusion
#8: Missing Car/Truck Expenses

## AAA Driving Costs Survey (2014)

<table>
<thead>
<tr>
<th>Vehicle</th>
<th>Cents/Mile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Sedan</td>
<td>46.4</td>
</tr>
<tr>
<td>Medium Sedan</td>
<td>58.9</td>
</tr>
<tr>
<td>Large Sedan</td>
<td>72.2</td>
</tr>
<tr>
<td>4WD SUV</td>
<td>73.6</td>
</tr>
<tr>
<td>Minivan</td>
<td>65.0</td>
</tr>
</tbody>
</table>

Figures assume 15,000 miles/year; $3.28/gallon gas
#9: Missing Meals/Entertainment

- *Bona fide* business discussion
  - Clients
  - Prospects
  - Referral Sources
  - Business colleagues

- 50% of most expenses

- Home entertainment

- Associated entertainment
#9: Missing Meals/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