

ACCOUNTING



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Special to New Business Minnesota

As a startup company, you have been experiencing many firsts – your first business card, web site, sale, invoice and hopefully your first deposit. Now it's time to get ready for your last “first time” event of the year – taxes.

Back when you were just a plain old 1040 filer, you probably had a good routine for handling your personal taxes to ensure everything came together by April 15.

Now you own a business. It's important to appreciate the differences between being an individual taxpayer and a business. No. 1, businesses need to be strategic. No. 2, you have to be proactive – not reactive – if you're going to keep more of what you earn.

Plan, Plan, Plan

The only way to keep your taxes in line is to plan, be organized and do it early enough so that all of your options are in play. There are literally hundreds of things you can do to mitigate taxes: buy equipment, start a retirement plan or provide bonuses for employees. Many of them have to be implemented before the year is out.

You lose out on options when you wait until January. Fewer opportunities are left come March 15th when S and C Corps are due and April 15th when taxes are due for partnerships, sole proprietorships, single member and multi-member LLCs.

I just had a client come in for 2007 taxes. There was not much he could do but pay the tax and the penalty. There is no strategic advantage to doing it that way.

Year-end tax planning begins as early as September or October. By coming up with an average monthly income, you can make a basic assumption for the balance of the year, both individually and as a business. If you owe tax and don't have the cash flow to mitigate it, you will at least have a good idea of what your tax liability is and can plan on how to have the cash available to pay it by April 15th.

The next step is to develop a strategy to mitigate your liability by taking deductions, managing losses and thinking strategically. Back when you filed only an individual re-

Tax Planning Now, Saves You Later

When the Year Ends, So Do Some Great Deductions.
There is Still Time to Get Your Tax Act Together

turn, you could get away with taking the standard deduction and looking up your adjusted gross income in a table.

On the good news front, as a business you have many more deductions available to you. The bad news is the IRS requires documentation to support any claims.

There are literally hundreds of options that could be part of your tax strategy. It all depends on your unique circumstances. Working with a tax professional gives you an edge over either doing it yourself or using any of the off the shelf tax preparation software. The quality of your return and the chances of you applying the correct rules for your circumstances are significantly improved by working with a professional. How well the software packages work depends on how well you use it. They give you a series of questions to ask yourself, but the results will depend on how you answer them and how well you understand the questions. You could be missing something important and not even know it.

Common Mistakes/Cautions

What startups frequently miss out in planning is that they need to set aside 30 percent to 40 percent of all net income just to cover taxes. As an employee you pay 6.2 percent in FICA and 1.45 percent in Medicare. When you are self-employed, you also pay the employer's portion, which, when combined, comes to 15.3 percent. You pay both halves plus the income tax.

You can reduce your income tax liability to zero with deductions, but still owe self-employment tax on the profit from the business.

Not planning for this tax reality can be devastating. I had a client who had decided to become a consultant after downsizing. I reviewed his plans and he didn't even realize that he'd just designed a pay cut for himself when he set his hourly rate. He didn't examine gross vs. net, all his taxes and business expenses. He was making \$50 an hour before, so he just thought he would charge the same rate to his clients.

An easy place to make mistakes are with auto deductions. There are two methods. With the *Mileage* approach, you can claim 58.5 cents per mile for part of 2008 (the first half of the year was 50.5) as the standard deduction. Be prepared to back up your mileage with a diary that details dates, odometer readings, persons met, etc. Using the *Actual* method, you calculate all costs and the percentage of business use to come up with the amount to deduct. Very detailed records are required. One method might be better for you than the other.

Review withholding for your paycheck or quarterly estimate to make sure it will be 100 percent of what you paid in 2007. Plan for it now. Not properly estimating withholding can come with some IRS penalties.

It's not uncommon for some home-

based businesses, multi-level marketing or any other business activity that is in the part-time or hobby category to run the risk of having “excessive” write offs. The IRS sees red flags when a limited revenue business has a lot of deductions for auto, travel, meals, special events, season sports tickets, etc. that are disproportionate to income. For these types of businesses, deductions are tricky and limited.

Fear of the unknown or little understanding causes some small businesses to avoid deductions they deserve. They don't feel up to the challenge of all the complex rules, calculations and computation needed for figuring out depreciation, office in home allowance, net income or self-employment tax, etc.

Preparation

The Wrong Way: A small business owner walked into my office one year with a box of receipts, unopened envelopes with bank statements and W2s, and said, “Here ya go.” To get from there to a finished return was very time consuming for me and my staff. And that was reflected in the bill he received.

If you're in business, you shouldn't be in a shoebox. You need financials statements at least quarterly so you will know your income, expense and profit. If a problem develops, you'll find out in time to do something about it. You can't adjust if you don't have the details. Without that information, you can't even do accurate bidding because you won't know your gross margin.

The Right Way: Get your books in order. At the very least have a box with 12 folders (not envelopes): one for each month. Organize your receipts by month. Download your credit card statements if you don't already have them, and put them in the monthly folder. Do the same with bank statements. This will save you money by doing it yourself: pair up your receipts with your credit card statements. Summarize it all in a spreadsheet, by month.

Total all income: Set a trend line for the first nine months of the year and forecast 9/12 for the each of the remaining months. Identify the major categories of expenses. Have your W2s and 1099s at the ready.

It may sound like a lot of work, but if you do it every month throughout the year, it's actually pretty easy.

Remember, inaction costs money when it comes to tax preparation. Get your box ready, while you still have options.

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Here are just a few deductible ideas to get you in the “holiday” spirit.

1. Buying a piece of equipment at the end of the year rather than after January might give you a needed advantage. It must, however, be “in service” by the end of the year.
2. Contribute to a SEP (Simplified Employee Pension) Plan. You can put up to \$46,000 into these plans if you have a high enough net income. You defer the tax until you take it out.
3. If you're a cash basis taxpayer, you can receive a lump sum of revenue in January or accelerate expenses in December, such as make a mortgage payment early – paying 13 months in one year – and take the credit in 08 if that helps your position.
4. As a startup, you can deduct the fair market value of all equipment and supplies you bring to the business. This one is frequently overlooked.
5. Losses can be valuable – this is a new concept for many startups. Make sure you take full advantage.
6. As long as you have a profit, you may write off up to \$128,000 in equipment costs.
7. Accelerate first-year depreciation on equipment.
8. Sole proprietorship or single member LLC, can employ their children under age 18 without self-employment tax. You can set your children up to work in your office (filing, stacking, folding, cleaning) and pay them up to \$5,300 (compensation must be reasonable to the work performed) a year with no tax on that income. Put it into a Roth IRA to save for the future.
9. Self-employed can write off 100 percent of health care if there is a profit in the business.
10. Make sure you're taking all deductions. For example, if you travel and have dry-cleaning or laundry done while on the road (not at home), you can claim that.
11. 50 percent of meals, hotel and car rental are deductible when you travel.