

# Tax Tips

For Small Business

Winter  
2006/2007

## Health Insurance for Your Business

A simple error may deny your deduction

As a business owner, you most likely provide health benefits for you and your employees. Even if you do not have employees, having a health insurance policy in your business may save you money.

As a self-employed taxpayer, you are allowed to deduct from your adjusted gross income, 100 percent of the cost of the health insurance policy. While this may not save in self-employment tax, the deduction will reduce your overall tax liability. You can title the policy in your name, or in the name of your business.

If your business is incorporated, the policy must be in the name of the business. C corporations are allowed to deduct on their corporation return the cost of health insurance provided to the shareholders while the cost remains tax-free to the shareholder.

The tax treatment is slightly different for S corporations. For these corporations, shareholder's who own two percent or more of the stock must include the cost of the benefit in their wages. The cost is then offset by a deduction on the shareholder's tax return.

The important error to avoid is not knowing how to title the insurance policy in order to preserve your deduction. As a self-employed taxpayer, you can title the policy in your name, or in the name of your business. As a corporate taxpayer, you must title the policy in the name of your business, even if you are the only owner and have no employees.



## Making Improvements to Rental Property

What qualifies as a current deduction and what does not

It is often difficult to determine what repairs and improvements you make to your rental property qualify as a current expense, and what improvements must be depreciated. There is a general rule which states that if the repair merely returns the property to its normal working condition, it's most likely a current expense. Examples of these types of repairs include replacing light fixtures, windowpanes, torn shingles, or other incidental repairs to your property.

Major improvements such as a new roof, siding, a driveway, extensive renovation, or a new addition are capitalized and depreciated over the life of the building. Other improvements like new carpeting, furnaces, and air conditioners are also depreciated, but over a shorter time period.



## Hire Your Children

Save your business some payroll taxes

If you are a business owner and you are short on help, hire your children. One of the key advantages to hiring your children is that it will save you some payroll tax. If your children are under the age of 18, you are not required to withhold Social Security and Medicare from their wages, nor are you required to pay in the employer's share. You are not required to pay federal unemployment tax on their wages until they reach the age of 21.

This tactic will not work for all parents, however. Only self-employed business owners can hire their children and avoid payroll taxes. This includes businesses operated as a partnership provided you and your spouse are the only partners. As a result, if your business is incorporated, your children will be employees of the corporation and not you. Therefore, the exemption from payroll taxes does not apply and Social Security and Medicare taxes will be due just as with any other employee. Remember, if you hire your children, they must be bona fide employees who actually provide a service to your business.



## Selling Your Business Assets

Take advantage of the installment method

In most cases, there is generally no way to completely avoid paying tax on the gain from the sale of your business assets. If you exchange a business asset for a new asset that is of the same type, you may qualify for a like-kind exchange and defer your tax liability until you sell the replacement asset. However, this strategy won't work if you are selling your assets and retiring. There are ways you can sell your assets and at least defer paying the tax on some of the gain until the year you actually receive the money.

Selling your assets and reporting the gain using the installment method enables you to collect the sales proceeds in years following the year of sale. The installment method of reporting gain

automatically applies any time you sell assets and receive proceeds in the year following the year of sale. You may elect out of the installment method by reporting all the sales proceeds in the year of sale, regardless of when you actually receive them, and paying tax on the gain. For a valid installment agreement to exist, you must

have an adequate rate of interest stated in the contract. This interest is taxable to you as you collect the payments. If no interest is included in the contract, it will be imputed, resulting in part of each payment being taxed as interest. Interest is always included in income in the year you receive the payment.

If you are looking for a way to spread out your income and tax liability, utilizing the installment method is a good strategy. Just remember, ask a fair price for your assets and include an adequate interest rate in the contract.

## Thinking of Starting a Retirement Plan?

Small employers may qualify for a tax credit

Certain small employers are eligible for a tax credit equal to 50 percent of qualified startup costs for establishing a new qualified plan. The maximum amount of the credit for any one year is \$500.

For purposes of this credit, a small employer is defined as an employer that employs 100 or fewer employees who received at least \$5,000 of compensation from the employer for the preceding year. Qualified startup costs are any ordinary and necessary expenses which are paid or incurred in connection with the establishment or administration of an employer plan or retirement-related education of employees with respect to the eligible employer plan.

This provision, although not new, was set to expire in 2010. Recent legislation has made this credit permanent.

## Charitable Contributions for Businesses

New rules extend contributions for food inventory

The amount of a business's deduction for inventory contributed to a charitable organization is normally limited to the property's adjusted basis. Under the

# QUICK TIPS

**1** The §179 expense deduction equals \$108,000 for 2006. This means you can write off the first \$108,000 in equipment purchases you made during the year. You can wait until the last day of your tax year to purchase equipment and still deduct the full \$108,000, provided you haven't used any of the deduction on a prior purchase during the year or you are not subject to other limits.

**2** Instead of deducting the actual expenses for the business use of your vehicle, opt for the standard mileage rate. In 2006, you can deduct 44.5 cents for each business mile you drive.

**3** The Social Security wage base increases to \$94,200 in 2006, up from \$90,000 for 2005. This means that you are no longer required to withhold Social Security tax for employees after meeting this threshold. You are required to withhold Medicare taxes regardless of the amount of wages paid.

**4** If you incur entertainment costs for business reasons, you may be able to deduct 50% of the amount. The expense must be considered ordinary or necessary to your profession. Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation.

**5** If your business owns vehicles that are available for employees' personal and business use, the vehicle is nevertheless considered used 100% for business on the business tax return. The personal-use percentage is included on the employee's W-2 as additional compensation.

**6** Starting a new business? There are many costs associated with the start-up of a business that can be deducted once your business opens. To qualify as a start-up cost, the expense must be one that you could deduct if you were already in business. Examples include travel to suppliers, training for your new employees, advertising, utilities, and other pre-opening expenses. You are allowed to deduct the first \$5,000 of expenses you incur in the current year. The remaining start-up expenses are deducted over a remaining period of not less than 180 months.



*Katrina Emergency Tax Relief Act*, businesses are allowed an enhanced deduction for the contributions of wholesome food inventory. This provision has been extended to donations made before December 31, 2007. This means businesses can deduct, in addition to the basis of the contributed property, up to half of the property's appreciation, or two times the donated item's basis, whichever is more.

Wholesome food is food that is intended for human consumption and meets quality and labeling standards imposed by federal, state, and local laws and regulations, even if the food is not readily marketable because of appearance, age, freshness, grade, size, surplus, or other condition.



## Pay Your Taxes Electronically

Save your business time, money, and paper

The Electronic Federal Tax Payment System (EFTPS) is a free service provided by the U.S. Department of Treasury that allows individuals and small businesses to pay federal taxes electronically, including income, employment, estimated, and excise taxes.

In 2006, the IRS began to allow taxpayers to make a credit card payment for taxes owed on employment tax returns such as Forms 940 and 941. The payment can be made for the balance on the current return that is due. Additionally, Form 941 filers can make credit card payments for up to three prior quarters. This adds up to convenience for many busy business owners. EFTPS is accurate, secure, and convenient, and it eliminates the paper-based federal tax deposit coupons. As an added benefit, EFTPS users are 31 times less likely to be assessed a penalty for errors or late payments than are non-EFTPS users.

## Corporate Contributions of Book Inventory

Enhanced deduction extended for two more years

Generally, deductions for charitable contributions of property or inventory used in a business are limited to the lower of the basis or fair market value of the property. However, a C corporation that makes a "qualified book contribution" to a public school that provides elementary or secondary education is entitled to an enhanced, "above-basis" deduction.



For purposes of this rule, a qualified book contribution means a charitable contribution of books, but only if:

- The donee is a public school that satisfies specified requirements;
- The donee provides elementary or secondary education (kindergarten through grade 12); and,
- The donee satisfies specified certification requirements regarding the donated books and its use of those books.

This extended provision was due to expire for donations made after December 31, 2005. Recently passed legislation extended this enhanced deduction to contributions made by C corporations before January 1, 2008.