Small Business Tax Planning Part 1

Course #3161A

Taxes

2 Credit Hours

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SMALL BUSINESS TAX PLANNING PART 1

This course covers strategies for a variety of small business tax planning needs. Topics in this course include: income and deduction strategies, strategies for opening or closing a business, strategies for running a side business, and strategies for running more than one business.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Income and Deduction Strategies
Tax Strategies for Opening or Closing a Business
Tax Strategies for a Sideline Business
Tax Strategies for Multiple Businesses

Study the course materials from pages 1 to 60

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Identify beneficial income and deduction strategies.
- Identify workable strategies when opening or closing a business.
- Identify tax strategies when running a side business.
- Identify helpful strategies when running more than one business.

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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CHAPTER 1: INCOME AND DEDUCTION STRATEGIES

Chapter Objective

After completing this chapter, you should be able to:

- Identify beneficial income and deduction strategies.

Understanding what income you must report and the various business deductions you may claim is only half the job. You must also know when to report income and when to postpone it, when to claim certain deductions and when not to claim them. You should also be aware of the common traps that business owners often fall into with their income and deductions so you can audit-proof your return to the extent possible.

Tax planning is always complicated, but this is a time of particular confusion. While many of the tax changes made by the Tax Cuts and Jobs Act are permanent, such as the 21% tax rate for corporations, many others are temporary. For example, the lowered individual income tax rates and the qualified business income deduction for owners of pass-through entities are set to expire at the end of 2025. What's more, this law has created many uncertainties requiring technical corrections in Congress or IRS guidance. Finally, it is important to recognize that you should not always go at it alone. You may need to get the assistance of tax professionals or additional information from the IRS. You need to know how to obtain referrals to tax professionals. You also need to know some important IRS telephone numbers to call for assistance. This information is included throughout this chapter for your convenience.

TAX-SAVING TIPS

Tax-Planning Decisions

Some deductions are under your control because you can decide whether to incur the expenditure. Also, sometimes you are permitted to make tax elections on when to report income or when to claim write-offs. Here are some pointers that can help you minimize your income and maximize your deductions. Or, you can follow the reverse strategy if you already have losses for the year and want to accelerate income to offset those losses (and defer deductions).

- *Cash-basis businesses.* If you account for your expenses and income on a cash basis, you can influence when you receive income and claim deductions for year-end items. For example, you can delay billing out for services or merchandise so that payment will be received in the following year. In deferring income for services or goods sold, do not delay billing so that collection may be in jeopardy. Also factor in your tax bracket for this year and the bracket you expect to be in next year. If you will be in a higher tax bracket next year because your income will be greater or because of tax law changes, you may not want to defer income. You may prefer to bill and collect as soon as possible to report the income in the lower-tax year.

On the flip side, you can accelerate deductions by paying outstanding bills and stocking up on supplies. Again, determine whether accelerating deductions makes sense for you.

However, in accelerating deductions, do not prepay expenses that relate to items extending beyond one year. For example, if you pay a 3-year subscription to a trade magazine, you can deduct only the portion of the subscription (one-third) that relates to the current year; the balance is deductible in future years as allocated.

- *Accrual method businesses.* The board of directors of an accrual-basis C corporation can authorize a charitable contribution and make note of it in the corporate minutes. A current deduction can be claimed even if the contribution is paid after the end of the year (as long as it is paid no later than 2½ months after the close of the year).

  Similarly, accrual method businesses can accrue bonuses and other payments to employees in the current year that are paid within 2½ months of the close of the year. However, this rule does not extend to payments to S corporation owner-employees—payments are deductible only when received by the owner-employees.

- *Owner participation.* If you own a business, be sure that your level of participation is sufficient to allow you to deduct all your losses under the passive loss limitation rules and avoid the 3.8% tax on net investment income. Increase your level of participation, and keep records of how and when you participated in the business.

- *Increase basis to fully utilize losses.* If you are an owner in a pass-through entity, your share of losses generally is deductible only to the extent of your basis in the business. Explore ways in which to increase your basis so that the losses can be fully utilized. For example, if you are an S corporation shareholder, you can increase basis by lending funds to your business. Alternatively, you can work with the corporation's lenders to restructure debt, making you primarily liable for the amount borrowed (which you then lend to the corporation and increase basis).

- *Minimize FICA.* Owners who work for their corporations may be able to extract distributions on a FICA-free basis by arranging loans or rentals to the business and taking payments in the form of interest or rents. Of course, these arrangements must be bona fide. However, S corporation shareholders who perform substantial services for their corporation should not erroneously characterize compensation as dividends. And W-2 wages are important for optimizing the qualified business income deduction.

- *Review qualified plan selection.* If you are self-employed and use an IRA, SEP, SIMPLE, or other qualified plan to save for retirement, review your choice of plan annually to see if it optimizes your benefits while keeping costs down.

  Similarly, corporations should review existing plans to see whether terminations or other courses of action are warranted as cost-cutting measures. If you want to terminate one plan and begin another, do not do so without consulting a pension expert. You must be sure that your old plan is in full compliance with the tax laws before it is terminated.

- *Carry medical coverage for yourself and employees.* Buy the kind of coverage you can afford as long as it meets minimum essential coverage requirements. The business picks up the expense for your personal insurance protection. Even if you cannot receive this benefit on a tax-free basis (if, for example, you are a partner or S corporation shareholder who must include business-paid insurance in your income), you can deduct 100% of the coverage on your individual return.

  You can reduce the cost of coverage to the business by buying a high-deductible plan that allows employees to contribute to health savings accounts on a tax-deductible basis. Alternatively, you can make deductible contributions to an HSA on behalf of your employees. If you are not subject to the employer mandate under the Affordable Care Act, you can shift most of the cost of coverage to employees by adopting a premium-only cafeteria plan. Or you may be able to use a type of health reimbursement arrangement to help employees pay for their individually-obtained coverage.

  If you have a C corporation and are a shareholder-employee, you can institute a medical reimbursement plan to cover out-of-pocket medical costs not otherwise covered by insurance (such as dental expenses, eye care, or prescription drugs) as long as the plan conforms to Affordable Care Act requirements (if still in effect).

  If you pay at least half the premiums for your employees and qualify as a small employer, you can claim a tax credit for a percentage of your payments.

- *Institute other employee benefit plans.* If you have a C corporation that is profitable and you are a shareholder-employee, you may be able to turn your nondeductible personal expenses into deductible business expenses. For example, you can have the corporation institute a group term life insurance plan for employees and obtain tax-free coverage up to $50,000. Of course, in weighing the advantages and disadvantages of employee benefit plans, be sure to consider the cost of covering rank-and-file employees, since most benefit plans have strict nondiscrimination rules. Also, take into account the fact that employer-paid educational assistance and adoption assistance plans cannot give more than 5% of benefits to shareholders owning more than 5% of the stock, usually making such plans undesirable for closely held corporations.

- *Reimbursement arrangements.* If your corporation reimburses you for travel and other business costs, be sure that the arrangement is treated as an accountable plan. This will ensure that not only does the corporation save on employment taxes but also that you are not taxed on reimbursements. With an accountable plan, the corporation deducts the expenses, and no income is reported to you.

- *Abandonment versus selling of property.* If you have property that simply is of no value to