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Determining Qualified Business Expenses

Be sure to deduct every legitimate expense

Amounts you spend in the course of conducting business are generally deductible from the gross income of that business. This includes any start-up expenses. You can claim amounts spent for items ordinary and necessary in your trade or business as a deduction against your income. Otherwise, the amounts are amortized, depreciated, or expensed depending on the nature of the purchases.

The IRS scrutinizes entertainment and meal expenses more than others because of the potential for abuse. You'll need to keep track of the business that was discussed during these events. Other expenses such as cellular phones, computers, and cars are specially classified as listed property because they can be used for both personal use and business use. The IRS requires you to keep written documentation of the business use of your car and computer, plus meals and entertainment expenses, so be sure to keep accurate records.

Expenses must be directly related to your trade or business to qualify as a deduction; amounts spent on items that may help you indirectly do not necessarily qualify. However, to increase your profit, be sure to deduct every legitimate expense that you can reasonably prove. Take advantage of your tax preparer's expertise throughout the year to assist you with tax planning opportunities as they arise.





Automobile Expenses

Which is better—deducting the standard mileage rate or actual expenses?

With the increasing cost of gas, it might be a good idea to revisit which tax deduction is the most beneficial—claiming 50.5 cents per business mile or your actual vehicle expenses. Claiming the standard mileage rate is easier. All you have to do is keep track of your business miles and multiply them by the current rate. In addition to the standard mileage rate, you may also deduct the costs for parking and tolls. Plus, if you are self-employed, you can deduct the interest paid on your car loan.

Claiming actual expenses may result in a larger deduction, but requires a bit more diligence in your record keeping. First, keep all receipts for gasoline, oil, repairs, and tires. Also, track any amounts paid for licensing and registration, insurance, garage rental, leasing, parking, tolls, and rentals. Sales tax and luxury tax are not deductible, although the amounts you pay can be added to the cost of your car and recovered through depreciation.

Regardless of what method you choose, the expenses are limited to your business use. Therefore, you must document the total miles and the business miles for the year to calculate the business-use percentage.

Reimbursing Your Employees for Business Expenses

What method should you choose?

Attracting and keeping good employees is a goal in any business. One way to make life easier for your employees is to have an easy to use reimbursement plan. Travel, transportation, moving, and educational expenses are common reimbursable expenses. As the employer, you have the option to set up an accountable or nonaccountable reimbursement plan. Under either plan, you can deduct many of the business expenses paid to or for employees. However, the plan you choose can make a big difference to your employees.

Qualified items that are reported under an accountable plan are not included in the employee's wages. Under this plan, you issue a check to the employee, who accounts to you for the expenses and returns the excess advance, if any. You take the deduction for the business expense, but the expense never shows up on the employee's W-2. For a meal expense, the employee must provide you with the time, place, and business purpose. You are allowed to give and deduct the meal per diem amount given to the employee. If the meal per diem is within the federal guidelines, no income is reported on the employee's W-2, even if he or she doesn't spend the entire amount. Keep in mind that you and your relatives are not allowed to use the per diem method.

Under a nonaccountable plan, you grant a certain amount of money to the employee to cover business expenses. The employee's W-2 income includes the expense money. You deduct the expense money as wages paid to the employee. The employee can deduct the allowable business expenses on his or her personal return, subject to a limit. Tax wise, the accountable plan is generally easier and more advantageous for the employee.



Turning Interest Payments Into Tax Deductions

Make interest payments work for you, not against you

You can deduct business-related interest on your business return if you used the borrowed funds to purchase business supplies, equipment, services, etc. Commingling business and personal expenses makes it difficult to determine what amount of the interest is business versus personal. If this happens, the IRS may consider the entire amount as non-deductible personal interest and disallow the deduction. Therefore, keep all business purchases made with loans and credit cards clearly separate from your personal expenses. Use a separate credit card for your business to make it easier.

Also, make sure to tell your tax professional if you use home equity debt for business expenses. He or she will be able to determine how much of the interest you can elect to deduct directly against self-employment income.

Thinking of Selling Your Corporation?

Carefully review your options before making a decision

When it comes time to sell your corporation, you have two options. You can either sell the corporation stock or have the corporation sell the assets and distribute the proceeds. The tax implications of the two sales are very different. If you choose to sell the stock, you are the seller. The corporation is not affected by the transaction. The new owner steps into your shoes as the shareholder and takes over the existing corporation. If your share of the proceeds exceeds your basis in the stock, you'll have a capital gain to report on Schedule D.

If the corporation sells its assets, the corporation may close its doors. The assets could be sold to one person who intends to operate a business similar to yours, but does not want your corporation. The corporation return will reflect the sale of

QUICK TIPS

- 1 Use your credit card to buy equipment and supplies that you will need in the upcoming year. Charges on your credit card for deductible business expenses are allowed in the year you make the purchase, not in the year the charge is paid. Pay off your credit card after the beginning of the year and avoid finance charges.
- 2 If you are a self-employed taxpayer, you may deduct 100 percent of your health insurance premiums from your income. The deduction for health insurance premiums does not reduce your self-employment tax, however.
- 3 If you have contributed personal assets, such as a computer or vehicle to your business, the lower of the fair market value or your cost basis of these assets qualifies as a business deduction, subject to depreciation limitations, beginning with the date of conversion.
- 4 The optional standard mileage rate for the business use of an automobile is 48.5 cents per mile in 2007.
- 5 Truck drivers and other employees who are subject to the Department of Transportation's "hours of service" rules are allowed to deduct 75 percent of their meals in 2007. In lieu of using actual expenses for meals and incidental expenses, you can deduct the federal rate of \$52 per day.
- 6 If you are an eligible home builder, you may claim a business credit for each qualified new energy efficient home that you construct and which is acquired from you for use as a personal residence. The credit is either \$2,000 for a 50-percent energy reduction in energy usage, or \$1,000 for a 30-percent energy reduction in energy usage. The credit is extended for one more year through December 31, 2008.



the assets. When the corporation liquidates, your share of the cash will be reported on Form 1099-DIV as a liquidating distribution. You'll use Form 1099-DIV to report the sale of your stock on Schedule D. Selling the assets of the corporation could result in double taxation. The sale of the assets is taxable to the corporation and the liquidating distribution is taxable to the shareholder.

If you are selling the corporation stock for a loss, you may qualify for special tax treatment. It's a good idea to review the tax consequences of the sale with your tax advisor before making a move.



Do You Know How Much Your Business Is Worth?

Tips for placing a value on your business

There are several reasons why you should know the value of your business. If you are planning to sell your business, the general rule is that you should sell it for fair market value. In many instances the term "fair market value" is somewhat ambiguous. In the simplest sense, fair market value is what a willing buyer would pay a willing seller, with each party knowing all the pertinent facts.

There are several acceptable methods for determining the fair market value of a company. The most common three methods use (1) the value of the company's assets, (2) the earning power of the company, or (3) the stock value, assuming the company is a corporation. When determining the value of the corporation's stock, you must research the sale of stock for a substantially similar business. If you have been operating the company for many years, you have built up a reputation for providing good service. This goodwill is a valuable asset and should play an important role in determining a fair asking price for your business.

The fair market value of the business is also relevant if you plan to transfer the company to a family member. If the transfer is for less than fair market value, the IRS considers the transaction as part sale and part gift. Inter-family transfers are more closely scrutinized, making an accurate valuation even more important.



Starting Your Own Business?

Here are a few quick tips to help you reduce taxes

Open a separate business checking account. Many small business owners don't realize the complications that can arise from using their personal checking account to pay for business expenses. If business expenses are mixed in with personal expenses, the IRS may disallow them. When you set up a business checking account at the bank, be prepared to submit either your social security number (SSN) or an employer identification number (EIN). Your SSN will do if you plan on establishing a sole proprietorship and do not have employees or a retirement plan. If you plan on operating a partnership or corporation, you'll need to submit an EIN.

Keep track of expenses you incur before you start your business. Expenses incurred once you decide to start a business, but before business operations actually begin, are deductible up to \$5,000 in the first year of business. The rest is deductible over a 180-month period after your business opens its doors.