GETTING READY FOR Tax Season

Don’t forget these deductions in the rush to April 15th

by Milton Zall

With April 15 approaching quickly, it’s time to see how much of your hard-earned money you’ll have to share with the IRS. In the rush to file your income tax return by the April deadline — later, if you request an extension — don’t overlook legitimate deductions that can reduce your tax liability. In reviewing these suggestions, however, remember that since every business is unique, it always helps to consult with a tax professional.

The Basics

On all tax returns, payments, and related correspondence, be sure to use the complete and exact name submitted when the IRS assigned your Employer Identification Number (EIN). Any variation could cause a mismatch for the taxpayer account on the IRS master file. This could cause delays in processing, duplicate EINs, and possibly result in the incorrect posting of your taxpayer information.

Also keep in mind that every deduction claimed on your return must be verifiable. That means that the burden of proof is on you if the IRS audits your return and questions a deduction you have taken. If you can’t produce acceptable documentation, the IRS can disallow the deduction.

The IRS doesn’t demand documentation for every deduction you claim, but they usually ask you to document deductions that appear questionable. However, you never know who is going to audit your return and some auditors can get carried away. To be safe, don’t claim tax deductions for items that you can’t readily document.

Home-Office Expenses

There are a number of ways to satisfy the IRS that the office in your home qualifies for a tax deduction. The office must be used regularly and exclusively for your trade or business, so you can’t include a room that is also used for non-business purposes. In addition, your home office must be one of the following:

- Your principal place of business for your trade or business
- A place of business where you meet or deal with patients, clients, or customers in the normal course of your trade or business
- A separate structure (not attached to your home) that you use in connection with your trade or business

Thanks to the Taxpayer Relief Act of 1997, which contained a modification of the IRS's definition of "principal place of business," many contractors will qualify for the home-office deduction on their 1999 income tax returns. Before, many small businesses and self-employed individuals who performed services outside their homes, but who used their homes for administrative tasks, were not able to take the deduction because the IRS did not consider their homes their principal place of business. Beginning with 1999, however, the new rules allow a builder who performs specific services away from home, but who does not have off-site office space, to deduct the expenses of a home office where he or she conducts administrative and management activities.

Even if you perform some of this work in a non-fixed location, such as your car or a hotel room, you will not forfeit the deduction. Similarly, conducting some management and administrative activities in another fixed location of the business does not mean you lose the home-office deduction, as long as those other administrative tasks are not substantial.

To prove that you qualify, make sure you have records of the activities performed in the home office and a log of the time you spent working there.

Commonly Overlooked Deductions

- ⇨ Advertising giveaways (such as a complimentary calendar)
- ⇨ Audio and video tape purchases related to business skills
- ⇨ Bank service charges
- ⇨ Business gifts (to clients, subcontractors, or employees)
- ⇨ Business-related magazines and books
- ⇨ Business development courses
- ⇨ Casual labor and tips
- ⇨ Casualty and theft losses
- ⇨ Coffee and beverage service
- ⇨ Consulting fees
- ⇨ Credit bureau fees
- ⇨ Dues for a business association (such as the Chamber of Commerce)
- ⇨ Office supplies
- ⇨ Online computer services related to business (must be a separate account for business use)
- ⇨ Parking and meters
- ⇨ Petty cash funds (documented in General Ledger)
- ⇨ Postage
- ⇨ Promotion and publicity
- ⇨ Sales Commissions
- ⇨ Seminars and trade shows
- ⇨ Taxi and bus fare
- ⇨ Telephone calls away from the business (business calls must be documented)

Health Insurance for the Self-Employed

Self-employed individuals can deduct 45% of their health insurance costs, including long-term care insurance costs. If you are self-employed and covered under an employer-sponsored health insurance plan (through your spouse, for instance), you can't deduct health insurance premiums for a supplemental plan. But you can deduct 40% of long-term care premiums so long as the employer-sponsored plan does not provide long-term care coverage.

Operating Losses

If your business lost money, be sure to get the most benefit from a net operating loss (NOL). One option is to carry back the NOL to generate a tax refund for 1999. On the other hand, if you envision greater profits in 2000 that will put you into a higher tax bracket, consider waiving the NOL carry-back, and carry your loss forward to 2000 instead.

Bad Debts

It's not as easy as you might think to claim business bad debts as deductible business expenses. You must be able to prove that a debt is uncollectable and that you have done all you can to collect it. That means you have to keep records of your attempts to collect the debt, such as collection letters, telephone logs, and documented collection agency attempts.

Travel Expenses

Business trips, including travel to professional association conventions, are deductible — even if you mix some vacation into the itinerary. When figuring deductions for a trip that combines business and pleasure, you must prorate hotel and meal costs. But if the primary purpose of your trip was business, you can deduct the full cost of roundtrip transportation. In addition, if you had business to conduct on a Friday and a Monday, you can write off your hotel and meal expenses for the weekend in between — even if you spent Saturday and Sunday as a tourist. Be careful though: The IRS is on to this technique and will want to know why you couldn't schedule your business time some other way. Again, be prepared to document your answer.

Saturday stay-over. If your business is all taken care of by Friday but you decide to stay until Sunday, you may be able to deduct the extra lodging and meal expenses if your layover enables you to take advantage of lower airfares for a Saturday night stay-over. The IRS says you can deduct the extra lodging and meal expenses provided they did not exceed the airfare savings.

Alone together. If you take your spouse with you on a business trip, you can't deduct your spouse's expenses, but that won't affect your own travel deductions. The IRS allows you to deduct what you would have paid if you had traveled by yourself. When figuring deductions for lodging, for instance, you're allowed to deduct the single-room rate, which often is only slightly less than the double-room rate you actually paid. Similarly, when figuring deductions for transportation, you can deduct what you would have paid had you traveled alone, whether it was your own car, a rental, or a taxi.

Business Trip Meals

To claim actual meal expenses, you have to save your receipts. That's not the case, however, if you use the IRS "standard meal allowance," which ranges from $30 to $42 a day depending on the destination. This fixed-rate meal allowance does require you to keep a record of the time, place, and business purpose of your travel. Also, if you use the standard meal allowance for any business trip, then you have to use the same method to compute meal expenses for all your business travel during the year.

Business Startup Expenses

Business startup expenses are deductible once you are actually in business and ready to serve customers or clients. Any expenses you incur before that, however, must be capitalized. One workaround is to delay significant expenses as long as you can; another is to hold yourself out as ready to serve customers before all the expenses have been incurred.

Keogh Deductions

If you are self-employed and have a Keogh retirement plan, how you calculate your write-off depends on the type of plan you have. In a profit-sharing Keogh retirement plan, you can deduct up to 13.04% of your net self-employment income. In a money-purchase Keogh retirement plan, however, you can contribute and deduct up to 20% of your net self-employment income.

Medical Reimbursement Plan Expenses

If you are a regular C-corporation and you don't have a medical expense reimbursement plan, you should (see "Tax Talk," *Notebook*, 4/99). In the plan, you can set limits on the amount that will be reimbursed and the types of care that will be covered, as long as all full-time employees are treated equally. An employee who incurs a medical expense submits documentation and the expense is reimbursed according to the plan.

You save money because your company can buy a less-comprehensive health insurance policy — one that will cover expenses that exceed your company plan's limit. Plus, the medical reimbursements are not taxable to employees and owner-employees as long as the plan is nondiscriminatory. Sole proprietors, partnerships, and S-corporations cannot set up medical reimbursement plans.

Employee Credits

If you hired employees in 1999, you may be entitled to claim a tax credit, such as the work opportunity credit, the empowerment zone credit, or the Indian employment credit. Keep this in mind before making new hires in 2000 as well. Check with your state employment agency on whether they can assist you in hiring workers who will entitle you to a tax credit.

Deferred Gains

Some owners who borrow money in connection with business property (to refurbish it, for example) negotiate a reduction of their debt if they can't make the payments. This kind of loan settlement results in "cancellation of debt" income on which the IRS wants to collect taxes. To avoid this rather unpleasant tax bite, exchange the property for another property (there are real estate attorneys who specialize in arranging such swaps). By doing so, you defer any taxes due until the new property is sold. To make sure everything goes smoothly, record the exchange on IRS form 1099-R and file it with your tax return.

Milton Zall *is a freelance writer based in Silver Spring, Md., who specializes in taxes and business issues. He is a Certified Internal Auditor.*