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## Guidelines for Sole Proprietorships (Self Employed Individuals) and Small Businesses (Corporations and LLC's)

- Requirements for an expenses to be deductible
  - Must be ordinary and necessary
  - Must be incurred in connection with conducting a business or trade
  - Must be properly supported
    - ❖ Cancelled checks
    - ❖ Invoices from suppliers/vendors/provider of services
    - ❖ Logs
    - ❖ Signed receipts
    - ❖ Credit card receipts
  
- Type of expenses
  - Office supplies – pencils, paper, stationery, paper clips, photo copy paper and supplies, file folders, business cards, postage and shipping costs
  - Printing – letterhead, business cards, brochures
  - Communications costs – telephone, fax, answering service, pager, cell phones, e-mail, web site
  - Professional fees – accounting and tax services, computer consultants, legal/attorney, clerical support, billing services, transcription services (medical practice)
  - Advertising and promotional costs – yellow pages, church bulletins, newspapers, radio, television, web-site, ad books re: charitable fund raising (church schools chamber of commerce etc), items with business name on them (pencils, pens, magnets, shirts & jackets) tickets and related items purchased from clients/customers/patients as good will gestures to retain business etc
  - Continuing education – seminars, classes (if course meets certain requirements), educational tapes (must be related to business or trade), professional or trade journals and reference books
  - Dues and subscriptions – community organization dues, chamber of commerce dues, trade association dues (union dues under certain circumstances), professional society or organization dues, newspapers and magazines (for reception area)

- Travel – local (bus, “el”, “Metra”, taxi, tolls, parking) out of town (airlines, trains, bus, lodging, car rental, tolls, “limo service” [to/from airport train station etc.] parking)
- Automobile – can be either actual method (must have documentation of fuel costs, insurance, licenses [state, city/village, drivers], repairs, cost of vehicle or lease costs plus log of business miles driven and total miles driven during year) or standard method (IRS authorized mileage rate plus log of business miles driven)
- Meals (cannot be included with travel costs must be listed separately since only 50% deductible) – ONLY meals with a customer/client are deductible and business matters must be discussed (must state business purpose, who attended, what was discussed), meals when out of town meals with staff or potential clients/customers are no longer deductible [under the GOP Tax Bill],
  - ❖ Meals are only 50% deductible – should report 100% of cost to tax preparer and he/she will adjust to allowable deduction (usually automatic via tax preparation software thus reason for reporting 100% of cost)
- Entertainment tickets to events [sporting events, opera, theatre, concerts, etc.] are no longer deductible [under the GOP Tax Bill]
- Interest – on credit cards (if 100% use for business), line of credit, business operating loans, working capital loans
  - ❖ Under the GOP Tax Bill the deductible amount net interest [interest expense less interest income] is limited to 30% Net Taxable Income [NTI]
- Payroll and related expenses – gross wages paid to employees, related payroll taxes (OAB/DI, Medicare, FUTA, SUTA), payroll service fees (ADP, Paychek, Paylocity, etc.), employee benefits (health insurance – only group policy <under the Affordable Care Act>, retirement plan costs, matching re: SIMPLE IRA and 401(k) plans, life insurance premiums (employees only), disability insurance, cafeteria plan costs (so called 125 plans)
- Retirement plans – there are various retirement plans that can be established [NOTE: if a sole proprietor establishes a retirement plan for himself/herself, he/she must fund an equal amount (same % of compensation) for all qualified employees (general an employee who works 1,000 hours or more)]
- Cost of merchandise sold – cost of goods for resale (may be required to inventory merchandise held for sale), cost to produce merchandise to be sold, cost of freight and shipping re: material purchased
- Taxes – payroll taxes (employer’s share of OAB/DI, Medicare plus SUTA and FUTA), sales tax paid (depends on the method of reporting sales on income tax return), real estate tax (if property is used in trade or business), franchise tax (corporation registration fee with state of incorporation), use tax, personal property tax
- Occupancy costs – rent and utilities or other costs of business facility (depreciation of building, if owned by business, plus all cost of maintaining building and land such as real estate taxes, insurance, repairs, maintenance)

- Repairs and Maintenance – cost to repair and/or maintain business equipment (office, building, vehicles), cleaning costs, maintenance contracts
  - Insurance – general liability, workers’ comp, professional liability (so called malpractice), employee health (see payroll and related expenses), omission and errors
  - Cost of credit cards – fees paid when customers/patients/clients remit payment to you via credit cards (so called discount rate charged by credit card companies) [NOTE: this is NOT the interest you pay for your charges not paid in 25 days etc or cash advances taken by you]
  - Supplies – costs unique to your business [examples: medical supplies, pharmaceuticals, patient care supplies, minor medical equipment (medical practice), minor tools, hardware and supplies used in providing services or repairs to customers (“trades”), packing materials and packaging supplies (retail and shipping businesses), yard supplies (lumber yard etc),
  - Vehicle expenses (vehicles such as delivery trucks and vehicle used 100% as business equipment – carrying equipment and supplies to service customers)—fuel, insurance, repairs, maintenance, licenses
- Equipment, furniture fixtures (FF&E) [desk, cabinets, exam tables, computers, chairs, reception area sofa/chairs/lamps/tables]
    - Cost of most FF&E is depreciated over five years [Note sec 179 of IRS code allows for \$1.0 million of qualified equipment be depreciated in one year [under the GOP Tax Bill], if certain conditions are met – CANNOT create a loss or increase a loss]
    - Cost of vehicles (basically automobiles) depreciation is limited based on vehicle total weight, cost, and business use
- Leasehold improvements – cost to upgrade office space not owned by you [amortized over 39.5 years straight line as required by IRS regulation]
  - Income or revenue – All income received for services rendered, merchandise sold, etc must be reported as income for tax purposes
  - Interest earned on business account is taxable
- **SPECIAL ISSUE**
    - *HOME OFFICE >>>>* This is an area closely reviewed by the Department of the Treasury – Internal Revenue Service (IRS) and prior to claiming this deduction you should thoroughly discuss the requirements for a home office deduction with a professional tax preparer who fully understands your business and your tax situation
      - ✓ Safe Harbor is an optional method of claiming Home Office expenses [Expenses are computed as follows ...\$5 time the number of square feet of the home office. There is a limitation ... 300 square feet. The maximum deduction under the safe harbor method is \$1,500

- **RECOMMENDATIONS**

- There should be a separate bank account (checking account a/k/a an operating account) for the business [separate from owners personal checking account] ie: DO **NOT** commingle funds
- It is strongly suggested a separate credit card be utilized for business activities [assign (in your mind) a credit card that will be used only for business purposes. Charge only business expenses or expenditures on this credit card and pay credit card balance with business check]
- All business receipts (income) should be deposited in the business checking account
- All business expenses or expenditures should be made from the business checking account
- If there should be insufficient funds to remit business disbursements from the business checking account, owner should advance funds [ie; deposit funds in business checking account]. The advance should be in a round amount such as: \$500, \$1,000 \$5,000. The deposit should be clearing marked “*ADVANCE*”.
- When funds are sufficient for the advance to be repaid, the advance should be repaid in the same amount as the original amount advanced, if possible [ie: \$500, \$1,000 \$5,000]. If the owner needs cash, and the business account does not have sufficient funds to repaid the entire amount of the advance, a partial repayment of the advance can be made [this should also be in round amounts such as \$300, \$750, \$3000] and marked *Repayment of Advance of XX/XX/XXXX (date) and in the amount of \$XXX (amount of advance)*.
- **(Corporations ONLY)** For some business entities, it is difficult to determine the salary of the owner/shareholder until the end of the year. A payment of a salary during the year [during periods of high cash flows] may result in over funding or payment of salaries to owner/shareholder. This can create a large tax loss for the business, higher taxable income for the owner/shareholder, and an advance to the corporation that is not necessary. Before salaries are paid, it is strongly suggested the salary issue be discussed with accountant advisor. [NOTE: Once salaries are reported to the Department of the Treasury – Internal Revenue Service (IRS), State of Illinois, Illinois Department of Employment Security (I.D.E.S.) and taxes remitted to the taxing authorities, it is difficult to reverse these reported amounts]

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<see disclaimer - legal>