Things to Tell Your Small Business Clients for Year-End Tax Planning

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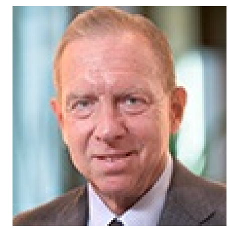

While the traditional end-of-year tax tip checklist contains such tried and true suggestions as defer income and accelerate deductions, there are a number of other steps Tom Wheelwright takes in advising his small business clients.

Wheelwright is a Scottsdale, Ariz.-based CPA and CEO of ProVision. His clients include Robert Kiyosaki, and he is a frequent speaker at Kiyosaki's Rich Dad seminars.

"The way I present taxes to my clients is to show them that tax laws are a series of incentives for business owners and investors," he said. "The tax code is basically an instruction guide on how to reduce your taxes."

Among his end-of-year suggestions to his clients is the advantage of doing business as an S corporation. "We like to see the primary business taxed as an S corporation," he said. "There are all sorts of legal benefits to an LLC, but it can still be taxed as an S corporation."

Most LLCs are operating partnerships or sole proprietorships, according to Wheelwright. They get the limited liability protection while being taxed as a pass-through. "However, the downside is that the owners will be subject to self-employment tax," he added. "If they're a partnership or sole proprietor, then they probably report 100 percent of earnings from the business as subject to self-employment tax."

"We've found the IRS to be very forgiving," he added. "If we can make a retroactive S corporation election to the beginning of the year, we can considerably reduce self-employment tax for this year and going forward. Only the portion of earnings paid out as salary is subject to self-employment tax, while distributions are not."

This is particularly so for medical professionals, Wheelwright noted.

"Prior to 1986 it made sense for them to be C corporations in order to maximize pensions," he said. "Since then the rules have changed so you can get the same pension benefits contributions amount as the owner of an S corporation, so there's no longer any tax reason for a physician to be a C corporation. It also causes headaches at the end of the year because you'll have to pay out all of earnings as salary in order to avoid paying the high C corporation taxes."

"If someone is considering whether to change to an S corporation, they have to look at the built-in gains issue, but most doctors are still better off making an S election as soon as possible, and getting rid of the downside of being a C corporation."

Of course, not everything is shielded from the self-employment tax. The owner must be paid a reasonable salary, which is subject to the tax. Wheelwright observed that reasonable can mean "what you would pay someone else to do the same job." For example, he said, "If the client is a chiropractor, they routinely hire other chiropractors on an hourly basis, some as low as $50 per hour. Of course, we want to pay ourselves as low as possible, but we don't want it to be too low because then the IRS will come in and re-characterize distributions as salary."

Wheelwright advises self-employed clients who regularly visit clients at their offices in varying locations to consider a home office. Accountants often portray the home office deduction as raising a red flag for the IRS, he observed. “But there’s no reason for a good tax professional to be afraid to take a deduction that’s specifically allowed in the code, as long as you’re following the rules,” Wheelwright said.

“A lot of people miss the fact that the home office deduction can serve to increase your deductions for automobile expenses, because it allows you to essentially eliminate your commute,” he said. “If you visit a number of clients at their offices, under the normal rule, the first and last trips would be nondeductible commuting expenses. But if you start from a home office, your first trip of the day is not a commute because your commute is 30 feet down the hall.”

Wheelwright recommends that accountants sit down with their clients and develop a tax strategy that is a long-term plan. “Don’t just tell them to max their IRA or 401(k), which just serves to postpone taxes to a later date,” he said. “Rather, look at how we can help clients permanently reduce taxes by changing expenses from non-deductible to deductible. For example, by changing the fact pattern, they can change the cost of dining out from a nondeductible expense to one that provides a legitimate deduction.”

“It can be with your spouse if it has a business purpose, and is ordinary and necessary,” he said. “There has to be a discussion with a business purpose, and it has to be ordinary, meaning it’s typical. It could be with your spouse, or someone not in the business. Just bouncing ideas off someone is an ordinary situation. The purpose is to increase the profitability of the business so there has to be a real business discussion. And it has to be substantiated. Keep track of who, what, when, where and why. This can all be done on the receipt itself, or in a diary.”