

IT'S HOW
MUCH YOU
KEEP
That Counts!
Not how much you Make.

The **ONLY** 'Plain English' Step-by-Step Guide to
Home-Business Tax Breaks
Authorized by Congress™

All New
FOURTH EDITION
Released July 2005

by
Ronald R. Mueller, MBA, Ph.D.
and Joe H. Craft, CPA
with
John I. Harrison, CPA

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The ONLY Plain English Step-by-Step Guide to Home-Business Tax Breaks Authorized by Congress™

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“Tell us, is it against our law for us to pay taxes to the Roman Emperor, or not?” Jesus saw through their trick and said to them, “Show me a silver coin. Whose face and name are on it?” “Caesar’s,” they said. So Jesus said, “Pay unto Caesar that which belongs to Caesar, and pay to God what belongs to God.”

Luke 20:22

Author’s Note:

Notice it says nowhere, that overpaying Caesar is a good idea.

Foreword

by
Robert G. Allen

For more than two decades I have been writing, lecturing, teaching and coaching thousands of people about the importance of establishing multiple streams of income. I've been on the New York Times bestseller list with five books: *Nothing Down*, *Creating Wealth*, *Multiple Streams of Income*, *Multiple Streams of Internet Income* and *The One Minute Millionaire*.

The media has referred to me as “the millionaire-maker” because of the great number of people who have taken my message to heart and acted on the advice I gave them.

Ron Mueller, the author of this step-by-step guide, is one of my protégés and has been a close personal friend of mine for several years. Ron's book delivers a truly important message:

- No matter how many streams of income you put into place,
- No matter how large those streams grow to become,
- No matter how successful each stream turns out...

**Ultimately, as the cover of the book says
“It's How Much You *KEEP*, That Counts!
Not how much you Make.”**

This authoritative guide is thoroughly researched, carefully documented, fun to read and easy to use. In a word, it is invaluable.

With this information, anyone can understand and use all of the tax laws Congress has passed in order to encourage average Americans to establish and run small and home-based businesses.

I'm not aware of any other material like this available anywhere. Nothing this complete, this straight-forward, this easy to read and use.

“It’s How Much You *Keep*, That Counts! Not how much you Make” holds a valuable place in my own personal resource library. Congratulations to you for making it a part of yours too. But don’t just put this on your bookshelf. Use it! My own businesses are all based in my own home, for the very reasons Ron Mueller describes in this terrific guide.

Do you want to know a secret? **A simple home-based business offers more tax breaks than the super-wealthy can get with their expensive tax lawyers.** That’s no lie!

You know, I’ve always thought that reading about tax-law was about as exciting as watching paint dry. But in *this* book, Ron actually makes tax-law fun to read about! No kidding, you will actually enjoy reading this material! This is a “light read” with a “powerful impact.”

Everyone with a home-based business needs this book!
Anyone without a home-based business needs it even more!

Financial Freedom is an attainable goal. I think the most powerful way to accomplish it is to:

- (a) Establish multiple streams of income,
- (b) Focus on streams that produce residual income, and
- (c) Use the tax laws wisely in order to ensure that you are paying only the minimum required by law.

My own books will help you with the first two, but “It’s How Much You KEEP, That Counts!” is what you will need for the last one.

Prosperously yours,

Robert G. Allen

Dedications and Acknowledgments

As author, I dedicate this book first and foremost to **GOD**, without Whom nothing is possible (John 15:15).

A special debt of thanks goes to my good friend and personal mentor **ROBERT G. ALLEN**. One of his many #1 bestsellers, *Multiple Streams of Income* and its phenomenal success, stimulated me to create this tax-reduction guide. Everyone who reads Bob Allen's books and then follows his advice, will have one or more home-businesses, and thus be able to reap massive benefits from this step-by-step tax-savings guide.

I also acknowledge my parents **Clare and Betty Mueller** who instilled in me the core values of integrity, honesty and a sense of purpose – values that I hope are evident throughout this book.

Ron Mueller

As co-author, I wish to thank Dr. J. Ross for getting me started in tax education for home-based business owners. I want to thank Dale Johnson for finding me opportunities to share this valuable information. I also want to thank Bill Andreoli of Financial Destination, Inc. for giving me my first big opportunity to share this education with others.

Joe Craft

As Contributing Editor, I dedicate this work to my partner and wife, Arden, who has walked with me step by step in all of our entrepreneurial endeavors. Without her efforts we would not have been able to help our many friends and business associates.

John Harrison

In the parable of the talents in the New Testament, when the master learned that one servant had not been a good steward of the master's money, he "threw that worthless servant outside, into the darkness, where there will be weeping and gnashing of teeth."

Matthew 25: 14-30

Author's Note:

We are legally, ethically and honorably bound to pay every penny of taxes required under the law. But are we being good stewards of God's money if we overpay our taxes, instead of using that money for a much greater good? This book will show you how to reduce your taxes to the legal minimum.

Why Would You Trust What's in this Book?

By profession, I am not a tax lawyer, a CPA or an Enrolled Agent.

What I am is an investigative journalist. A journalist who asks good questions, who probes until I get answers that make sense, who follows up on every lead, who checks out every inconsistency, and who doesn't report anything until I thoroughly understand everything I can about the topic I'm writing about.

In 1999 decided I had enough of sucking up exhaust fumes and following tail lights. I had heard all my life that when you work for yourself – even with a part time business – you get lots of new tax deductions. But nobody had ever told me exactly what those tax breaks are, or how to qualify for them or what records I would need to keep.

So I went to the book store. Then to another book store. When I couldn't find what I was looking for, I went online. When that failed me also, I even went to the Library of Congress, which has a copy of every book ever copyrighted in America. Nothing.

Now, as an investigative reporter, I am wondering if these “big tax breaks” I had heard about, were real, or were just an urban legend.

By then I was on a personal mission to uncover the truth. I started by interviewing CPAs. **One of the first things I discovered absolutely shocked me!**

It's a fact – an understanding of home-based business tax law is not taught in most accounting schools, and isn't even tested on the CPA exam! Even CPA Continuing Education in most states don't contain sections or offer courses on home-based business tax law.

Like millions of Americans, I used to turn to CPAs for tax advice each year, assuming they knew all the legal tax deductions. I admit that I was naïve. I had no idea that the Tax Code is some 18,500 pages long. No one can be an expert in everything contained in a bookcase full of tax law!

So simply finding a person with the initials CPA after his or her name, is no indication whether they do or don't know ANYTHING about home-based business tax law. In most cases, they will only know it if they are self-taught.

If I needed surgery, I would automatically seek out a specialist. I now know that I need to do the same for tax preparation. The right surgeon can save my life. The right tax advisor can save my financial life.

By interviewing enough tax preparers and tax advisors, I did find enough who were experts in this narrow area of tax law, to give direction to my investigation.

According to the National Taxpayers Union, the U. S. Tax Code contains some 5-million words printed on 18,500+ pages. Since no one can possibly understand all of that, tax preparers need to specialize.

Along the way I discovered that there really **are** tax breaks for business owners (even for part time businesses), and they are **not** “loopholes” or “tax dodges” or “gray areas.”

The bottom line is this: Congress has passed a series of tax laws for the intended purpose of encouraging and rewarding the operation of small or home-based businesses because it's good for the national economy. (More on this is Chapter XIII.)

My research took about 12 months, followed by a six month effort to translate it into English – from legalese, IRSese , and governmentese. The result is this easy to read, easy to use, step-by-step guide you are now reading.

I strongly believe we should each willingly **Pay Uncle Sam every penny required by law. But the law does *not* require any of us to *over-pay!***

When you learn about some deductions in this Guide that intrigue you, and then you go ask your own tax preparer about them, he or she just may say, “I don’t think that’s allowed.”

Why? **Because they don’t know!**

Why don’t they know? As stated earlier, they have never studied small/home business tax law.

But you shouldn’t have to fight with your tax preparer about the legality of these deductions, so here’s what you will find throughout this guide:

For every major deduction we describe in this guide, you will find, right here in black-and-white, the exact Congressional Law, Article in the U.S. Tax Code or Federal Tax Court Ruling which specifically authorizes it.

So, when your tax advisor says that one of these deductions is not legal, point them to the source cited right here in this book. When he or she reads the sources we cite for you, they can arrive at only one conclusion – **the deductions described here are 100% legal, ethical, safe, proper and low in carbs.**

It's not their "fault" they didn't know about them. They never had an incentive to learn home-business tax law – that is until now.

After discovering huge tax deductions you have missed out on due to their lack of knowledge, you may consider giving them a copy of this book and saying to them:

“I intend to take advantage of far more deductions than you've ever told me about before, and I can prove that each one is 100% IRS-compliant. I need for you to learn this stuff, or I will have to begin working with another tax advisor.”

Then do what you need to.

About the Authors

Ronald R. (Ron) Mueller is a baby-boomer, born in Sioux City, Iowa, the son of a career postal worker and a career bookkeeper. He left the Midwest in 1965 to accept an appointment to the United States Naval Academy in Annapolis, MD, where he earned a Bachelors Degree in Business Management.

After serving his country for eight years on active duty as a Naval Officer, including a combat tour in Vietnam, Ron worked briefly as an investigative reporter for the Atlanta Journal, and then entered the business world focusing on the fields of advertising and marketing. His many business successes included heading the Washington, DC offices of Ketchum Communications, Earle Palmer Brown Advertising, and Burson-Marsteller Marketing, plus two years as vice president of marketing communications for McDonnell Douglas Corp.

While holding these demanding positions, he was also advancing his education, earning a masters in communication from the University of Oklahoma, a masters in business administration from The George Washington University, and a Ph. D. in business economics from Sacramento Regent University.

Ever since he was a young boy working as a caddy for several successful businessmen at his hometown Country Club, he heard repeatedly that real success belongs to those who are self employed. Now this was quite a contrast from what he had learned from his parents -- that the way to get more money is to take on a second job. Years later, in 1999, having grown weary of his corporate 14-hour workdays and exhausting 4-hour daily commutes, Ron fired his boss and hired himself.

While building a successful career out of making other people's businesses thrive, he had learned this: **It's how much you keep, that counts, not how much you make.** So Step One in starting his own business was to gain a thorough understanding of small-business tax laws.

Right away many well-meaning friends began offering Ron the 'free advice' that home-based business owners get huge tax benefits. But not one of those well-meaning friends was able to tell him what those tax benefits *are*, or how to *qualify* for them, or what *records* he would need to keep. So he began spending hours in bookstores, on the Internet, and even in the United States Library of Congress looking for information about those "small business tax advantages." After running into one dead-end after another, he concluded that there was no source that was complete, affordable and easy to use.

Since he could find no useful resources on this subject, Ron drew on his earlier experience as an investigative reporter, and launched into doing his own research. After several months, what he had discovered was exciting. First of all, yes, small businesses *can* qualify for most of the same tax breaks as big businesses. Second, the potential *value* of those tax benefits is *huge*. And third, many of the largest tax breaks actually were authorized by Congress *specifically* to stimulate and reward the start-up and running a small business.

He was not looking for ‘tax-dodges’ or ‘loopholes’ or ‘gray-areas,’ so he traced every individual small-business tax break all the way back to the precise Article in the U.S. Tax Code, or the specific Congressional Tax Law, or the exact Federal Tax Court Ruling that authorized it.

By now Ron’s Midwestern work ethic and Christian values began “screaming” that he needed to find a way to make this information available and affordable to every one of the 25 million small-business owners who need it –especially since many were unaware of how *much* they needed it.

His response to that “Inner Passion” was to write a step-by-step guide that explained, in layman terms, what tax breaks are available to small businesses, how to qualify for them, and how to spend only a few minutes a day keeping the necessary records. That book, which has become a bestseller, is called, “**It’s How Much You KEEP, That Counts! Not how much you Make,**” now in its Fourth Edition, which you are now reading.

Joe H. Craft, CPA is the founder and senior partner of Craft, Lee & Sievertson CPAs, PLLC and chairman of Freedom Tax Service, LLC, a firm dedicated to serving the tax and accounting needs of home-based business owners.

Joe has nearly 20 years experience as a CPA. He began his career with Price Waterhouse as a tax associate, and then moved to Deloitte, Haskins & Sells as a senior tax consultant.

In 1989 he relocated to Paducah, Kentucky where he began developing his CPA practice specializing in serving the tax and accounting needs of small business owners. He has authored tax education books and produced tax education tapes. In 2001, he began an active seminar schedule where he has shared this tax education with thousands of people all across the United States.

Unlike many tax educators, his firm provides tax and accounting services to thousands of clients in all 50 states. His firm offers unique services to small and

home-based business owners to help them better manage their businesses and tax compliance responsibilities.

John I. Harrison. CPA is the founder and President of CFOToday, a national franchise providing accounting, tax and payroll services to small businesses.

John has nearly 30 years experience as a CPA. He began his career with Price Waterhouse & Co. for three years as an auditor, and then moved to Peat, Marwick, Mitchell & Co. for two years in their tax department.

In 1978 he started his own CPA practice – Harrison and Associates, CPA, P.A. – providing financial planning services and products to small businesses and to individual clients. Four years later, in November 1982, he expanded his practice to include an active seminar schedule. His most popular seminar was *How to Gain Control of Your Finances and Become Debt-free*.

While on the seminar circuit, thousands of small business owners told him how frustrated they were with the “industry standard” financial reports they received from their accountants, stressing that they were “cumbersome” and “not very useful” for making business decisions or for tax planning. John felt compelled to do something about an issue that impacted the success or failure of so many small business owners.

He “stepped outside the box” of traditional accounting methods, and the result was a revolutionary new accounting system, which today provides small businesses with easy-to-understand, easy-to-use monthly financial statements, that business owners say is “as easy to read as a monthly bank statement.”

Concluding that he could help more small business owners more quickly by franchising his successful accounting system to other like-minded accountants, he launched his franchising concept, CFOToday, in 1990. In January 2004 *Entrepreneur Magazine* ranked CFOToday in the top 10% of franchises in the United States for Financial Strength and Stability, for Rate of Growth, and for Size of the System.

One of his primary focuses today is helping small business owners – including home-based businesses – negotiate the income tax quagmire, and reduce their taxes to the legal minimum.

Let's Get Into It

Everybody thinks they are paying too much in taxes, yet it is a rare person who does anything about it.

Congratulations! By actively running a small or home-based business with the intent to make a profit, you have created a second source of income *and* begun to *qualify* for the huge tax breaks described in this guide. By reviewing this information, you put yourself into that small percentage of the population willing to at least **consider** taking some actions to reduce your taxes to the minimum required by law.

The working American's average wage today is \$23,316. That works out to \$11.21/hour. Not much, huh? But that's *before taxes*! **After taxes, the average American worker takes home only \$8.00 an hour!**

Let me ask you a question: If someone offered to show you a legal way to significantly reduce your **mortgage** or **rent** payments, or to slash the size of your car payment, would you be interested? Of course!

Why, then, do most people freeze in their tracks when offered information on how to reduce their **taxes**? The three main reasons:

- (1) Fear of the IRS,
- (2) Fear of the time it will take to keep detailed records, and
- (3) Not having a full understanding of what is legal.

Here's good news for you on all three counts!

No Need to Fear the IRS

For example, If you're not a shoplifter, do you care one way or the other about those theft detectors at the exit door of the drug store? Why would you? Or if you're driving and have not been drinking, do you fear being stopped by police at a Breathalyzer checkpoint? No, because you have nothing to fear if you haven't been drinking.

When you obey the law, there is no reason to fear law enforcement.

Well, if you understand and follow tax laws passed by Congress and authorized in the Internal Revenue Code, would you have any reason to fear an IRS audit?

Look, if you have three dependents, do you "play it safe" on your Tax Returns by claiming only two of them? No! Why not? Because you know what the tax law allows and you know how to count to three.

Well then, you don't need to "play it safe" by declining to claim the legal tax deductions passed by Congress to benefit your business – once you understand the tax laws.

A taxpayer's chance of being audited is less than one percent, but even if you are audited, you'll have nothing to fear once you understand the laws and are staying within them.

For people who carefully follow this guide and get tax advice from experts on home-business tax law, an audit would simply be an inconvenience – not something to be feared.

Recordkeeping – It's Not as Bad as You Think!

This guide will show you how spending a minute or so a day keeping records, could qualify you for substantial tax deductions every year – up to \$5,000 or more in tax reductions for many people.

There IS Another way to put an extra \$5,000 in your pocket...

You could take-on another part-time job. But you would have to make \$12.50/hour and work *at least* 10 hours a week, 50 weeks a year, to put \$5,000 after-tax cash into your pocket.

Or, you could spend an hour or so per day running an active home-based business you enjoy, plus a few minutes a day whenever it is convenient for you doing the recordkeeping – instead of working two

hours every weeknight for a full year at a part time job you'd most likely hate... and seeing your family even less than now.

Financially, the result is the same either way. Which would you rather do?

As you read this guide, you're going to discover that it is amazingly easy to qualify for thousands and thousands of dollars in legal tax deductions that you had no idea about before.

This Book is **NOT about
'Loopholes' or 'Tax-Dodges' or 'Gray-Areas' or
'Tax Evasion Schemes' or 'IRS-bashing'**

As said earlier, every deduction discussed in this step-by-step guide is based on an Act of Congress, a Section in the Tax Code, a Tax Court Ruling, or other authoritative source. Think about it – since the laws themselves allow so many **100% legal** deductions for home-business operators, who needs to take on the risky ones? Not you, and definitely not me!

A few pages earlier we discussed why you should have no fear of the IRS. **First**, the chance of an audit as a sole proprietor or an LLC, averages well under one percent – that's less than 1 out of every 100

people. And **second**, even if you end up being the 1 out of the 100, it'll be an easy audit, since you now have the **specific reference** which authorizes every single deduction you claim, right here in this book.

With a tax return prepared in compliance with the law and properly documented, the IRS Auditor will likely stamp your return:

Accepted as Filed

Why? Because the purpose of most audits of an individual, a sole proprietor or an LLC, is simply to see if a taxpayer qualified for all the deductions he or she claimed. By following the advice in this book, you will be able to establish that very quickly with an Auditor.

The Auditor's job is to identify people who are trying to cheat on their taxes or who have filed inaccurate or undocumented returns, and then to collect the money they should have paid the government in the first place.

Why would an Auditor want to waste his or her time going over the Tax Return of a taxpayer who can very quickly establish that he/she understands the tax laws, has followed them carefully, and has kept

the required records? They will say, “Thank you for your time,” and go drop their fishhook in a different pond.

*Thoughts on Legitimate Tax Avoidance
by former Supreme Court Justice Louis D. Brandeis*

I live in Alexandria, Virginia. Near the Supreme Court chambers is a toll bridge across the Potomac. When in a rush, I pay the dollar toll and get home early. However, I usually take a free bridge outside the downtown section of the city, and cross the Potomac on the free bridge.

This bridge was placed outside the downtown Washington, D.C. area to serve a useful social service: getting drivers to drive the extra mile to help alleviate congestion during the rush hour.

If I went over the toll bridge and through the barrier without paying the toll, I would be committing tax evasion.

If, however, I drive the extra mile and drive outside the city of Washington, I am using a legitimate, logical and suitable method of tax avoidance, and I am performing a useful social service by doing so.

For my tax evasion, I should be punished. For my avoidance, I should be commended.

The tragedy of life today is that so few people know that the free bridge even exists.

This book is your map to the ‘free bridges.’

Chapter 1

The United States Has TWO Tax Systems

(You Just Might be in the WRONG ONE!)

The United States has one tax system for **employees**, which includes most working Americans, and a very different – and much better – tax system for **business owners**.

Employees are very limited in what they can write-off. **Businesses** engaged in working toward or earning profits are entitled to a wide variety of legally deductible business expenses in their pursuit of that income and profit.

In this Guide, you will learn how you, as an *individual*, can legally and easily qualify for nearly all of the same tax breaks *big businesses* get year after year!

First, a little background on America's tax system. Or, we should use the plural, tax systems, since we have just said there are two tax systems in America.

The first type of Taxpayer is the *Employee*

Employees, or W-2 wage earners, work for someone else. Most taxpayers fall into this category. They have very few tax deductions available to them, usually just

- Mortgage interest & Real Estate taxes,
- Standard deductions for dependents,
- Gifts to church or charity and
- Contributions to a retirement plan.

Essentially, for employees, it's a three-step process:

- Step 1:** Work hard to earn a decent wage.
- Step 2:** Immediately lose a huge chunk of those hard-earned wages to taxes.
- Step 3:** Then you get to live on whatever is left after taxes are withheld.

The Second Type of Taxpayer is the *Business Owner*

Business Owners, on the other hand, get to write-off lots and lots of expenses, from rent to phone bills to furniture to cleaning crews.

Business Owners have a **very different** three-step process:

- Step 1:** Earn revenue from selling goods or services,
- Step 2:** Spend whatever they need to on operating expenses to keep the business financially solid,
- Step 3:** **Then** pay taxes **only** on whatever is **left over**.

The long list of deductions commonly available to

Business Owners, include:

- Mortgage interest or Rent
- **Gas, electric, water and sewer**
- Cleaning crews to dust, vacuum and empty the trash
- **Computers, copiers, fax machines and telephones**
- Advertising
- **Paper, pens and even postage**
- Bank fees on business accounts
- **Desks, sofas, coffee tables and other furniture**
- Credit card annual fees (for business-only cards)
- **Depreciation**
- Painting, wallpaper, carpeting and other repairs/remodeling
- **Legal and professional services**
- Bad debts from sales or services (accrual method)
- **Phones bills, cell-phones, pagers and Personal Digital Assistants (PDAs)**
- Cost of goods sold
- **Magazines and books for business education**
- Newspapers, magazines, books and on-line media
- **Services performed by Independent Contractors**
- Supplies and materials
- **Plane fares, hotel costs, meals and rental cars**
- Taxes and licenses
- **Special work clothing or uniforms**
- Lunches, dinners, ball games and theater tickets
- **Security alarms and hidden cameras**
- Health, life, dental, vision, disability and unemployment insurance
- **Company cars (and even boats)**
- Contributions to Employee Retirement Plans
- **Holiday cards, gifts and postage.**
- And just about any other expense that qualifies as “ordinary and necessary” to operate their business.

If you operate an **Internet eCommerce Business**, your deductions could **also** include:

- **Internet access fees**
- Merchant discount fees
- **Web hosting fees**
- Cable, DSL or Broadband internet service
- **Computer extended warranty costs**
- Database backup services
- **Ink and Toner cartridges for printers**
- Software used for business
- **Spyware and Antivirus subscription services**
- Firewalls
- **Routers**
- Peripherals
- **Surge-protection equipment**
- Conference call services

If you operate an **Insurance or Real Estate Business**, for example, your deductions could **also** include:

- **Advertising**
 - Commissions
 - **Licenses**
 - Professional fees
 - **Sponsorships**
 - Chamber of Commerce membership
 - **Signs and promotional materials**
 - Continuing education courses
 - **Insurance**
 - Seminars & Conferences
 - **Permits & fees**
 - Cell phone, pager and voicemail
 - **Printing, copying and faxing**
- and much more.**

If You are an *Employee*, How Much are You *Really* Paying in Taxes?

The answer may astound you!

Taxes represent ***by far*** the single bill the average American employee pays! The amount withheld from your paycheck for taxes before you even see it is probably more than your mortgage or rent, *PLUS* your car payment, *PLUS* your food costs, and *PLUS* your clothing expenses -- **combined!**

When you add together Federal taxes, State taxes, Social Security taxes, Medicare taxes, sometimes County or City taxes, and all the rest, if you're like the "average" wage earner in America, **you could easily be losing between 40 and 50 percent of your hard earned wages to taxes, before you even see your paycheck!**

Now, most people believe in paying their "fair share" of taxes, but do you think **half of your hard-earned wages** is "your fair share?"

**Do You Know WHY our Government uses
“Payroll Deduction”
as its Method of Collecting Income Taxes?**

Here’s an educated guess ...

What if you earned \$1,000 in wages, and your employer put it all in your paycheck, but *then* as soon as you got it, you *immediately* had to write a check to the government for \$400 for your taxes (40%), leaving you only \$600 out of your hard-earned \$1,000 to live on? What do you think would happen?

There would be a taxpayer revolt that would make the Boston Tea Party look like child’s play, that’s what would happen!

So what does our government do? They make your employer withhold all those taxes from your wages *first*, and then just give you the part that is left over.

That way, they’re hoping you won’t realize how much of a huge bite Uncle Sam is taking out of your pay!

The **IRS collected \$2 TRILLION** from some 183 million taxpayers last year. And “Enforcement Actions” (their term for Audits) raked in

another \$43 Billion. Those numbers are from IRS Commissioner Mark W. Evans, in a speech he delivered at the National Press Club in Washington, DC on March 15, 2005.

The only way to snatch \$2 Trillion out the pockets of 183 Million American workers without a revolt is to withhold it before you see it, showing you only the part left-over – commonly referred to as take-home pay.

Now, IMAGINE for a Moment ...

How much less would you pay in taxes if you only had to pay Uncle Sam a percentage of **your after-expenses “leftover money,”** like businesses do, instead of paying a percentage of the gross wages you earn, like you do now? You would pay a whole lot less in taxes, that’s for sure!

What if you were allowed legally to treat a portion of your home like an “office-building space” (which is tax-deductible), and what if you could convert some of the expenses you’re already paying for, into “business expenses” (which are also tax-deductible)? Do you think that would make a difference in the taxes you pay?

Yes, a major difference!

Here's the Good News You Have Been Waiting For...

It **is** possible for an **individual** to get most of the **same tax breaks** as a business owner can get!

But before we continue, I have to ask you an important question ...

Would you mind if it turned out to be both 100% legal and really **EASY to cut your taxes significantly?** Would it be okay if what I'm about to share with you is not at all complicated?

I'm serious. Some people really believe, "No pain, no gain." And many believe that if it has to do with taxes, "if it's easy and legal, my tax guy would have told me about it." Don't believe either one! They're both wrong, as you soon will discover for yourself.

But first, let me share with you a story that I'm told is true.

Back when Coca Cola was a new company, their total business was selling syrup to "soda fountains," which then combined it with carbonated water to make a soft drink called a "Coke."

One day a visitor called on the Chairman of the Coca Cola Company in Atlanta, and said to him:

“If you decide to act on the idea I am about to share with you, will you give me one-half of one percent of the profits you make from it?”

The Chairman agreed, of course, because if the idea was a good one, he'd gladly pay ½ of 1%, because the Coca Cola Company would still get to keep 99½%. And if the idea wasn't any good, it wouldn't cost him anything. So the visitor leaned over and whispered these two words:

“Bottle it.”

Those two words very quickly made the visitor a multi-millionaire.

Was the idea complicated? **Of course not.**

Was the idea powerful? **Absolutely!**

Why did I want to share that little story with you? Because, just like “Bottle it,” what I am about to share with you is **not complicated**, and is **very, very powerful!**

If you operate a legitimate **home**-based business with the intent to produce a profit, you can qualify for most of the same deductions as an “**office**-based” business.

In addition, expenses associated with your home office become even *more* deductible as your business turns profitable.

[IRC Section 280A(c)]

VERY IMPORTANT ADVICE:

No one should ever start a home-based business for the purpose of getting new tax deductions. That's not the intent of the law and frankly it just doesn't work. Tax deductions are the result of having a home-based business, not the reason for it.

If you're wondering when this amazing new set of tax laws were passed and why you haven't heard about them, this is going to surprise you: **Almost *nothing* in this guide is new.** Seriously! Most of these Tax Laws, Tax Codes and Tax Court Rulings have been in place for years. So they're not all new, just new to you.

Are you just starting up your own business?

If so, here is some Great News!

The American Jobs Creation Act signed into law by President Bush in October, 2004, now allows taxpayers to elect to deduct up to \$5,000 in new-business start-up costs *AND* \$5,000 in organizational expenditures in the tax year in which their business begins. This is a huge new benefit for small and home-based businesses.

By the time you finish reading this book, you will have a thorough understanding of three things that the vast majority of American taxpayers (and most tax *preparers*) do not understand in the least:

- Exactly what deductions the tax laws allow,
- How to qualify to use them to reduce your own taxes to the legal minimum, and
- What records will make your Tax Returns “Audit Proof.”

“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them by means which the law permits, cannot be doubted.”

Unites States Supreme Court in case of
Gregory v. Helvering, 293 US 465

“According to a new poll, seven out of ten Americans say our tax code is too complicated. Well, of course, it's complicated. That's why they call it a 'code.' They don't want you to understand.” **Jay Leno, April 2005**

Chapter 2

Your Home-Based Business Could Legally Qualify You for Thousands of Dollars in New Tax Breaks!

This is the equivalent to “Bottle it,” as we discussed in Chapter I. It’s **uncomplicated** like “Bottle it.” And it is just as **powerful** as “Bottle it!”

But many people who don’t have a home-based business aren’t even looking for one. Why? Because they’re too busy at their job (or jobs) trying to earn enough after-tax money to make ends meet. Do you have a “traditional” W-2 job? You know what the word JOB stands for, don’t you? My friend and best-selling author Robert Allen, who wrote the Foreword to this book, says a **J.O.B.** stands for **Just Over Broke!**

First we chuckle at that, but then we realize it’s TRUE! In fact, for many of us, the word should be spelled **JUB** for Just Under Broke since most of the time we run out of money before we run out of month.

That’s why the average American household today holds 2.5 jobs and is \$7,000 *or more* in credit card debt! Isn’t that sad?

But it doesn't have to be this way!

You are already learning several things you probably didn't know before, and you are about to discover that several things you thought you knew about home businesses and the tax law, just are not correct.

Myth #1:

“My tax guy told me that I have to show a profit in two out of every five years, or else I'll lose all my tax-deductions.”

The Truth:

That's the “Hobby Loss Rule.” But we're not talking about “income-producing hobbies,” we're talking about you running a legitimate home-based **BUSINESS**. What is the difference? Among other things, unlike a hobby, to qualify as a bona fide business, you have to prove your **intent** to produce a **profit** and to work the business **actively** and **regularly**. You could potentially claim losses year after year as long as you can **prove** that you have the **intent** to produce a profit.

[Reg Sec 1.183-2(a)]

NOTE: In just a few pages, we will show you exactly how to prove your “profit intent.” A simple Business Plan is one key to satisfying the requirements. You can download a fill-in-the-blanks draft of a Business Plan to adapt to your business by going online to www.HomeBusinessTaxSavings.com.

Unless you've been living under a rock you've heard of Amazon.com. They legally wrote off millions in business losses for many years in a row. How was that legal? Because they could **prove** they had an **intent** to produce a profit, and you can too!

Myth #2:

“I can only write-off a room and the equipment and furniture in it if I use it exclusively for my business.”

The Truth:

That’s the “Exclusive Use Rule,” which applies primarily to home-offices. You’ll soon learn how, when and how you could *also* write off furniture and equipment used wholly *or partially* for business whether they are in the exclusive use room(s) or not.

[IRC Section § 280 A(c)(2)]

Myth #3:

“I’ve been told that the amount of my write-offs can’t be any greater than the amount of money I make in my home-business. If I’m not yet making much from my home-business, why bother with all of this for now?”

The Truth:

That’s a half-truth. First, this is only true for “Indirect Expense” deductions -- such as utilities, rent, home insurance, etc. (However, the good news is these deductions can be “rolled forward” for use in future years when you are making much more money, and thus could claim the “unused” deductions from prior years.) Second, when you are **in business with the intent to make a profit**, your deductions in all other categories can be used to offset all personal income from any source (including your W-2 job, investment income, rental properties, etc.).

“Intent to Produce a Profit.”

What’s that Mean, and How Can I Prove it?

It means, simply, that you are trying to make a profit – i.e., that you are in business for the purpose of making a profit, not for the purpose of producing tax write-offs. The first is honest, the second is illegal.

Fortunately, some of the same activities that help you to build your business are those which the IRS looks for in qualifying your intent to make a profit. The specific actions you are taking to create profitability are also the key factors to sustaining your deductions.

IRS Auditors use several “relevant factors” to determine whether or not your business qualifies for small/home business tax deductions.

[Reg. Sec. 1.183(b)]

Here are the main ones:

1. “Expertise of the Taxpayer or his/her Advisors”

You, personally, do not have to be an expert, even in your own business category, IF you are actively learning from someone who IS an expert. If your company provides “trainings,” including ones conducted by conference calls, and you participate in them regularly, your conference notes and notations in your day planner will document your “effort to establish expertise.”

2. Time and Effort the Taxpayer puts into “Running the Business”

Run your Business like a Business. Work it *regularly* and *consistently*. The Federal Tax Court recently ruled in favor of a taxpayer who “worked her business 45 minutes a day, 4 to 5 days a week.” The court said she met the “regularly and consistently” test. You might use that as a guideline for establishing a “minimum.”

3. The Manner in which the Taxpayer Carries on the Business Activity

If all of your “business activity” is conducted when you and your co-workers take a lunch break, or when on the golf course with friends, it won’t look like you are carrying on your business in a businesslike manner. But if you make business presentations, mail promotional letters, and actively work a list of customers and prospects, you should easily meet this ‘factor.’

4. Taxpayer’s History of Income or Loss with Respect to the Activity

If you run the same business (the “Activity”) year after year, and it loses money year after year, and the amount of your losses is not decreasing, you may have a hard time satisfying this “relevant factor” -- *unless* the reason is that you are reinvesting would-be profits back into the growth of your business.

5. Adequate records of business Income, Expenses and Activity.

A good first step toward satisfying this ‘factor,’ would be to have a separate business-use-only checking account, and a business-use-only credit card. Do not co-mingle your *personal* income and expenses with your *business* income and expenses. (Document business activity with your notes in a day planner.)

All five Relevant Factors, especially number five, require good recordkeeping. This chore can be reduced to a minute or two a day by using either the *Sixty Second Tax Savings Organizer*[™] software program or the *Tax MiniMiSer*[™] recordkeeping system. You'll find them both by clicking on "Business Success Tools" at www.HomeBusinessTaxSavings.com.

Chapter 3

Some of Your Current Day-to-Day Expenses can Now become Valuable NEW Business Tax Deductions

A business is a business no matter what its size, whether or not it makes a profit, or where it is located.

This means as the owner of a small, part-time business run out of your home you should be treated no differently, for tax purposes, than the owner of a large business that is run out of a huge office building.

With a home-based business, your home is your office building, so the costs to maintain the business portion become tax-deductible business expenses.

In order to really “get it,” try this shift in thinking... Most people think of their street address as, “This is where I live, and also run a business here.” Try, instead, thinking, “This is my place of business, where I also sleep.” Do that and you will intuitively understand many of the tax breaks your business can qualify for.

What exactly are the *non*-deductible current expenses you could convert into *tax-deductible* business expenses?

Here's a *partial* list of some of the tax-deductible expenses that businesses legally and routinely write-off, and some of the home-based business expenses that YOU can legally write-off, too.

[IRC Section § 280 A]

Legal BUSINESS Deductions	Legal HOME-Business Deductions
√ Mortgage Interest or Rent	√
√ Gas, Electric, Water and Sewer	√
√ Cleaning Service to Dust, Vacuum and Empty Trash	√
√ Computers, Copiers, Fax Machines and Telephones	√
√ Paper, Pens, Ink Cartridges and even Postage	√
√ Desks, Sofas, Coffee Tables and other Furniture	√
√ Painting, Wallpaper, and other Repairs/Remodeling	√
√ Phones Bills, Cell-Phones, Pagers and PDA's	√
√ Newspapers, Magazines, Books and On-line Media	√
√ Plane Fares, Hotels, Meals, Rental Cars while Traveling	√
√ Dinners, Ball Games and Theater Entertainment	√
√ Security Alarms and Hidden Cameras	√
√ Health, Dental, Disability and other Insurance	√
√ Company Cars and even Boats	√
√ Contributions to Employee Retirement Plans	√
√ Pest Control and General Maintenance	√
√ Holiday Cards and Postage and Gifts	√

It sure looks like the two columns of deductions are identical!

Of course they're identical! Remember that your street address is your place of business, and “business expenses are business expenses,” whether the business is “housed” in a high-rise office building or “housed” in a suburban home or in-town apartment.

The primary difference is that, since your home is used for **both** business **and** personal purposes, you will need to define and provide support for the “deductible business portion” of your home-related expenditures. With the exception of your mortgage interest and property taxes, the business portion of the costs associated with maintaining your home (rent, insurance, maintenance, utilities, etc.) will be accumulated from year to year, so that you can use them as soon as your business becomes profitable.

**Now let's look more closely at that list and
see what it means in terms of Your Tax Savings...**

Mortgage Interest or Rent

Yes, Rent! Finally, renters get a tax-break. Since business owners do not normally own the office building in which they have offices, why should you have to own the house in which your home-based business is based? You shouldn't, and the government agrees. Renters may now claim a business rent

deduction on their Schedule C according to the Business Use Percentage (BUP) of their home. (The next section of this chapter shows you how to determine your BUP.)

[IRS Publication 587]

Please **NOTE**: “Double Deductions” may be available for some homeowners. Any taxpayer can claim Standard Deductions on their Form 1040 or they may itemize their deductions on a Schedule A (Itemized Deductions). But, as a home-based business owner, you may now be moving many of your personal (Schedule A) deductions over to Schedule C (Profit or Loss from Business). This may reduce your Schedule A “write-offs” to almost nothing. If that is the case with you, consider not filing a Schedule A at all, and take advantage of the “Standard Deduction” option on your Form 1040.

Gas, Electric, Water and Sewer

Of course this not only includes the utilities themselves, but any equipment, repairs, service or maintenance. For example, installing new heat pump or furnace, adding a humidifier, buying salt for your water conditioner, repairing plumbing, replacing a well-pump, inspecting your furnace, cleaning your chimney and air ducts, etc. See Chapter IV for specifics on how much of these costs you can deduct. **[IRS Publication 587]**

Janitorial Service to Clean your Office Space

If you have a “maid service,” you may qualify to deduct a portion of the fee you pay them. Or perhaps you can hire your kids (tax-deductible to you, tax-free to them) to perform those business services for you as “employees,” instead of paying them a non-tax-deductible “allowance,” which you’d pay out of your after-tax wages. In order to be deductible, their services must meet some requirements, which you’ll learn about in Chapter VI.

Computers, Copiers, Fax Machines and Phones

Contrary to popular opinion, these items do NOT have to be used *exclusively* for business purposes, in order for you to be able to benefit from tax deductions. The next chapter shows you how to determine how much of the cost you can deduct.

[IRC Section § 280 F(d)(4) and IRS Publication 956]

SPECIAL NOTE: If you would like details and examples about depreciation and potential tax write-offs regarding business furniture and equipment, as well as laws about converting currently owned furniture and equipment from personal use to business use, consult with a tax professional who specializes in home business tax law.

Paper, Pens and Postage

Of course these items, and all other kinds of office supplies that are used for business purposes, are deductible for any business, including your own home-based business.

Desks, Sofas, Coffee Tables and other Furniture

The rule of thumb is “if you use it in your business, even only part time, at least a portion of the cost is probably deductible.” Think about a traditional business run out of an office building. Don’t you think they are ‘tax-deducting’ the cost of the sofa and coffee table in the lobby, the small round meeting tables and chairs in private offices, and even the coffee maker and water cooler in the kitchen? Of course, and you may be able to also. See Chapter V for specifics on how much you can deduct.

Painting, Wallpaper, Carpeting and Maintenance

Many people think that “upgrades” may be deductible but “routine maintenance” is not. If you have a home-based business, that’s not correct. That is the tax rule regarding deductibility of expenses associated with selling a home, but it has nothing to do with home-business deductions. As long as the home or apartment is used at least part of the time for business purposes, then at least part of maintenance expenses are probably deductible. See next chapter for specifics on *how much* you can deduct. **[IRS Publication 587]**

Phone bills, Cell-phones, Pagers and PDAs

They’re all deductible if they’re used in your business, but there is one exception, and we’ll cover that in detail in the next chapter. **[IRS Publication 587]**

Newspapers, Magazines, Books and Online Media

Again, if you need it for your business, it’s probably deductible. You probably don’t need *Reader’s Digest* for your business, but you may need *Entrepreneur*, or even a daily newspaper if you check the Classifieds for competitive intelligence and read the news pages for current news about your product category or about your customers.

Plane fares, Hotel costs, Meals, Rental cars

Expenses related to business travel are usually deductible, so if you can combine your personal travel with your business travel - and meet specific IRS rules - even personal travel (including “vacations”) could become deductible. (All the details are in Chapter VIII.)

[IRC Section § 162(a)(2)]

Lunches, Ball Games and Theater Tickets

This is a category that confuses many people, but it's worth understanding because thousands of dollars worth of deductions are available under the right circumstances -- and those circumstances often are under your control. Much of the cost of "fun" could become legal business deductions. (See details in Chapter IX.)

Health, Dental and other types of Insurance

Under the right circumstances (consult your tax professional for ideal structuring), you can deduct not only the cost of the premiums, but also the annual deductibles, co-pays, etc. (Chapter VI spells out details.)

Security Alarms, Motion Detectors and Hidden Cameras

A business owner needs to protect his or her place of business, and this is a normal cost of doing business (i.e., a legal tax deduction). By the way, when you think "alarm system," think broadly. If you install floodlights with motion detectors on your home (which is your place of business), you may be installing a security alarm system, which could be deductible.

[IRS Publication 587]

Company Cars and Even Boats

A car (or boat) does not have to be used exclusively for business purposes in order to be partially deductible. Chapter VII will blow your mind, because the proper use of these rules could result in very large tax deductions for many businesses.

Contributions to Employee Retirement Plans

The rules are similar, whether you are an employee or a home-business owner, so be sure to take the deduction if it applies.

General Maintenance and Repairs

If you owned an office building, general maintenance costs would be deductible, right? The amount you can deduct for your home-business depends upon your “Business Use Percentage” (see next chapter). **[IRS Publication 587]**

Holiday Cards, Postage and Gifts

They could be deductible, as long as they promote your business. That could be done within the context of a Christmas Letter which many people insert in their cards, or you could simply have the card be signed, “Frank and Bonnie Smith and Smith Enterprises.”

How about Health Insurance Premiums?

This recent change in the tax law can be worth a lot of money, as insurance premiums continue to soar out of sight.

If you are self-employed and are not included in any health insurance plan paid for (even partially) by an employer, you may be eligible to deduct 100% of your own health insurance premiums -- but only up to the amount of the net income (that means ‘profit’) from your business.

NOTE: This deduction applies **only** to sole proprietorships, single-owner LLCs, and C-Corporations, and is *not* subject to the 7.5% threshold that applies to other medical-related expenses.

Chapter 4

Determining Your Business Deductions when Your Business is Based in your Home

Remember all those “non-deductible” Indirect expenses we just discussed converting into tax-deductible business expenses? Well, we cannot write-off 100% of those expenses, because after all, we do live there too.

What dollar amount or percentage of those expenses can you deduct? There are three categories of expenses and different (but easy) methods for calculating each. The only three terms you’ll need to understand are:

- 1. Indirect Expenses**
- 2. Direct Expenses**
- 3. Business Assets**

INDIRECT Expenses:

Indirect Expenses are *indirectly* related to your home-business. Rent, utilities and general maintenance (such as replacing a roof or repainting the exterior of a house), are examples of ***Indirect Expenses***. The amount of Indirect Expenses you can deduct depends upon the “Business Use Percentage” (BUP) of your home, and upon the profit of your home-based business.

First of all, the “**P**” in BUP is a **P**ercentage of ***what?*** It is the ***finished*** square footage of your home (i.e., it does not include such areas as your garage, barn, land, or unfinished basement or attic).

This starts, usually, with your **Home Office**. It is now much easier to qualify to have a home office, since Congress recently passed new legislation to “overrule” a Supreme Court decision.

To qualify for a home office, you now need only to pass any ONE of three tests. Your home-office must be

1. Where the primary ***value*** of your business is delivered, OR
2. Where you ***regularly meet with*** customers or prospects, OR
3. Where the primary ***Management*** or ***Administrative Function*** of your business is conducted.

Almost everyone operating a legitimate business from their home can qualify under test #3. But the Home Office is just one of the many elements in computing the Business Use Percentage of your home.

Let’s look at an example...

Let’s say your home has a Living Room, a Kitchen, a Dining Room, 3 Bedrooms, a Den and 2 Bathrooms. Now, let’s say the Living Room, Den, Dining Room and one (Bedroom) Office are all used in your business – the Dining Room and 1 Bedroom exclusively (let’s say that’s 15% of your finished square footage area), and the Den and

Living Room are used regularly and primarily – but not exclusively – for your business.

How could **portions** of your den or living room qualify for inclusion in the BUP even though they are not used exclusively for business? Here are some examples...

If you have bookcases in those rooms containing **only** business related books, your BUP calculations can include the square footage occupied by that bookcase, plus “a reasonable amount of walking space around it.” (Of course, the bookcase itself may be a tax-deductible Business Asset, as we will discuss soon.)

If you have a “conference table” in a section of your den which is used “regularly and exclusively” for meeting with customers or clients, then you could also include the square footage occupied by the table and the chairs around it (plus walking space around it) in your BUP calculations.

Now, what if you also need to store business products (and **only** business products) in a cabinet, or need to place a business-use-only copy machine in a hallway? Again, the space occupied by the cabinet and the copy machine, and “a reasonable walking space around them,” can be added to your BUP calculations.

“Exclusive use” areas do not have to be bound by walls or other partitions. They can simply be portions of rooms that are used only for business purposes.

So, no matter where your business-use-only furniture and equipment best “fits” in your home, the area it occupies can be included in your BUP calculations.

You can include 100% of the square footage of any exclusive-use rooms in your BUP, plus the exclusive-use areas of other rooms.

If your Business Use Percentage (BUP) ends up being 15%, for example, your indirect expenses are calculated at that rate.

Imagine that! Legally deducting 15% of the cost of your home heating and cooling bill, 15% of your rent cost (**yes, RENT**, not just mortgage interest!), 15% of your home maintenance and upkeep costs, etc.!

[IRS Publication 587]

Draw a floor plan (with dimensions) of the room or area that you plan to use regularly and exclusively for your HOME OFFICE right here. ▼ ▼ ▼

Now draw a rough floor plan of your home or apartment. ▼ ▼ ▼

Take a **color marker** or **highlighter**, and outline *every* area you will use *regularly* and *exclusively* for your business, including any areas used to store or display your inventory or product samples, including a reasonable allowance for access to those areas.

Now, add up the total square footage used *regularly & exclusively* for business. Divide that number by the total finished-square-footage of your home. That's your Business Use Percentage (BUP).

Here is an 'extreme' (but real) example...

If a professional wedding photographer displays his photographs ("product samples") throughout his home, he or she could have a very high BUP. How's that?

When an engaged couple visits the photographer's place of business (in his home, of course!), thinking they may want this photographer to photograph their wedding, and they ask to see examples of his previous work, guess what he does?

Instead of handing them a photo album, he takes them on a tour of his home, of course, where examples of his work are framed and hanging on most of the walls! He may have legitimately converted a very large portion of his home into "product display areas."

You could potentially write-off the majority of the square footage of more than one room in your house, if the use of each of them is “reasonable and necessary” to effectively conduct your business.

[IRC Section § 280 A]

Let’s look at another example...

Do you have a formal dining room in your home? If so, how often do you use it for dining? If you’re like most of us, you use it two, maybe three, times a year, for formal family meals. (Oh yes, also on Saturdays when you go in there to dust the furniture!).

If that’s the case with you, then perhaps you “re-label” your dining room, thinking of it simply as another room that you could decide to use regularly and exclusively for business purposes.

Let’s say you “regularly and exclusively” use that room to...

- Assemble mailings to your customers/prospects
- Process your invoices and payments, and to fill out deposit slips
- Store ‘samples’ and products that you sell
- Lay out your marketing plans, etc.

Even if you “clean up” that room once or twice a year to host a family Thanksgiving or Easter dinner, that would probably not invalidate the deduction under the “Exclusive Use Rule.”

In addition to “**Exclusive**,” the other key words are:

- **Ordinary**
- **Necessary** *and*
- **Reasonable.**

If you **Ordinarily** use the room on an “exclusive basis” for your business, if it is **Necessary** to use that room in the conduct of your business (in the opinion of an unbiased person), and if it is **Reasonable** to conclude that the room is used and needed for business, that room could meet the BUP requirements.

NOTE: A key word here is “Reasonable.” I.e., in a “traditional business,” if the office conference room is occasionally used to throw a birthday party for an employee, that action would not disallow the conference room as a legitimate business deduction, would it? Of course not. Why should it be any different for the business based in your home?

Let your business *e—x—p—a—n—d* to encompass as much of your home as is Necessary and Reasonable. Can you see why a small home would probably have a much higher Business Use Percentage than a mansion? The business-use *square footage* may be larger in a mansion, but the business-use *percentage* would likely be lower.

How about the non-finished square footage? Let's say you store business products, inventory and supplies in the loft of your barn. Under these circumstances, what's another term you might use for the 'loft?' How about 'warehouse?' Maintenance and upkeep of a business warehouse or storage area is tax-deductible. Not necessarily the whole 100%, of course, but a "reasonable percentage."

What if the barn needs repairs and repainting? The percentage of the barn that is used exclusively for business purposes (storage, in this case), can be applied to the repair and maintenance expenses, as a business tax deduction. **[IRS IRC Section § 280 A(c)(2)]**

Keep thinking like a business owner who rents space in an office building. Your 'office building' just happens to be your home.

These are just examples. Do not claim these (or any other) deductions without the advice of a tax professional who specializes in home-business tax law.

You might want to provide your tax professional with a sketch of each business-use room of your home, including dimensions of the rooms themselves and dimensions of the business-use areas within them, along with the total square footage of your home. Your tax pro can then help you compute your BUP, and also the depreciation you could claim for your Business Assets (which we will discuss soon).

DIRECT Expenses:

Direct Expenses are expenses directly related to the conduct of your business. This category would include office supplies; telephone service; necessary media subscriptions; perhaps cellular phones, beepers and pagers; employee benefits; repairs and upkeep of exclusive use areas; and professional dues and memberships. Direct expenses generally are 100% deductible.

There is One Important Exception to “Direct Expense” Deductions

The rules about deductibility of your **telephone bill** are a little bit different.

[IRS Publication 587]

Your **base** phone charges are **not** tax deductible, **period**. “Base phone charge” refers to the amount you would pay if you had no long distance calls, no second line, no add-on services like call waiting, call forwarding, caller ID, 3-way calling, etc. The cost of minimal phone service = your “base phone cost.”

This “base phone cost” exclusion applies only to the first phone line in your home. Any additional lines may be 100% deductible if they are used only for business purposes (such as a dedicated fax line, for example).

Even though your “base phone cost” is not deductible, your “add-on” services could be 100% deductible if subscribing to them is “ordinary and necessary” for your business.

If you get an itemized phone bill, every long-distance call must be annotated as either a business call (“B”) or a personal call (“P”). If the primary purpose of a call is to discuss business, and “personal chat” is secondary, the call may still be deductible.

If you have “flat rate” long distance service, and if the reason you subscribe is because you make a large number of long distance *business* calls, then 100% of your flat-rate bill could be deductible. Occasionally calling your sister would have no affect whatsoever on the amount of your phone bill, so the cost should still be 100% deductible.

BUSINESS ASSETS:

As you would expect, Business Assets include **equipment** such as computers, fax machines, etc.; and **furniture** such as desks, desk chairs, filing cabinets, etc. These assets are deductible at 100%, providing they are used exclusively for business purposes.

Thanks to the “Jobs Growth and Tax Reconciliation Act” signed into law by President Bush in October, 2004, you now have an accelerated

depreciation option. Under a “Section 179 Election,” you can *immediately* depreciate the *entire* amount of new or used business assets you purchase in 2005 (as long as business use is at least 50%) up to \$105,000, *this year*, rather than depreciating the item over 5 or 7 years. (In Chapter VII we’ll discuss how this applies to vehicles purchased for business use).

Now, what about assets used partially for business purposes, but not exclusively? If customers, clients and/or prospects visit your place of business (your home) regularly and frequently, it would be customary to furnish a lobby (your living room?) and perhaps a meeting room (maybe your den?), and to have equipment available for making business presentations (TV and DVD, for example).

The furniture and equipment in these rooms also are tax deductible, although not at a full 100%, because they too, are only partially used as Business Assets. So, exactly how much can you deduct?

Let’s say (based on your day planner records or upon an “actual-use-log”), your sofa is used 3 out of every 10 times for business purposes, and 7 out of every 10 times for personal, family use. You would likely be allowed to deduct 30% of the cost of the sofa as a **Business Asset**.

What Happens When You SELL YOUR HOME That Contained a Home-Based Business?

Good news for home-business owners! A recent change IRS regulations now state that there will no longer be taxation on the ‘gain on sale’ (i.e., profit) portion of a principal residence that would be allocated to the business use of that residence.

If you claimed depreciation of your home for the portions used exclusively for business, under some circumstances a ‘recapture’ of the depreciation taken for home office could be required, but that amount is miniscule compared to what taxation on the ‘gain’ could have meant. Be sure to consult with a tax professional if this situation applies to you.

You Can Even Write-off Your RENT !

Yes, it is true! As we said earlier, when you have a home-based business, you can legally deduct the Business Use Percentage of **either** your mortgage interest **OR** the BUP of your **RENT**.

Does a “traditional business” have to own its office space in order to deduct the cost of using it? Of course not, so why should you?

Since your home is your place of business, it does not matter whether you own or rent your “office space.” You can deduct the “Business Use Percentage” of your mortgage interest or your rent payments, *either one!*

Finally, for profitable businesses, *renters* can get the same tax deductions as their home-buyer friends!

Is this a great country, or what?

**Also Deduct Business Publications,
Cleaning Services and Much More!**

Yes, again, it’s true! If reading certain newspapers and magazines is ordinary and necessary for running your home-based business, which is highly probable, they could be tax deductible business expenses, just as they are for businesses based in office buildings.

Also, a traditional business can deduct the costs of janitorial service, and likewise, the owner of a home-based business can deduct house cleaning expenses for the business-use portions of the home.

Does a **traditional** business get to write-off the costs of repairs, general maintenance, trash collection, etc.? Of course. Well, if the “business use percentage” of your home is 15%, for example,

shouldn't **you** get to write-off 15% of **your** repairs, general maintenance, driveway resurfacing, snow removal, trash collection, etc? Of course. And you can if you know the law.

If you find this information amazing, just wait until you read the rest of this tax-reduction guide.

Hold On, We Have Barely Begun Saving You Money on Your Taxes!

You are about to learn some tax information your current tax preparer probably hasn't even thought about – unless he or she is a seasoned expert in home-business tax-law. (That's why we are even citing the sources to prove it!)

Pull out a pencil and calculator and go to the next page to see how much of YOUR current expenses could become tax-deductible...

Typical Home-Based Business Expenses

Calculating Your “Business Use Percentage” (BUP)

1. Total finished square feet of your home = A: _____
2. Total sq. ft. used exclusively in your business = B: _____
3. $B \div A =$ BUP: _____ %

Estimating Your Tax Deductions

<u>Expense Category</u>	<u>ANNUAL Cost</u>	<u>Conversion Factor</u>	<u>Estimated Tax Deduction</u>
Mortgage or Rent	\$ _____	x BUP%	\$ _____
Gas	\$ _____	x BUP%	\$ _____
Electric	\$ _____	x BUP%	\$ _____
Water/Sewer	\$ _____	x BUP%	\$ _____
Trash Collection	\$ _____	x BUP%	\$ _____
House Cleaning	\$ _____	x BUP%	\$ _____
Deck Treatment	\$ _____	x BUP%	\$ _____
Driveway Repairs	\$ _____	x BUP%	\$ _____
Security Alarm	\$ _____	x BUP%	\$ _____
Repairs/Maintenance	\$ _____	x BUP%	\$ _____
Business Supplies	\$ _____	x 100%	\$ _____
Postage and Courier	\$ _____	x 100%	\$ _____
Subscriptions	\$ _____	x 100%	\$ _____
Cards and Stamps	\$ _____	x 100%	\$ _____
Internet Access Fees	\$ _____	x 100%	\$ _____
Books/Magazines	\$ _____	x 100%	\$ _____
Phone Bills**	\$ _____	x 100%	\$ _____
Asset Purchases***	\$ _____	x 100%	\$ _____
Depreciable Assets	\$ _____	x 14.28%	\$ _____
Other	\$ _____	x ??%	\$ _____

Current Expenses = \$ _____	▼	▼
------------------------------------	---	---

Estimated Business Deductions = \$ _____

** Excluding “base amount” for first phone line.

*** Maximum deduction is \$105,000 for 2005.

Remember, There Are Dollar-Amount Limits on SOME of these Deductions

Deductions for expenses falling into the *INdirect* Expense category (rent, utilities, repairs, maintenance, etc.) are limited by the amount of net income (profits) of your home-based business in any particular year.

For example, if your home-based business earned a profit of \$4,000 last year after all other expenses and deductions, your total INdirect Expense deductions on last year's Tax Return would be capped at \$4,000. **However, you never lose these Indirect Expense deductions because they can be carried-forward for use in any future profitable year.**

For example, if you qualified for \$9,000 in indirect expenses deductions last year, but were able to claim only \$4,000 worth, you can “carry forward” the entire remaining \$5,000 worth of deductions for use *in any future year*.

In addition, you never lose the full amount of your mortgage interest and property tax deductions if you itemize. In fact, it is possible that these two items could be deductible to you on a Schedule A, even if you have a business loss.

Deductions for all **other** expenses generally **are** allowed to exceed the amount of net income generated by your home business, and usually be applied against ALL other income sources, including interest, dividends, rental properties, W-2 and 1099 income, and more.

Chapter 5

How to Write-Off Furniture and Equipment Purchased Prior to Starting Your Business and Additional Business Assets Acquired Later

As mentioned in the last chapter, a business in an office building would be expected to have a sofa, coffee table, lamps, etc. in its lobby for the use of customers and prospects visiting the office, right?

You've already discovered that if you meet customers and prospects in your home-office, you have the same tax deduction rights.

Let's use a sofa for our example. You could either "convert" a currently-owned sofa from Personal Use to Business Use or you could acquire a new sofa as a Business Asset.

For "converting," the calculation goes like this...

First you determine the approximate value of your sofa at the time of conversion. Then you compare that to your cost basis and pick the lower of the two amounts to arrive at its "depreciable value." Then you determine the percentage of business-use versus personal use of the sofa. Next you multiply the depreciable value times the

percentage for business-use. The resulting number is then depreciated over a seven-year period.

An example may help to clarify...

Let's say your sofa was purchased new for \$1,000, and today it's worth about \$700. And let's say out of every 10 times the sofa is used, 6 are for business and 4 are for personal use (thus, business use = 60%). Next you multiply \$700 by 60%, and the result is \$420. Now, since you are required to depreciate the "asset" over a 7-year period, you can claim 1/7th of \$420 (which is \$60) on each of your next seven tax returns as Asset Depreciation.

The tax law is **much more liberal** when you **buy** a sofa for partial business use, rather than **converting one** from Personal use to Business use. By the way, it doesn't matter whether you purchase a new sofa or a used sofa – as long as it is "new to you."

After your business is established, if you bought that same sofa for \$1,000 (whether it was new or used), Uncle Sam actually gives you a choice of two methods you can use to get your tax benefits.

1. You can choose to multiply the \$1,000 by your 60% business-use (which = \$600), and then depreciate that \$600 amount over seven years. (Same as in the example above,

except in this case you get a \$85+/year deduction for Asset Depreciation instead of only \$60/year.)

- or -

2. You can choose to deduct the entire 60% of the \$1,000 purchase (which = \$600) ALL in the same tax year in which it was purchased in most cases. It must have been purchased “for your business” and the deduction cannot exceed your total earned income in the year of purchase, subject to an annual maximum of \$105,000 in 2005.

If you need tax deductions this year, you might choose the second option, but if you do not need the deductions this year, the first option might be a better decision. Be sure to consult with your tax professional **before** purchasing **any** asset that will be used in your business.

Note: The depreciation period is only FIVE years for electronic equipment (classified for tax purposes as “listed property”) **such as:**

- Computers and peripherals
- Phones and phone systems
- TVs, VCRs, DVD players, tape players, CD players
- Photo-copiers, fax machines, scanners and printers

[IRC Sec 280F(d)(4)(A)]

By the way, items of furniture or equipment which cost less than a few hundred dollars may be considered as “supplies” and thus,

written-off as Business *Supplies* rather than Business *Assets*, and not subject to the multi-year depreciation rules that apply to business equipment and furniture.

For example, if you purchase a filing cabinet for \$200, you do not have to depreciate it over a 7-year period, or if you purchase a new calculator for \$100 you do not have to depreciate it over 5-years.

Assets and Supplies in the Exclusive Use Areas

Of course, the assets (equipment, desks, chairs, etc.) and the supplies (items worth less than a few hundred dollars) in your exclusive use home-office, and other such rooms in the home, are 100% depreciable, whether they were purchased before you went into business (converted assets and supplies) or after you went into business (newly acquired assets).

A key point is that assets (new or used) purchased and placed into service when or after you go into business may qualify for “accelerated depreciation” under the Section 179 Expense Election, which means that you can deduct the entire BUP of the asset cost (as long as it is used more than 50% for business) whether it is totally paid for or financed (up to \$105,000 in 2005).

[Jobs Growth and Tax Reconciliation Act of 2004]

Chapter 6

Hire Your Family Members to Perform Services for Your Business, and Watch Your Deductions SOAR!

Being self-employed and hiring employees (even family members), presents you with more obligations, but also with more tax deductions. Your obligations include paying quarterly self-employment taxes on your business income, and filing quarterly and annual reports for each of your employees.

But those requirements are minor compared to the HUGE additional tax benefits you can qualify for. (At the end of this chapter, I'll show you how to easily get somebody *else* to handle those chores for you.)

Hire your kids

Instead of Paying Them an Allowance!

It is quite common to see children actively involved in the family business. Even young children can perform valuable services that are “reasonable and customary” for your type of business. Many sole proprietors, however, miss out on the major tax savings available for actually hiring their children and paying them a fair wage for their

services – simply because they don't know the tax rules you are now discovering. **[Tax Court Memo 1992-50 in Jordan v. IRS commissioner]**

The wage *expenses* are tax-deductible to you, and the wage *income* is tax-free to your child. **[Reg Sec 1.162-7(a)]**

The federal tax-free limit on earned income for dependent children is \$5,000 (per child) for 2005. The amount is equal to the Standard Deduction, which changes each year.

[Rev. Proc. 95-53 and IRC Section § 63(h)(2)]

If they earn *more than* \$5,000 in 2005, they'll simply need to pay the 10% minimum tax rate on any amount over and above \$5,000.

Most states follow the federal guidelines on tax-free income for dependents. However, earnings of a minor may be subject to a local payroll tax, depending on where you live. Be sure to check with your professional tax advisor to be certain that you are complying with all state and local tax laws.

In order for you to employ anyone, you should have an Employer Identification Number (EIN). The application form is available at **www.HomeBusinessTaxSavings.com**, under "Docs, Forms & Special Reports." No cost, no hassle, **but very important.**

The requirements to qualify are easy and logical, but specific.

1. You should have a signed *Employment Agreement* in order to establish a bone fide employer-employee relationship, and for documenting hiring date, assigned duties, agreed-upon wage level and payday schedule.
2. The type of work must be *ordinary and necessary* for your type of business.
3. Document that the *services were actually performed* (timesheets or work log).
4. The wage level must be *reasonable* for the services actually rendered.
5. Wages must be *paid on a consistent and timely basis* (at least monthly).
6. Document that the wages *were actually paid* (use a business check).
7. *File a W-2* at the end of the year, documenting wages paid.

NOTE: There may be quarterly or annual state and local reporting requirements depending upon where you live.

Can you employ *young* children? The Federal Tax Court has ruled that **children as young as seven years old can qualify** as employees of their parents' sole proprietorship or LLC business.

[Eller v. Commissioner, 77 T.C. 934 (1981)]

And if they are family members and qualify as Dependents on your tax return, they are exempt from payroll taxes, and the business is not required to withhold or to pay Social Security or Medicare taxes on wages paid to those children. Dependents are generally defined to be under 19 years old, or under 24 if they are full-time students at least 5 months during the tax year.

[IRC Section § 3121(b)(3)(A) and § 3306(c)(5)]

[Tax Court Ruling 48 TC 439, 450 (196) in Denman v. Commissioner]

In order to audit-proof this category of your home-business deductions, start by completing a formal Employment Agreement to hire your family members. (For a fill-in-the-blanks version of a *Family Member Employment Agreement* go online to www.HomeBusinessTaxSavings.com, and click on “Docs, Forms & Special Reports.”)

The wage rate has to be “reasonable and customary” within your region of the country and within your industry for the type of work being performed. **[Revenue Ruling 73-393]**

How do you establish what is “reasonable and customary?” One way would be to get an outside company to give you a written estimate for the work to be performed. Put a copy in your tax file, and then pay your family member approximately that amount or a little less.

Or you could determine what a reasonable person might pay an employee or outside contractor for such services, and pay a similar or lower wage to your family member. **[IRS Regulation § 1.162-7(a)]**

As a broad-brush rule of thumb, **PayDays™** payroll service recommends:

- 7-9 years old: about \$8.00/hour
- 10-13 years old: about \$10.00/hour
- 14-18 years old: about \$12.50/hour

NOTE: Before hiring your children, be sure to check with your home-business tax advisor to be sure your all of your documentation and reporting will comply with IRS rules.

The kids (as employees) have to document what they did to earn the money, [**Revenue Ruling 73-393**] so have them fill out a simple “work log” with headings like:

- Date they worked
- Type of work performed
- Amount of time spent working
- Hourly/weekly/monthly wage rate

Pay Attention Here, because...

You're about to discover how you could pay for ...

- The **car** your high-schooler wants
- Designer-label **clothes** the kids ‘require’
- **Movie and Concert tickets**
- A High School **graduation trip**
- **College tuition**, books and supplies
- Your daughter’s expensive **wedding**
- And lots of other personal out-of-pocket expenses

...ALL in PRE-TAX Dollars!

Here's how...

The tax-deductible \$5,000/year Uncle Sam lets you pay your children tax-free as employees (in 2005), is equivalent to \$100 per week, for a 50-week year!

Now, you're saying, "Who gives their kids 100 dollars a week in allowance?" YOU may now! And here's why...

Let's say you employ your child to perform ongoing work in your home-based business, and agree to pay him or her \$75 per week for those services. After they turn in their "work log" pay them with a business check.

You'll have to open a separate checking or savings account for them to deposit and cash their payroll checks. The bank will require it to be a "custodial account," since *minors* cannot legally conduct banking transactions. That means **only you will be authorized to make withdrawals or to write checks on that account**, since the child is a minor.

For recordkeeping purposes, you should deposit every paycheck into that account. (Make sure it's an interest-bearing account -- you will see why in a minute.) You may wish to go to the bank *with your child* to make the deposits and make any withdrawals. Why? They'll learn

quickly that they have to put money IN the bank before getting money OUT of the bank. How many kids have grown up thinking that adults can get money anytime they want, if they just put a plastic card in the slot of a bank machine?

Reader Alert!

Here is Where It Gets REALLY Interesting...

The law requires you to **pay them** the wage they **earned**, in order for you to be able to deduct the amount as a business expense.

BUT . . .

There is very little restriction on how the wage earner (your child) or his/her custodian (you), can use the money after it has been paid.

[Revenue Ruling 73-393]

These funds can be used in a variety of ways to the benefit of your employed child/children.

[Rev. Rule 73-393]

So, you might decide to simply tell your child,

“You may withdraw \$10 (for example) out of each week’s pay, to spend any way you wish; however, the other \$65.00 will stay

in the (interest-bearing) account to be used to pay for your _____.”

Fill in the blank with whatever you like. Perhaps the costs of music lessons, sports equipment, school trips, new clothes, etc. Or words like car, graduation trip, college, wedding, technical school, or whatever you like.

Did you ever, in your wildest dreams, anticipate that you would be able to pay for school supplies and tennis shoes, or pay for cars, trips and weddings, out of *pre-tax* dollars? **It's true! It's real! And it's 100% legal!**

There are other practical benefits to this strategy that are at least as important as the tax benefits.

First, the child learns that money is earned by providing value to someone else, who pays them for the value they produce.

Second, as they grow older, they'll learn that providing greater value to the employer is the key to earning greater income.

Third, your child will begin learning the value of money, and the trade-offs between spending and saving money, and between instant-gratification and delayed-gratification.

Imagine being in a store with your child to buy a new pair of shoes. The child wants the \$150 ‘designer-label’ shoes; you prefer the \$45 ‘generic’ brand. Perhaps you offer to pay \$45, but tell them that anything over that amount will come out of their checking/savings account. Perhaps you let the child choose, knowing that whatever they have left in their checking/savings account will be theirs someday.

(Here’s a thought: Offer to turn over the balance to them whenever they turn 18 OR graduate from high school, whichever comes *second*.)

Isn’t that a great tax-savings strategy *and* a great learning opportunity for your children?

**If You Hire Your SPOUSE in your Business,
You May be Able to Write-off Medical
“Out-of-Pocket” Expenses
for YOUR WHOLE FAMILY!**

What? When your spouse is an **employee** of your home-business, he/she could be eligible for “Employee Benefits” from his/her

employer (that's **you**), and the cost of employee benefits are deductible to you as business expenses. **[IRC Section § 162(a)]**

First, you go through similar start-up steps as you did for hiring your kids...

1. You should have a signed *Employment Agreement* to document that a bone fide employer-employee relationship exists, and for documenting hiring date, assigned duties, agreed-upon wage level and payday schedule.
2. The type of work must be *ordinary and necessary* for your business type.
3. Document that the *services were actually performed*.
4. The pay must be *reasonable* for the services actually rendered.
5. Wages must be *paid on a consistent and timely basis* (at least monthly).
6. Document that those wages *were actually paid* (use a business check).
7. File a *W-2* at the end of the year, documenting wages paid.

BUT, for ADULT Employees, you must ALSO:

8. *Withhold Social Security taxes from wages (unemployment taxes are exempt)*.

Note: Wages are taxed at 15.3% or Social Security and Medicare. The employee pays 7.65%, and the employer pays a matching amount. Self-employed persons pay the full 15.3% on all earnings as a sole proprietor or under an LLC.

9. File a *Form 941 quarterly*.
10. File Forms *W-2, W-3 and 940 at the end of the year*.

Remember, as we said before, there may also be state and local quarterly and annual reporting requirements, depending on where you live.

Now, here's how you can make every penny of health care costs that are not reimbursed under any insurance plan or any other employee benefit, legally deductible business expenses.

Establish this Employee Benefit as “official company policy:”

“All employees, **and members of their immediate families** [that includes the employee’s spouse (you) and all dependent children], will be reimbursed for all health-related expenses that are not covered under any other Insurance Plan.”

Therefore, your entire family would become covered under this Employee Benefit.

A Word of Caution: Only establish this company policy if your business will be hiring only your own family members. If you establish this policy and then hire non-family members, you may be required to offer the benefit to them as well, and that could defeat the purpose.

By the way, this also covers many of the costs of weight loss programs if prescribed by a licensed medical practitioner, and the cost of nutritional supplements if prescribed for treatment or prevention of a specific health condition. **[Pub 535, p 56]**

So, What Just Happened?

You just set into place a strategy for legally tax-deducting ALL insurance plan annual deductibles, co-pays for doctor visits and

prescription drugs, plus ‘non-covered’ expenses like orthodontics, eyeglasses, contact lenses, dental work, chiropractic visits, etc.

[Reg Sec 71-588; Plr. 9409006]

Even nutritional supplements, vitamins, herbs, and “natural remedies,” etc. may be included as health care expenses **IF** a licensed (in your state) medical practitioner has recommended them (get it in writing) for “treating or preventing a specific health condition.

[IRS Pub 502, p. 15]

No minimum thresholds apply; every single dollar is tax-deductible by the business as an employee benefit cost.

Note:
Auditors are now looking carefully at whether the potential payout under the Insurance Benefit Plan is reasonable *for the wages paid*. To be safe, you might want to specify, in the Benefit document, an annual payout maximum.

It is important that this “Employee Benefit” be established in writing, as a legal document, and that the Benefit is reasonable in relation to the level of services the employee provides to your business.

[Reg Sec 1.105-5(a)]

To download this legal document and customize it for your own use, visit www.HomeBusinessTaxSavings.com, and click on the tab labeled “Docs, Forms & Special Reports.”

NOTE:

If you do not want the responsibility of filing quarterly Form 941s and annual Forms 940, W-3 and W-2 visit www.HomeBusinessTaxSavings.com, and click on “Getting Honest Help from Real Experts.” It’s inexpensive to have a professional handle these reports and tax payment requirements for you.

A Word About the Level of Your Spouse’s Wages

Since Social Security and Medicare payroll taxes are calculated based on a *percentage* of the employee’s wages, the lower the wage level, the lower the dollar amount of taxes.

Therefore, you may want to stay on the conservative side of “reasonable wage level,” in order to minimize the taxes you’ll be required to pay.

Even if you employ your spouse at “minimum wage,” you qualify to use this medical expense reimbursement tax strategy, so long as this benefit is reasonable in relation to the level of services provided by your spouse.

[IRC § 3306(c)(5); IRS Publ 15, and IRS Circular E apply]

**In order to be considered Bone Fide Employees,
How Many Hours Do They Need to Work?**

In order to meet the IRS “*Significant Participation Guidelines*,” each employee (child or spouse) should work at least 100 hours per year, which is about 20 minutes a day. **[Temp Reg §1.469-1T(g)(3)(i)]**

That’s the bare minimum to show that they are actual employees.

But if you want to be able to justify taking an employee on business trips as a Business Expense, or want to justify large health care reimbursements, you will want them to qualify under “*Material Participation Guidelines*,” which requires him/her to meet ONE of these two requirements:

- 1.** Work more than 500 hours/year (about 10 hours/week), **OR**
- 2.** Work more than 100 hours/year AND this level of activity is not less than any other employee. **[2001 FED ¶21.965]**

Employed children generally work 20-30 hours per month (240-360 hours/year). Twenty hours a month is equivalent to an hour per day, five days a week. Thirty hours a month would be equivalent to an hour per day, seven days a week.

The number of hours often increases during summer months, when they are on school vacation.

IMPORTANT:

To qualify under either the *Significant* Participation Guidelines or the *Material* Participation Guidelines, you must be able to prove the number of hours each employee worked.

If you are using the *Sixty Second Tax Savings Organizer* software, an Employee Timecard function is already built-in. Or develop your own timecards, if you prefer, but use some form of time-tracking system or you risk losing these big tax advantages.

An Employment Agreement with family member employees, is a legal document that substantiates that a bona fide Employer–Employee relationship exists, and specifies the agreed upon type of work, wage/salary level, and payroll schedule. You can download a fill-in-the-blanks Employment Agreement by clicking on “Docs, Forms & Special Reports” at www.HomeBusinessTaxSavings.com

Chapter 7

The Key to Your Largest Single Tax-Deduction May be in Your IGNITION!

Your car, whether you own or lease, probably represents your third-largest monthly expense, coming in right behind **taxes** and your **mortgage** or **rent**.

In all likelihood, however, **your car** also represents **your largest single source of potential tax-reduction**. So, finding a way to legally write-off a significant portion of your automobile costs, represents a major tax-savings opportunity for you, potentially worth thousands of dollars in new, legal tax deductions.

[IRS Temp Regs, § 1.274-5T(b)(6)(1)(B)]

You will probably use the same vehicle for both personal-use and business-use, so the IRS requires that you maintain a vehicle-use log for “a typical 90-consecutive day period” **each year** in order to determine what percentage of your driving is primarily for business and what percentage is primarily personal.

But that “task” can be reduced to doing just one simple thing each time you slip behind the wheel.

The record keeping *literally* takes about as little time as it takes to fasten your seat belt. Simply keep a “Vehicle-Use Log” handy in your car, and each time you put the key in your ignition, you simply record four items:

<u>Date:</u>	<u>Odometer:</u>	<u>Destination:</u>	<u>Primary Purpose</u>	<u>Miles</u>
11/11/05	37,820	Coffee Shop	Business Presentation	12
11/12/05	37,832	Bank	Business Deposit	6
11/13/05	37,838	Personal	Personal	5
11/13/05	37,843	Post Office	Business Postage	5

That’s it. And by the way, Destination and Primary Purpose of the trip do not need to be precise. For example, under the heading Destination, you can simply fill in “coffee shop,” and under Business Purpose, you can simply write “business presentation.” Then just enter your odometer readings and/or total miles traveled.

[IRC Section § 274(d)]

How long could that take? I’d guess about 5-10 seconds, and only for 90 days!

A Vehicle-Use Log which you are free to reproduce for your own use is printed on the next page ▼

Vehicle Use Log

Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				
Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				
Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				
Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				
Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				
Date	Starting Odometer Reading	Ending Odometer Reading	Total Miles Traveled	Expenses Incurred (gas, tolls, etc.)
Destination:				
Primary Purpose of Trip:				

What about “Commuting Mileage?”

Glad you asked. This one is not spelled out as clearly as some other deductions, but we can piece it together...

Revenue Ruling 90-23 states: “Daily transportation costs for going between the taxpayer's **RESIDENCE** and one or more regular **places of business** or employment are **NON-deductible Personal Commuting expenses.**”

[IRC §262; Revenue Ruling 90-23, and IRS Bulletin 1990-11]

HOWEVER, Revenue Ruling 55-109 states: “Daily transportation costs for going **between two specific BUSINESS locations** (whether in the same business or different businesses) **ARE deductible business expenses.**” This is often referred to as the “Two Business Location Rule.”

[Revenue Ruling 55-109, 1955-1 C.B. 261]

QUESTION: What if your “residence” is also a “specific business location?”

ANSWER according to Revenue Ruling 99-7: “If a taxpayer's **residence** is the taxpayer's **principal place of business** within the meaning of § 280A(c)(1)(A), the taxpayer **may** deduct daily transportation expenses incurred in going **between the residence and another work location** in the same trade or business.”

Note the use of the word “another” in the last line of that quote, which clearly implies that the “residence” is considered to be a “work location.”

NEXT QUESTION: What is meant by the last six words of that quote: “in the same trade or business?”

ANSWER again according to Revenue Ruling 99-7: “Where an employee (has) two separate employers ... both such positions constitute part of the employee's trade or business.”

Looks like they’re saying that your home-based business and your “day job” can be totally unrelated to each other, and you would still meet the definition of “same trade or business.” That’s good.

But there’s still one more wrinkle to iron out.

Consider this quote, also from Revenue Ruling 55-109: “*The deduction of local transportation expenses, especially in a dual employer situation, would usually be limited to a one-way trip between his two local places of employment on the same day because the employee ordinarily would not have to report back to his first place of employment on that day.*”

BUT what if the employee **IS** required to report back to his first place of business (the one based in his residence) to perform additional work-related functions? The same rationale that allowed the business mileage deduction for the **initial** trip from “business location #1”

(home-based) to “business location #2” (W-2 job), should also apply to the return trip, shouldn’t it?

What to do???

In order to safely claim vehicle mileage deductions for travel between your home-business and your W-2 business, do this...

- 1.** Be absolutely certain that your home-based business qualifies as a **bona fide Principle Place of Business**.
- 2.** Think differently about your “home.” No longer think of having a residence -- where you also have a business. **You now have a Principle Place of Business -- where you also live.** That is an important distinction.
- 3.** Make sure you *actively engage* in your home-based business **before leaving for your “other job.”** If you simply wake up, get dressed, have a cup of coffee, and then set out for the W-2 job, you will be commuting. Remember from above, going from the taxpayer's residence to a regular place of business or employment, is NON-deductible Personal Commuting.
- 4.** Make sure you *again* *actively engage* in your home-based **business** after returning from your “other place of employment.”

5. *Keep an activity log to prove that you actively engaged in your home-based business every single day before traveling to your “other place of business,” and again every single evening upon returning from that place of employment to the Principle Place of Business located in your home.*

These are steps worth committing into a habit. The deduction is worth 40.5 cents per business-mile in 2005. Let’s do the math.

If the distance between your home-business and your other place of employment is 10 miles, and you make that drive five days a week, 50 weeks a year, this deduction is worth more than \$2,000.00!

You Get More than \$400 in Tax Deductions for Every 1,000 Business Miles You Drive!

Not taking this deduction is like throwing a \$20 bill out your window every time you put 50 business miles on your car! Or think of it this way: You could be getting about \$150.00 in tax deductions for every tank of gas you put in your car. (Maybe that will make it a little easier to deal with the outrageous price of gas these days!)

If you currently put 10,000 business miles on your car each year, with simple recordkeeping you can qualify for \$4,050 in ***new tax deductions***.

This procedure is completely legal, and your vehicle-use log will document the deduction.

[Internal Revenue Rulings 55-109 and 99-7, and 1955-1 C.B. 261]

What About Errands and Shopping?

What about shopping trips and other errands? Yes, there are ways those miles could become tax-deductible also. Let's look at a few examples...

Do you need to go to a shopping mall to purchase something? With some advance planning, this one is easy, because you have so many options to use. For example, if there is a quick-copy center in the mall, you could go to the mall when you need to have copies of your business flyers printed. While you're there, you might decide to do some shopping.

This mileage would be deductible if Business was your Primary purpose, and shopping was the secondary purpose of your trip. The *secondary* purpose is not recorded in your vehicle-use log.

In the above example, you could substitute any reasonable and necessary business purpose for the quick-copy center – buying office supplies, leaving brochures on check-out counters, handing out business cards, customer prospecting, etc.

How do You Figure the Amount of Tax Deductions for Business Use of Your Vehicle?

You have Two Options.

Author's Comment: Some of what follows is a little bit tedious, but the deductions could be worth thousands of dollars for most people. I suggest you read this section slowly and re-read paragraphs if necessary until you "get it." The examples I provide will help clarify the complicated stuff. If you find this section hard to grasp, just keep good records and let your accountant deal with it at "tax time."

The IRS gives you the option of determining the amount of your vehicle-use deductions by using the "Standard Mileage Rate" (SMR) method or the "Actual Operating Cost" method. **[IRS Proc. 94-73]**

The **Standard Mileage Rate** (SMR) method involves simply using the vehicle-use log for documentation, as described before. At year-end, determine your total Business miles, and then multiply that number by the Standard Mileage Rate.

The Standard Mileage Rate is determined by the IRS annually, and tends to change almost every year. For 2005, the rate is 40.5 cents per mile -- 17¢ for depreciation and 23.5¢ for operating expenses. So if you put 10,000 business miles on your car in 2005, you will have \$4,050 in vehicle deductions, using the SMR method.

The “**Actual Cost Method**” option requires keeping a record vehicle operating costs for the full year. This option may give you a higher deduction in many circumstances.

**If you choose Option 2, which is based on your
Actual Vehicle Operating Costs:**

1. From your 90-day Vehicle Use Log records, determine what *percentage* of your total miles were driven for Business purposes, to determine the “*business use percentage*” of your vehicle.
2. Add-up your total vehicle operating costs for the entire year (actually it’s very easy – I’ll show you how a couple of pages later), and then multiply that amount by your Business Use Percentage. The resulting figure will be the amount you can deduct on your Tax Return for Vehicle Operating Costs.

In addition, you can *also* claim an amount for depreciation (let your tax pro do this).

For example, if you drove your car 15,000 miles during the year, and 10,000 of those were “business miles,” your business use percentage (BUP) would be 66.6%. So you would multiply your total actual vehicle operating costs by 0.666, and you will have determined the amount of tax write-off you can claim using the Actual Cost Method (plus depreciation, remember).

The “actual cost” option may give you higher deduction:

- when gas prices are soaring
- if you have a ‘gas guzzler’
- if you have frequent and expensive repairs and maintenance,
- if you drive an exceptionally expensive car.

What, exactly, are “Vehicle Operating Costs?” That term applies to just about anything that keeps your car running, such as...

- **Gasoline**
- Oil and oil changes
- **Front end alignments**
- Wheel balancing
- **New tires**
- Tune ups
- **Repairs**
- Maintenance
- **Windshield wipers**
- Car washes
- **New battery**
- License & Registration fees
- **Automobile Insurance**
- Depreciation
- **Collision deductibles**
- Road Hazard Insurance (such as AAA)

- **Extended warranties**
- Repair of scratches and dents
- **Road Emergency supplies (flares, road hazard signs, etc)**
- etc., etc., etc.

Does that sound like a lot to keep track of? It doesn't need to be a chore. Keeping track of your actual vehicle operating costs does not have to result in a shoebox full of receipts. There are two very easy ways to track these expenses.

1. If you use the quick and efficient software program named the "*Sixty Second Tax Savings Organizer*," ALL of your record-keeping chores will become easy, *including* the costs of operating your vehicle.

At www.HomeBusinessTaxSavings.com, you can download a free 30-day trial version or purchase the full-use license very inexpensively.

2. Select one credit card that you don't need to use for anything else. Charge all vehicle operating costs -- and only vehicle operating costs -- to that credit card. At the end of the year, simply add-up the totals from your 12 monthly statements, and the sum will be your vehicle operating costs for the year. (And, your 12 credit card statements will document your deductions without the need to keep any charge card 'flimsies.')

Regardless of whether you use the Standard Mileage Rate method or the Actual Cost method, you can also deduct 100% of parking fees and tolls incurred while driving for business purposes.

[IRS Proc. 90-59, and IRS Bulletin 1990-52 § 4.04]

And, regardless of which method you select, you can also deduct the business-use percentage of the interest paid on your vehicle loan, and the business use percentage of your Personal Property Taxes.

[IRS Proc. 95-54 § 5.04]

What if you are leasing your vehicle? You can deduct the business use percentage of your lease payments, plus the business use percentage of your vehicle operating costs, adjusted for depreciation. (Trust me, have your tax pro calculate this for you.)

IMPORTANT NOTE: Once you choose a method (Standard Mileage Rate or Actual Cost Method), you must continue using that method for *the next five years* or when you get a different vehicle, whichever comes first. Therefore, it is very important to pick the method you want to stick with for up to five years. You cannot switch back and forth between methods from one year to the next.

[IRC Section 168]

Some “Non-Business” Miles Also Can be Deducted

You can also deduct miles spent doing charitable work, miles going to and from medical appointments, and miles for moving/relocating to a new job location (if it is at least 50 miles away).

These rates also tend to change frequently, but for year 2005 the mileage deduction allowances are set as follows:

Business Mileage	= 40.5 ¢/mile	[IRS Proclamation 04-64]
Charitable Work	= 14.0 ¢/mile	[IRS Proclamation 04-64]
Medical Care	= 15.0 ¢/mile	[IRS Proclamation 04-64]
Moving/Relocating	= 15.0 ¢/mile	[IRS Proclamation 04-64]

What About Depreciation?

Claiming depreciation on the car or truck you use for business purposes gives you additional tax advantages.

If you use the “Actual Cost Method” and your vehicle is considered “Listed Property,” the depreciation “recovery period” is generally five years. Beware however, if the business use percentage of your vehicle falls *below 50 percent* before the end of the “recovery period,” special depreciation rules apply (and they are not in your favor).

[IRS Publication 946, Section 280F]

If this happens, you must re-compute the depreciation using the straight-line method **[IRC § 280F(b)(2)(B)]** and any excess depreciation then becomes taxable income. **[IRC § 280F(b)(1) and 168(g)]**

If you use the SMR method, depreciation is “built into” the SMR rate, so you are not affected by the 50% rule just discussed.

What are the Tax Implications When You Sell or Trade-in Your Automobiles?

First of all, you should consider seriously the tax impact, when making the decision to “trade-in” or to “sell” your vehicle.

When you sell a vehicle on your own, you’ll usually get more money for your car, than if you trade-in the vehicle. From a tax standpoint, when you sell the vehicle you will report either a gain or a loss on your tax return for the business portion of the vehicle you sell.

If your decision is to trade-in the vehicle towards the cost of purchasing another one, any gain or loss will be transferred into the “basis” (“cost,” for tax purposes) of the new vehicle. If that results in a loss, you will not be able to claim that loss on your tax return. Simply, your basis in the new vehicle will be adjusted upward accordingly. In the case of a ‘gain,’ you will defer the gain into the new vehicle by adjusting the basis downward.

To determine whether you will have a gain or loss on the sale of your business vehicle (for tax purposes), you will need to compute the accumulated depreciation that has been taken over the business life of

the vehicle. This accumulated depreciation lowers the “basis” or “net tax value” on the company records.

For Example...

Bill bought a car for \$20,000 on January 1, 2000, and used it 60% for business. The starting basis, or “depreciable basis,” of the vehicle is \$12,000 (60% of \$20,000). For simplicity sake, let us assume that the depreciation allowed for 2000, 2001, and 2002 was \$2,000 per year. As of 12/31/02 (three years after purchase of the vehicle), the tax basis of the vehicle had been reduced to \$6,000 (\$12,000 starting basis, minus the \$6,000 accumulated depreciation).

If Bill sold his car on 12/31/02 for \$8,000, he would have incurred a business loss calculated as follows:

Since the car was used 60% for business, the business portion of the sales price was \$4,800 (60% of \$8,000). Since the business basis was \$6,000, Bill had a deductible business loss of \$1,200.

In addition, Bill had a loss on the personal-use portion of the vehicle. However, this loss is not tax deductible.

Let's take a look at another scenario...

It is possible that Bill may have been able to trade-in this same vehicle for \$12,000 toward the purchase price of a new vehicle.

In this case, Bill would have had a “gain” on the disposition of the old vehicle, and that gain would be deferred into the new vehicle by adjusting the basis of the new vehicle.

Since the gain was “carried forward” into the new vehicle, no gain or loss would be reported on Bill’s tax return.

If this seems confusing, that’s because it **IS** confusing. (Hey, my eyes are glazing over just *writing* this stuff!) Recommendation: Don’t even try – get your tax pro to help (and make sure he/she is a small business tax law expert).

For taxpayers who take the option to calculate vehicle deductions on their tax return by using the Standard Rate Method, there is a built-in amount for depreciation (17¢ in 2005) that must be factored-in to determine if there is a gain or loss on the disposition of the vehicle.

The following table indicates, by year, the rate to be used to calculate the “accumulated” depreciation.

That rate has changed 12 times in the past 25 years. The depreciation rates for the past 10 years have been:

2004-2005	17.0 cents/mile
2001-2003	15.0 cents/mile
2000	14.0 cents/mile
1994-1999	12.0 cents/mile

Using the preceding table, you can compute the basis for the vehicle you are selling or trading, which will determine if the transaction will result in a tax gain or loss on the vehicle. **[IRS Proc. 95-54 § 5.05]**

No matter how old your car is, or how many miles you've put on it, a vehicle cannot be depreciated below zero. If your depreciation gets down to zero, your SMR continues as before, but with none of the deduction allocated to depreciation. **[IRS Proc. 98-63]**

Also consider the "Section 179 Elections" we discussed in Chapter IV. The "accelerated depreciation" under §179 applies also to the purchase of business-use vehicles, although there are special limits on depreciation you can take in the first year.

In the year of purchase, you may deduct the purchase price times the percentage of business use (as long as the business use is more than 50%), **but only up to a limit of \$2,960 for passenger automobiles** (Ouch! That's way down from the \$10,710 authorized for purchases made in 2004) **and \$3,260 for vehicles built on a truck chassis**. The

remainder can be depreciated over a 6 year period, counting the year of purchase.

However, there is an “SUV” exception to the \$2,960 limitation. **If the vehicle you purchase for business use weighs more than 6,000 pounds, but not more than 14,000 pounds, then the limit on first-year depreciation is \$25,000.** (That’s a whole lot better than a passenger automobile, but way lower than the \$102,000 authorized for SUVs purchased in 2004). Any remaining cost can be depreciated over a six year period, and, again, that includes the year of purchase.

Oh, one other IMPORTANT “little detail” ...

The amount you depreciate under Section 179 cannot exceed the net income (profit) from your business.

Whew, that’s a lot! Take a deep breath. Ready? Let’s continue...

**Here’s How to
Increase Your Vehicle Deductions
by an
ADDITIONAL 50%!**

The following is a valuable tax strategy if your family has two vehicles, each worth approximately the same value, and if at least two-thirds of the total miles driven (on both cars combined, not

individually) qualify as business miles.

For example: Let's say you put 35,000 miles on your car, and 30,000 of those miles qualify as "business miles." And let's say your spouse drives 5,000 miles, but none are tax-deductible business miles. And let's say each car is worth about \$20,000. That means

- Your total "family miles" equals 40,000 miles.
- 30,000 of those 40,000 miles (75%) are business miles.

If you put all those business miles on one car, you will be limited to the expenses and depreciation limits on one vehicle. The other car will receive no tax deductions, because no miles qualify as business.

However, if you alternate use of the two vehicles, you will still drive 30,000 business miles, but you will put 15,000 of those miles on each of the two cars. Your spouse still drives 5,000 personal miles, but he/she puts 2,500 of those miles on each of the two vehicles.

You may now claim 75% of the miles put on each of the two vehicles, and your vehicle use and depreciation tax-deduction limit increases to \$30,000, instead of being capped at under \$20,000. **This could result in a 50% increase in your vehicle deductions!**

Always consult with a professional Tax Advisor before buying, leasing, selling or trading a vehicle you will use in your business. Failure to do so could be very costly!

Chapter 8

You May *Never* Take Another Vacation! **From now on, your Personal Travel could become** **Tax-Deductible Business Trips!**

A business based in your home may not necessarily have any territorial limits. Your customers, clients or prospects may be anywhere in the United States, or North America, or even the world.

This means that, wherever you travel **you could be traveling on business**, and reasonable business-travel expenses are tax-deductible, even if tied into personal travel or family vacations! Pay close attention, because the IRS rules about tax-deductibility of business travel are very specific. But they are also very clear, so you should have no problem making sure you are staying within the legal parameters.

The tax law says that anytime your work “requires you to sleep or rest away from your principle place of business” (that’s your home), you may deduct reasonable travel and related expenses (such as meals, hotel, rental car, tips, etc.)

**[IRC Section § 162(a)(2) and
Revenue Rulings 54-497, 75-432, 63-145, 75-169, 76-453]**

The IRS's 3-Part Test

First, be sure that the Primary purpose of the travel is Business (more on that later). Then, to begin “audit-proofing” your business travel deductions, you must pass the IRS’s “3-Part Test”:

1. The travel must be usual and customary within your type of Business.
2. The travel must be conducted with the intent to obtain a direct business benefit.
3. The travel must be appropriate and helpful to developing and maintaining your business.

You Also Must Meet the “51/49% Transportation Rule”

For travel within the U.S., when you combine business travel with personal travel, the tax law allows you to **deduct 100% of your transportation costs, in addition to lodging and meals...**

- **If** more than ½ of your days qualify as Business days, and less than ½ of your days are for non-business purposes,
- **AND if** the *Primary* purpose of your trip is *Business*.

[IRC Section § 1.162-2(b)(2)]

**Another Myth to Dispel:
A trip does NOT become Business Travel just because
“everyone is a prospect.” For a trip to qualify, it must
meet ALL of the requirements in this chapter.**

What is Considered a “Business Day?”

Depending upon the method of travel and the length of the trip, getting to and from your destination can take up the majority of a day, each way. Therefore, it is important to know how the IRS defines “business day,” which we will cover shortly.

If the primary purpose of your travel is business, the cost of transporting yourself to your “business destination” is tax deductible, whether you travel First Class air, Coach Class, train, car, boat or even on a privately chartered plane.

Once you arrive at your destination, you will incur certain other expenses, such as taxi fare, car rental, hotel, meals, tips, etc.

You may deduct food and lodging expenses for “Business Days” even if your trip does not include enough business days for it to qualify as a “Business Trip.” For example, if you make a five day trip, but only two days are spent on business, you may deduct your meals and hotel

for those two days only, but you may not claim any of the transportation costs, because the trip will not have met the 51/49% Transportation Rule discussed earlier.

What About Weekends and Holidays?

If weekend days and/or holidays fall between Business Days, they are considered by the IRS to be Business Days. For example, if you travel to a destination on Wednesday, do business on Thursday and Friday, and do business again on Monday, the weekend days count..

Saturday and Sunday will be considered to be Business Days, as will Monday.

The test is this: Would it be practical to return home for the weekend or holiday days? If so, they are not deductible. But if it would not be practical to return home (due to the expense or the time required), they will be considered to be Business Days, regardless of what you actually do on those days. **[Reg § 1.274-4(d)(2)(v)]**

What About Saturday Night Stay-Overs?

Oftentimes airlines offer substantial fare discounts if a Saturday night stay is included. **Good news for you!**

If a substantial discount is available by including a Saturday night stay, Saturday may be considered a (tax-deductible) “Business Travel Day” and Sunday is considered a (tax-deductible) “Business Stay-over Day” even if you return home on Monday. **[PLR 9237014]**

When is a ‘Travel Day’

Also a ‘Business Day?’

Even if you conduct no business on the day you travel, it is still a tax-deductible business day **IF** you spend at least four hours in transit. That four hours includes the time it takes you to get to the airport, park, check-in, wait for the plane, fly, disembark, wait for your luggage, get a taxi or rental car and get to your hotel.

[IRS Regulations, § 1.274-4(d)(2)(i)]

As inefficient as airline transportation is these days, just about any trip you take could qualify under these criteria. Hey, it seems like four hours just standing in the security-check line.

So, if getting to and from your destination takes four hours or more, both days qualify as “Business Days.”

Exactly, What Can I Deduct?

If your trip qualifies as Business Travel, you may deduct 100% of your round-trip transportation expenses, 100% of your lodging costs,

taxis, rental cars, tips and incidentals, plus 50% of your meals on “business days.”

When you are required to remain out-of-town for one or more nights for business, you can also deduct the cost of laundering or dry cleaning any clothing soiled on that trip, even if you wait and have the cleaning done upon your return home.

[Internal Revenue Ruling 63-145 and 1963-2 C.B. 86]

When government employees travel on government business, they are paid a “Per Diem” (per day) rate, which covers their lodging plus all other expenses (called M&I, for Meals and Incidentals).

The Per Diem rate varies by location. For example, as of the time of this writing:

Lowest Per Diem Rate: **Spearfish, SD: \$91.00**

(\$60 for lodging + \$31 for M&I)

Highest Per Diem Rate: **Vail, CO: \$296.00**

(\$249 for lodging + \$47 M&I)

Note: Use your Search Engine to find the current Per Diem rates for continental U. S. locations.

If you're a sole proprietor, a partnership or an LLC, you, too, have the option of deducting the government per diem rate **instead of** keeping track of all of your actual M&I expenses.

For example, if you are on a business trip to Vail, you could keep all your documentation, and then claim half of your meals plus all of your necessary incidental expenses, **OR** you could claim a flat \$47.00 for the day.

If you're a fast food kind of person, or better yet, if you get your daily rations from a grocery store, you could actually come out way ahead by using the flat rate Per Diem rate.

And no receipts to keep.

Does It Make Any Difference

What Method of Transportation I Use?

Simple answer: No. If you travel by car, truck, plane, train, boat or motorcycle, your actual travel expenses are 100% fully deductible if the trip qualifies as "business travel." Deductibility also is independent of "class" of transportation. You could travel First Class or even by chartered aircraft or limousine, if you wish.

[IRS Publication 463]

Can I Claim My Spouse's Expenses if He/She Accompanies Me to a Business Meeting or Convention?

Expenses of an accompanying spouse are deductible **only if**:

- His/her travel is for a bona fide business purpose (i.e., not just accompanying you),
- He or she is an employee or owner of the business (see Chapter VI for details), and
- The travel and related expenses would be deductible for him/her even if he/she were making the trip alone.

[IRC Section § 274(m)(3)]

The test is this: Would you have paid (as a business expense) for this employee to join you on this business trip even if you were not related to him or her?

What About Seminars on Cruise Ships?

About those “seminars” held on cruise ships ... well... They’re not exactly deductible. (Sorry.)

Expenses for “business meetings” or “professional seminars” held on **any Foreign Flag Carrier** ship (which is essentially ALL cruise ships), **is not deductible**. Period.

So, how CAN you take a tax-deductible cruise?

Simple. Instead of having your seminar or business meeting ON the ship, what if it took place ashore, at the furthest point from your Port of Departure?

Then, your cruise ship becomes a *means of transportation*. Remember a few pages ago we established that the *means* of transportation *or class of service*, had no effect on the deductibility of business trip transportation!

One way to get to a seminar location in the Caribbean, would be to take a cruise ship, right? If that ship happens to make a few stops at other ports-of-call on the way to, or on the way back from, the seminar port ... oh well!

But How Much Can I Deduct?

On business travel, you can normally deduct 100% of your transportation, 100% of your hotel, 50% of your meals, and 100% of your incidental expenses.

But what about a cruise, where all of those expenses are combined in your “all inclusive” fare?

Good news! Easy answer! (Can you believe it? A tax question with an easy answer?)

When you travel via cruise ship *as a means of transportation* you may deduct 200% of the maximum Per Diem rate authorized anywhere in the continental United States.

Right now, that's Vail, Colorado, with a Per Diem rate of \$296.00. So, as of this writing, you could deduct \$592 per day ($\296×2) for use of a cruise ship as a means of transportation to a business meeting or professional seminar.

Let's Summarize the Deductions for Traveling on Business

“Ordinary and Necessary” business expenses include:

- 50% of the cost of all meals on Business Days
[Reg § 1.162-2(a)]

- 100% of transportation and lodging costs
[IRS Publication 463]

- 100% of laundry and dry cleaning of clothing soiled during business portion of trip
[Internal Revenue Ruling 63-145 and 1963-2 C.B. 86]

- Business-related telephone calls, both local and long distance
[Reg § 1.162-2(a)]
- Local transportation from airport to hotel, to customer meetings, and back to airport (including taxis, limos, trains, buses, rental cars, etc.)
[IRS Publication 463]
- All appropriate tips associated with otherwise-deductible expenses
[IRS Publication 463]

The Rules for Keeping Audit-Proof Business-Trip Records are EASY, but STRICT!

This is not difficult unless you procrastinate. All the IRS requires is the answers to 5 questions:

1. *What Did The Money Get Spent On?*

List each individual expenditure, such as plane tickets, taxi fares, meals (listed separately), tips, registration fees, etc.

2. *When Did You Spend It?*

Dates and times of departure and return, as well as date of each expenditure.

3. *Where Did You Spend It?*

City you flew to, restaurant where you dined, from-and-to of each taxi fare, name of hotel you stayed in, who you gave tips to, etc.

4. *Why Did You Spend It?*

Justify the business purpose of the trip itself, and the business reason for each expenditure. Not everything is automatically deductible. For example, in-room hotel movie rentals and purchases from a hotel room mini-bar are normally not deductible.

5. *Can You Prove You Paid Your Bills?*

You'll need copies of paid receipts or proof of credit card charges for hotel stays, transportation expenses (other than local transportation such as taxi), conference fees, and any individual expenditures over \$75.

What... When ... Where ... Why ... Prove You Spent It.

And this documentation **MUST be made within 24 hours** of when you spent the money. **The IRS can be very STRICT about this.**

Here's How to Turn this 'Chore' Into a Simple 'Habit'

1. Carry a small spiral-bound notebook in your pocket, with a pen attached and a paper-clip on the back cover.
2. Every time you spend a penny on anything (even non-deductible expenses), record it in your notebook and clip the receipt inside the back cover.

3. Each evening, review your notebook to make sure everything you wrote in your notebook is clearly legible, and write notes on your receipts to remind you (if you are audited three years later) what each receipt was for.
4. Staple or paper-clip that day's receipts together, and put them in a safe place, like your suitcase or briefcase.

Then, immediately upon return to your home or office enter the data into your tax deduction tracking software and file the receipts with your tax records.

NOTE: The *Sixty Second Tax Savings Organizer* software can be installed on your Palm/OS or Pocket PC, so you could keep your records on your PDA, and then synch the data to your PC when you return from your trip.

It's easy to keep IRS-compliant records "on-the-fly" with the *Tax MiniMi\$er*, which transforms your ordinary Day Planner into an audit-proof Daily Tax Diary. The *Tax MiniMi\$er* is a written accounting method which compliments any computerized tax recordkeeping system such as the *Sixty \$econd Tax \$avings Organizer*. Review them both by clicking on "Tax Savings Tools" at www.HomeBusinessTaxSavings.com.

Chapter 9

Many Meals and Entertainment Expenses Can be Legally Deductible, Too!

The IRS lumps together the broad categories of Entertainment, Business Meals, Business-Related Sports, Recreation and Amusement under the tax heading “Entertainment.”

First, in order to be deductible a meal or an entertainment expense must be “ordinary and necessary” to carrying on your type of business.

[IRC §274 and §162]

Be Aware of the 50% Rule!

There is one significant difference between tax-deductible entertainment expenses and nearly all other tax-deductible business expenses: Since 1994, qualifying **meal & entertainment** expenses generally are **deductible at only 50% of their actual cost**, although there are a few exceptions that allow for 100% deduction (such as employee picnics and business entertainment in your home).

[IRC§274(n)]

Here's How to Determine Whether Entertainment IS or is NOT Legally Deductible...

There are only three terms you must be familiar with:

- 1. Four-Requirement Test**
- 2. Clear Business Setting**
- 3. Associated Entertainment**

1. “The Four-Requirement Test”

If you meet all four steps of the **Four-Requirement Test** you probably have a qualifying business entertainment expense.

The Four Requirements are:

1. At the time you decided to spend the money, you expected that there would be a future business benefit.
2. During the entertainment, you actually talked about things that could produce that business benefit.
3. Your principal reason for entertaining this person was to actively conduct business.
4. You incurred the expense so that you could talk directly with the person who could produce a future business benefit.

2. “Clear Business Setting”

It is not necessary to meet those four requirements if your entertainment took place in a **Clear Business Setting**.

The IRS has a definition for that, of course. It says that entertainment occurs in a **Clear Business Setting** when:

- The person you are entertaining knows that you are spending money on him/her in order to directly attempt to further your business interests, or
- You spend money on a hospitality suite at a convention where you display products to further your business, or
- You have no meaningful social or personal relationship with the person or people you are entertaining.

Restaurants, your home, hotel meeting rooms and hotel dining rooms, for example, are considered to be “conducive to business discussion without significant distraction.”

Thus, business entertainment taking place in these locations are deemed to be in a “Clear Business Setting.”

Locations *not* considered to be “clear business setting,” include night clubs, theaters, sporting events, and stage shows, because these

locations all have distractions that make it unlikely that a serious business discussion can take place.

However, although expenses in those settings may not be deductible under the “Clear Business Setting” rule, **they may very well qualify for deduction under the “Associated Entertainment” Rule.**

3. “Associated Entertainment”

“**Associated Entertainment**” is entertainment that is not directly related to the conduct of business, but is indirectly associated with conduct of business. **[Rev Reg §1.274-2(a) and (d)(3)]**

For example, entertainment that precedes or follows active “conduct of business,” **at any time in the same calendar day**, may be considered “Associated Entertainment.” **[IRC §274(d)]**

Let’s say you take prospective clients to the theater and then after the event, you take them to dinner and have (to use IRS terminology) a “substantial and bona fide business discussion.” The dinner expense falls under Clear Business Setting and the theater expense falls under Associated Entertainment, so both would be deductible at 50% of their actual cost.

Or, let's say you call a business prospect or client to arrange a dinner meeting the following night, and while on the phone, say "how about some tennis tomorrow morning?"

The tennis would be deductible as "Associated Entertainment" and the dinner as an "Entertainment" expense, since the Associated Entertainment took place during the same calendar day as the Entertainment.

Can You Ever Deduct Your Own Meal Expense Without Paying for Theirs?

Yes, under two circumstances. The first is when you are on a business trip (at the 50% rate, of course). But there's another one that most people do not know about...

If you go to lunch with a casual acquaintance (i.e., not a close friend or family member) to discuss business, and you each pay for your own meal, you may be eligible to deduct your own meal under the "Dutch Treat Rule." The amount you can deduct is 50% **minus the amount you *would have spent* if you had eaten at home.**

Here's how you determine amount you would have spent if you had eaten at home...

1. You go shopping for one week's groceries for your family.
2. Do not buy any items that are not food.
3. Add up all the food costs.
4. Divide by the number of people in your household.
5. Divide that number by 7, and the result will be the average amount you spend per day on your own meals at home.

Not all meals cost the same, so use a logical allocation of the costs, such as 20% of the daily food cost for your breakfast, 30% for lunch and 50% for your dinner.

For example: If your daily food cost average is \$10.00, then \$2.00 is assumed to be for breakfast, \$3.00 for lunch and \$5.00 for dinner.

So, to apply the "Dutch Treat Rule," you'd take 50% of the amount of your lunch receipt, and then subtract \$3.00 – the amount you would have spent if you had eaten lunch at home. The resultant figure is the amount you can deduct under the Meals and Entertainment category on your Schedule C. If your meal cost \$26, for example, 50% would be \$13. Subtract \$3, and the amount you could write-off would be \$10.00. Doesn't sound like much?

This deduction could be worth thousands if you often have breakfast, lunch and/or dinner with prospective customers or associates to discuss business, but don't pick up their tab. If your Dutch Treat

deductions average \$50 per week, for example, your deductions from this category alone would total about \$2,500!

Regarding documentation, even if you are claiming only your own meal expenses, you will still be required to record, on your receipt or in your day planner, the same five items specified in the next section in this chapter. For individual meal or entertainment expenses under \$75 each, you do not need a receipt, but you still need to answer the five questions in your documentation. An annotation in your daily planner is usually sufficient.

Even GOLF Might be Deductible (as may some other leisure activities)

Are you a golfer? Want to deduct greens fees and/or lunch in the grill? Golf is one participation sport that can probably qualify under the Four Requirements Rule, and definitely qualify under the Associated Entertainment Rule. Of course you cannot play golf with the same people every week and still qualify, but if you're the type of person who likes to take prospects to the club with you, this is ideal.

Unlike most other sports, golf offers ample opportunity to "hold substantial business discussions" while walking or riding down the fairway, while waiting on the tee for the foursome ahead to putt-out, or while waiting for a fellow player across the fairway to hit his or her

shot. You could probably claim that the golf course was a location “conducive to business discussion without significant distraction.”

But to make absolutely sure that your deduction is allowed, simply host your guests to lunch in the club dining room or grill before or following your round of golf. Claim the meal expense under “Clear Business Setting,” and claim the golf as “Associated Entertainment.”

Other activities that might be treated similarly, depending on the circumstances, include boating and fishing. And you can probably think of others as well. In each case, be sure that you meet The Four-Requirement Test as explained above, or claim it as Associated Entertainment if you had a bona fide business discussion during the same 24-hour day.

**Documenting Business-Entertainment
Expenses is Not Difficult,
but the Rules Are STRICT!**

The simplest way to document your tax-deductible entertainment expenses is to get a receipt for everything, staple related receipts together, and write, in ink, directly on the receipt **(within 24 hours!)** the following:

- **The Date the expense was incurred.**
 Generally this means the date of the entertainment itself (i.e., if you purchased season tickets to a sporting event to entertain clients and prospects, you would record the date, etc., of each individual event, as it occurred).
[Reg Sec 1.274-5(b)(3)(ii)]
- **The Amount of the expense.**
 The numbers imprinted on the front of the receipt can fade over time, becoming illegible, so write the amount on the receipt in ink.
[Reg Sec 1.274-2(b)(1)(i) and Reg. 1.274-5T(c)(2)(iii)(B)]
- **The Place the expense was incurred.**
 Name and location of the venue, as well as the type of event, if not obvious. List the place of the bona fide business discussion if the event was “Associated Entertainment.”
[Reg Sec 1.274-5(b)(3)(iii)]
- **Your Purpose for incurring the expense.**
 Be sure to relate your “why” to your business, of course. Why are you entertaining this particular person, and what business result do you expect to come about as a result?
[Reg Sec 1.274-5(b)(3)(iv)]
- **The Relationship to you of the person(s) you entertained**
 or job title, and other relevant information that explains why you entertained that particular person.
[Reg Sec 1.274-5(b)(3)(v)]

READ THIS!

This documentation **MUST** be recorded within 24 hours of incurring the entertainment expense, so it is a good habit to do this as soon as you return to your home, office or hotel that night. I recommend you input this information into your tax deduction tracking software, and then file the paper receipts in your tax file, as additional back-up.

Want a Professional Recommendation?

Keep really good documentation. This area is frequently looked at in audits, but that's only because most people don't know the rules and record-keeping requirements, so it's easy to "catch" many taxpayers.

But if you follow these two steps for all of your Meal and Entertainment deductions, the documentation will be audit-proof:

- 1.** Answer, in writing, all five documentation questions for each deductible expense, and
- 2.** Record those answers within 24 hours of the time the expense was incurred.

If your own circumstances are such that you could derive large tax savings in this category, be sure to obtain good tax advice from someone highly experienced in home-business tax law.

Oftentimes making just a minor adjustment *in advance* can turn a non-deductible expense into a deductible one.

Chapter 10

Don't Dread that Dreaded Word, "Documentation"

We learned in Chapter VII how quick and easy it is to keep vehicle-use records, in Chapter VIII the rules for keeping audit-proof business travel records, and in Chapter IX the easy (but strict) rules regarding deductions for Meals and Entertainment expenses.

In this Chapter you will learn THREE OPTIONS for documenting ALL of your day to day business income and expenses in **about a minute a day**.

OPTION 1: Even if you have only the smallest amount of computer savvy you can record the IRS-required records into an easy-to-use software program that will store, consolidate and tabulate all your deductions. **It takes only about a minute a day!**

At the end of the year, at the "press of a button," so to speak, your deductions are compiled and totaled, exactly the way the numbers are to be reported on your IRS Schedule C (Record of Profit and Loss From Business). Download a 30-day trial copy of the *Sixty Second Tax Savings Organizer* at www.HomeBusinessTaxSavings.com.

OPTION TWO: If you prefer an easy to use a ‘manual’ system for tracking and documenting your business income, expenses and activity, take a look at the *Tax MiniMiser™*, also available online at www.HomeBusinessTaxSavings.com. The 12 monthly spreadsheet-like forms have all the categories needed to “prompt” you to record all the data you will want for tax preparation at year-end. And each of the recordkeeping forms has a ‘built-in’ envelope, allowing you conveniently store your receipts chronologically for easy referral.

This is an amazing easy (yet totally complete) ‘pencil & paper’ method of organizing all of your business records. “A dull pencil remembers better than the sharpest memory.”

OPTION THREE: As a bare minimum, set up 9 file folders or 9 slots in an accordion file to store your receipts in the major Schedule C business expense categories. Here are your file folder labels:

1. ADVERTISING and PROMOTION

(These expenses relate to line 8 of Schedule C)

Into this folder place documentation for:

- Paid Advertising: classifieds, radio spots, etc.
- Mailing List Rental Fees and Biz-Op Lists.
- Direct-Mail Costs: postage, envelopes, printing.
- Promotional Materials: prospecting tapes, videos, flyers.

Note: Attach evidence of payment (such as cancelled check) to each invoice.

Author’s Note: The IRS only requires Receipts and Proof-of-Payment, but I prefer to attach to each receipt, a copy of the advertisement or promotional piece.

2. VEHICLE OPERATING COSTS

(These expenses relate to lines 10 and 20 of Schedule C)

Into this folder place documentation for:

- Vehicle-Use Log (see Chapter VII and Appendix)
- Gas, Toll and Parking receipts
- Maintenance and Repair records
- Purchase/Lease Monthly Payments
- Interest, Taxes, Fees and Insurance paid

Note: Attach evidence of payment (such as cancelled check) to each invoice.

3. LEASE or PURCHASE of BUSINESS ASSETS

(These expenses relate to lines 13 and 20 of Schedule C)

Into this folder place documentation for lease or purchase of business assets such as:

Computers	Fax Machines
Scanners	Phone Systems
Beepers	Pagers
Furniture	Furnishings
Cell Phones	Tape Duplication System

Note: Attach evidence of payment (such as cancelled check) to each invoice/payment.

4. WAGES, COMMISSIONS & EMPLOYEE BENEFITS PAID

(These expenses relate to lines 14, 19 and 26 of Schedule C)

Into this folder place documentation for:

- Wages Paid to Family Member Employees
- Time-Sheets or Work-Logs
- Employment Contracts
- Evidence that wage-rates paid were “reasonable.”
- Copies of Payroll Tax Forms and Payroll Reports
- Commissions Paid to others, if applicable
- Costs of Medical Reimbursement benefit

Note: Attach evidence of payment (such as cancelled check) to each invoice.

5. LEGAL AND PROFESSIONAL FEES AND COSTS

(These expenses relate to line 17 of Schedule C)

Into this folder place documentation for:

- Legal Fees
- Tax Preparation and Tax Advice
- Outside Bookkeeping or Payroll Services
- Purchase of This System

Note: Attach evidence of payment (such as cancelled check) to each invoice.

6. BUSINESS USE OF YOUR HOME

(These expenses relate to line 30 of Schedule C)

Into this folder place documentation for:

- Calculations to Determine Business Use Percentage
- Mortgage Interest or Rent payments
- Utility bills
- Real Estate Taxes
- Receipts for pest control, house cleaning service, etc.
- Home Repairs, Maintenance and Improvements
- Alarm System

Note: It is easier to justify all of the above if you have a floor-plan of your home, indicating the Business Use of each room, and/or photos that show the Business Use of the rooms you are including in your Business Use Percentage (BUP) calculations. Attach evidence of payment (such as cancelled check) to each invoice.

7. OFFICE SUPPLIES

(These expenses relate to line 22 of Schedule C)

Into this folder place documentation for:

Stationery	Business Cards	Address Labels
Fax Paper	Calendars	File Folders
Desk Supplies	Mail Folders	Cleaning Supplies

Just About Everything from Pencils to Toner Cartridges!

Note: Even business equipment and other “assets” can be considered “supplies” if their purchase cost is only a few hundred dollars or less. Attach evidence of payment (such as cancelled check) to each invoice.

8. BUSINESS TRAVEL AND ENTERTAINMENT

(These expenses relate to line 24 of Schedule C)

Into this folder place documentation for:

Everything covered in Chapters VIII and IX, including...

- Air fare receipt - with date and time of departure and arrival written on it (Remember, spending 4 hours in transit counts as a Business Day)
- Receipts for all expenditures in excess of \$75.00
- Notes on all individual expenditures less than \$75.00
- Record number of hours of business activity and personal time each day
- Hotel receipts (with any Personal expenses annotated and deducted)
- Entertainment receipts, with required annotations.

Note: Attach evidence of payment (such as cancelled check) to each invoice.

9. MISC. OTHER BUSINESS EXPENSES

Into this folder place documentation for:

- Bank statements
- Business license, fees or taxes
- Repairs to business equipment
- Interest paid on business loans
- Interest and fees paid on business credit cards
- Banking fees
- Postage and delivery fees
- Homeowners or renters insurance
- Dues and subscriptions
- Costs of Internet Access, Cell Phones and Pagers
- Phone Bills
- *And anything else that might possibly be deductible.*

Note: Attach evidence of payment (such as cancelled check) to each invoice.

A Very Important Note About Recordkeeping

Most people do know that they need to keep copies of invoices or bills to document their tax-deductible expenses.

But many people do not know that they also are required to be able to prove they paid those invoices/bills. Proof of payment IS a requirement for making those expenses deductible.

The logic is not difficult to understand:

A taxpayer could order a \$5,000 piece of business equipment, receive an invoice for it, but then cancel the order. If the IRS required only the invoice for documentation, the taxpayer could claim a \$5,000 deduction for a piece of equipment he/she never received or paid for.

Therefore, the IRS requires the taxpayer to provide **proof of the cost of the item (invoice) and proof that it was paid.**

First, that proof could be in the form of a “PAID” stamp on the invoice, if the item was paid for in cash. Second, it could be documented with a cancelled business check. (If your bank provides only copies of your checks, be sure you have a copy of both sides of the check!)

Or, third, if you use a business-only charge card to purchase a tax-deductible item, the IRS considers the item to have been *paid for* in the *month the transaction appears on your statement*.

Example: You purchase a \$3,000 computer (for business-use-only) on March 20, and charge the full amount to your credit card. In April you receive your monthly statement for transactions you made in March, and it lists the \$3,000 purchase. For tax purposes, the full \$3,000 amount is treated as if you had paid in full on March 20th, even though you may take many months to pay it off.

Therefore, your proof-of-purchase and proof-of-payment, **both** will be considered fully documented simply by keeping a copy of your monthly invoice, which lists the charge on it.

By the way,

For smaller amounts, usually up to \$75 per individual expense, notations in your tax deduction documentation system or in your daily appointment calendar is accepted as proof of purchase.

Your **Tax Preparer** can **only** be a **good** as the records **YOU** keep, so remember: “***A that dull pencil remembers better than the sharpest mind.***” Timely recordkeeping is the key to maximum (and audit-proof) deductions. Check out the ***Tax MiniMi\$er*** for a simple but complete recordkeeping system.

Chapter 11

Easy Steps to “Audit-Proofing” Your Tax Returns

“Audit-Proof,” as we use the term in this book, does not mean you will not be audited. It means that if you *are* audited, you will have the IRS-compliant documentation to validate every deduction you claimed on your Tax Return.

BIG TIP: The #1 Reason for audits: Math errors on the Tax Return. #2 Reason: Incorrect Social Security number on the tax form. Seriously, those are #1 and #2. You definitely do not want to *invite* an audit, so double and triple check all of your calculations, and make sure your SSN is recorded correctly.

When most taxpayers hear the word “audit” they get the same “in the gut” feeling they get when they look in the rear-view mirror and see flashing blue lights behind them. And for good reason.

The IRS will feed the Treasury Department some **\$2 TRILLION** this year. And that’s before audits.

Audits will rake in an *additional* **\$43-BILLION!**

So first, let's put "audit" into perspective. An audit is nothing more than an attempt to see if you reported all of your income accurately, and if you qualified for all of the deductions you claimed.

If you are driving 65 MPH in a 65 MPH zone, you have nothing to fear if a highway patrolman uses radar to check your speed, right? Well, likewise, if all of the deductions you are claiming on your Tax Returns are legal and adequately documented, there's no reason to fear an audit.

Maintaining the required documentation does **not** have to be tedious, does **not** require an accountant, and does **not** take a lot of time, as we have just discussed in the previous chapter.

These are the 5 Most Important Steps every taxpayer should take to 'Audit-Proof' their Tax Returns...

1. When documenting deductions, **be sure that you can produce evidence that you incurred the expense**, which is usually going to be a copy of your invoice. And *also* be sure that you can prove that you *paid* the invoice. So keep your cancelled checks attached to your invoices for all expenses you are deducting on your Tax Return. (Remember, when an expense is charged to a credit card, it is deemed to have been paid when the card charge is incurred, so keep credit card statements also.)

2. Many people who have an active home-based business, **keep a separate checking account for their business** income and business expenses, which is highly recommended. But you must know this: **ALL deposits into that account will be considered “earned income”** (i.e., taxable!) unless your checkbook register is annotated to indicate otherwise. If they add up your deposits and come up with a different number than you reported as gross income, it may look like you under-reported your income. (That’s not a good thing!) Perhaps some of your deposits were personal funds you were loaning your company so that you could buy promotional materials. Solution: Mark clearly in your checkbook register the source (and sometimes, purpose) of every deposit into your business account.

3. **If you hire your children and/or spouse** in order to deduct their wages, **you should...**
 - (a) **Have (or get) an EIN Employer Identification Number.**
 - (b) **Use a Family Member Employment Agreement, to specify the duties they will perform and the amount you will pay them.**
 - (c) **Document the work they performed. For example, they could turn in monthly or weekly calendar pages or timesheets on which they’ve recorded the work they did and what days they did it on.**
 - (d) **Pay them on a regular and consistent basis, and always pay them with a Business Check.**
 - (e) **Withhold, and pay, Social Security and Medicare taxes on adult family member employees.**

You may also be required to show that the amount you are paying your family members is “**reasonable.**”

One way you could do that would be to get an outside company to give you a written estimate for doing the same work, and then pay your family member approximately that amount or a little less. Or determine what a “reasonable person” might pay an employee or outside contractor for a similar service, and then use a comparable wage or salary.

4. If your Schedule C shows your home-based business with a net loss for the year, an auditor may require you to **prove that you are working toward making a profit.** Profit-intent is required, in order to prove that you are in a legitimate business. A Business Plan can be an important part of your proof. **So have a Business Plan.** (*You can download a fill-in-the blanks Business Plan online at www.HomeBusinessTaxSavings.com.*) Be sure to also follow the other recommendations in Chapter II.

5. **Never attend a tax-audit in person** (see next section).
Retain a tax professional, such as an Enrolled Agent, CPA or Tax Attorney, and give them a Limited Power of Attorney to attend the audit in your place.

WHY You Should NEVER Attend Your Own Tax Audit!

You **never** want to show up **in person** for a tax audit! **Never, never, NEVER!** Always have an Enrolled Agent, CPA or other IRS-approved representative **who has lots of *successful* audit experience** appear in your place.

If you try to go it alone, here's what you can expect. • First, you'll be walking into an adversarial climate, where you know (or they'll remind you) that you are guilty unless you can prove your innocence. An agent's bully attitude and heavy-handed tactics will intimidate almost any taxpayer. • They'll fire question-after-question at you, while implying that you should have immediate answers. If you take a minute to think about a question (after all, they're questioning details on a tax return you filed two or three years ago!), they'll give you "the look." You know -- the one that says, "I know you're guilty, so don't try to weasel your way out of it." • They'll *lead you* like a good lawyer, into saying things that will cost you some of your tax deductions. • Everyone has less than perfect records, but your auditor will make you feel like yours are among the worst ever.

Whether they admit it or not, the career progression of an auditor IS related to the number of "successful" audits he/she completes. Take a guess what "successful" means. You're right!

Audits brought in an extra **\$43-BILLION** to the U.S. Treasury last year. Most of that came *not* from people who were trying to cheat. It came from honest taxpayers who didn't keep all their receipts or records, or who "spoke before thinking" while in the pressure cooker of an audit.

Why would you put yourself through that if there is another way?

If you have an Enrolled Agent, for example, attend your audit without you, the auditor can't put you on the spot and expect you to spontaneously provide an answer to every little question. If you are **not** personally present, you cannot answer questions about "apparent discrepancies" – questions that may cause you to answer inaccurately, simply due to vague recollections of something that occurred up to three years ago.

If the auditor asks your representative a question he/she does not have the answer to, he'll just say, "I don't have the answer to that, but I'll be glad to get with my client (you) and get back to you with the answer."

That buys you time to think about the answer, or to check your records for an explanation. **I do not mean time to "make up a lie." I mean time to remember the truth** -- without a heavy handed auditor breathing down your neck.

Even if you think you have all the answers, where is another *big* reason to have a tax professional represent you. The whole climate changes when an auditor is meeting alone with a “fellow professional,” as opposed to meeting with a “lying, cheating taxpayer.” A really good tax pro who is experienced in audit representation, will quickly get the auditor feeling that the fellow-professional is there “to help determine the accuracy of the tax return in question.” That gets the auditor a bit more relaxed, feeling that “we’re *both* on the side of truth, justice and the American way.”

Have no doubt, however, your tax professional is representing **YOU** and **YOUR** interest *only*. It’s just that, the more he or she can put the auditor at ease, the better the outcome will likely be for you.

“Nothing to Fear But Fear Itself”

If you use one of the three systems reviewed in Chapter X to keep good records, and use those records to have your taxes prepared by a home-business tax-law specialist, **you will have nothing to fear, even if you receive an audit notice.**

If all the deductions you claimed are legal, and if you’ve kept necessary records (both of which are described in this book), an audit of your Tax Return will simply be an “unavoidable inconvenience.” But it will not be something to be feared!

An Audit Can Actually be a Good Thing ---- Really!

On average, your chances of being randomly audited are about 0.5%. That's ½ of 1 percent, or one chance out of every 200 taxpayers.

But if you *are* audited and you've followed the rules and have the required records, there's nothing for an auditor to "find." So, here's the good news about having a "random audit"...

If the result of your audit result is "No Change," your chances of being audited again have significantly decreased. In fact the law protects taxpayers from multiple audits over similar issues when prior audits have confirmed the accuracy of the prior returns.

So, audits are rare, but they do happen. But "if you're driving within the speed limit, there's no reason to fear radar."

What "Triggers" an Audit?

The majority are "random audits," which means the computer picked you at random. If this happens, you will receive a love note in the mail suggesting that you two get together for a chat –otherwise known as an "Audit Notice." Don't take it personally. Many are

“Correspondence Audits,” meaning they are handled through the mail. Others are done in person. They’ll look over your entire return, not focusing on any one thing, unless they see something worth probing. See the section a few pages back, labeled “Why You Should NEVER Attend Your Own Tax Audit!” That recommendation applies also to Random Audits.

Sometimes that same ugly computer is kicking out Tax Returns because something attracted its attention. The best way to attract its attention is to fail to report all of your 1099 and W-2 income. The IRS gets an attitude when a taxpayer has unreported or underreported income, and they’ll send you one of those love notes.

In case you didn’t know, one of the biggest “improvements” to the IRS’ computer capability, is a sophisticated ability to match 1099s and W-2s to the individual taxpayer’s Tax Return. If they have a 1099 on file which didn’t show up on the taxpayer’s return, it generates an “Oops” message and sends it to the Audit division.

Sometimes that nasty computer kicks out a Return because the taxpayer claimed a deduction amount that was “outside the normal range” for your particular business type. (That’s why the signature line on the 1040 Tax Return form asks you to identify your occupation.) That does NOT automatically generate an audit. It does automatically generate a review by a real person, who will determine

whether or not auditing that specific return is likely to net the Treasury any additional money.

What's a Disclosure Statement?

If you know that you are claiming a deduction that is likely to be outside the normal range for most people in your industry, here's something worth considering... Instead of waiting to give your explanation to an auditor, you can actually can explain in advance. There is a little-known IRS Form number 8275, called a "Disclosure Statement" which you can attach to your Tax Return (obviously, you can't file electronically if you want to attach an 8275).

A "Disclosure Statement" could be called a "Let Me Explain" note, because that is what you would use it for. Since Tax Returns are processed by computers, you are not drawing attention to yourself by attaching a Form 8275. No human being (nor IRS employee) will see your 8275 unless the computer raises its hand and says "Hey, look at this one." When that Return is reviewed, the reviewer sees your Disclosure Statement. If you have explained the situation adequately, your Return will likely be put back in the file drawer.

To add even more power to your Disclosure Statement, you could type these words at the bottom of the form:

Under Penalty of Perjury, I swear that the above is true, accurate and complete, to the best of my knowledge, and then have your signature on that form Notarized.

The words “under penalty of perjury,” means “If I am lying, I know you could send me to jail.” Do you think your Disclosure Statement might be even *more* believable with that Notarized statement at the end? If you’re telling the truth, there’s no risk in adding that statement.

Audits Aren’t the Only Way They Get their Hands on Your Wallet

Have you ever received a letter from the IRS stating that their records indicate that two years ago you earned interest on your savings account but failed to report that income on your tax return. The amount they ask for is often way more than you would have owed initially, because by waiting for two years to bill you, they were able to tack on interest and penalties. The letter ends by saying “if you agree, then just send us the money.”

Most people just mail in a check for the amount requested, without even checking their own records to see if the IRS is right. But many of those computer generated letters are flat out wrong!

Think about it. The IRS sends out a gazillion letters (that are not written very well) printed in plain black ink on cheap white paper – and mail them postage-free! – asking for a specific amount of money. And most people who get those letters *immediately* write a check for the full amount asked for, and mail it in on the very same day. Those letters collect over \$2 Billion in cash without making even one phone call. And they keep running their money-making campaign successfully year after year after year!

Undoubtedly this will go down in history as the most successful (and lowest cost) fundraising campaign of all time!

You do NOT Need to File by April 15th

You may know that if you file an IRS Form 4868 prior to April 15, you can get an automatic four month extension on your tax filing deadline. That slides your deadline to August 15. Then, if you have any kind of a plausible reason, you can request (and usually get) an additional two months extension, sliding you filing deadline way back to October 15 – **six months after** the vast majority of taxpayers have filed.

Some people hold off until October 15 to file ever year. Their theory is that it substantially cuts their chances of getting ‘selected’ for a

Random Audit. Why? Well, if the IRS computer is programmed to select a million returns for Random Audits, it's going to start naming those people immediately – on (or even before) April 15.

The thinking of these “late filers” is that, by October 15, the computer will have already reached its pre-determined limit for Random Audits. If that's true, then their chance of being selected for a Random Audit would drop from ½ of 1 percent, to zero percent.

I can't confirm that their rationale is correct, but it certainly is an interesting theory, isn't it?

IMPORTANT:

An “Extension of Time to File”

is NOT an Extension of time to PAY.

April 15th is always the deadline for paying any taxes due.

To save you the time of fishing around the IRS web site for the forms you need, you can download the most frequently used ones by clicking on the tab labeled “Docs, Forms & Special Reports” on our own web site at www.HomeBusinessTaxSavings.com.

Chapter 12

**If Your Tax *Deductions* Will Increase, then
the Amount You'll Have to *Pay* will Decrease.**

**So,
Shouldn't Your Take-Home Pay Increase?**

Do you remember your first day on the job, when you had to fill out all sorts of paperwork? One of those papers was a W-4 Tax Withholding Form, on which you wrote the number of **Allowances** to claim.

That number, coupled with your answer to whether your filing status was Single or Married, told your employer what percentage of your money he or she is required to withhold from your wages for various Federal and State taxes.

FIRST, a Misconception Many People have about W-4s...

The term "Allowances" has nothing to do with the number of people in your family or household.

The term *Allowances* does **not** mean "*Dependents*."

The term *Allowances* does **not** mean "*Exemptions*."

“Allowances” is simply a term representing the amount of your wages to be withheld.

For example, if you claim two Allowances, a certain amount of your wages will be withheld for taxes. Now if you file a revised W-4 with your employer, changing your Allowances to one, much more will be withheld from your paycheck, which will decrease your take-home pay. Or, if you change your W-4 to increase the number to three, then less money will be withheld from each paycheck for taxes, which will increase your take-home pay.

Most people do not understand the purpose of withholding taxes. If you’ve ever owned a home, you probably understand the term “escrow.” It means that, with each month’s house payment, the mortgage company is collecting (in addition to principal and interest), 1/12th of your annual Property Taxes.

That way, when the tax bill arrives, your mortgage company has the money to pay it for you. Assuming your property tax amount does not change mid-year, when the bill comes in the mortgage company will have “in your escrow account,” exactly the amount needed to pay it off.

Withholding taxes work exactly the same way. The number of Allowances you put on your W-4, is related to how much you expect

to owe in Income Taxes during the course of the year. The employer, then deducts a pro rata amount from each paycheck.

To use round numbers, let's say you expect to pay \$12,000 in Income Taxes this year. If you get paid once a month, you want your employer to withhold \$1,000 from each of your 12 monthly paychecks. If you get paid twice a month, you want your employer to withhold \$500 out of each of your 24 paychecks.

In each case, the amount withheld during the course of the entire year, should come out to exactly what you owe in taxes. If the number of your Allowances was computed accurately, at the end of the year you will owe no additional taxes, and you will get no tax refund.

That's the way it should be.

If your withholding wasn't high enough (i.e., you claimed too many Allowances), you'll end up owing the government additional taxes at the end of the year. If you've had too much withheld (i.e., you claimed too few Allowances), you'll end up getting a refund at the end of the year.

Contrary to popular opinion, **a Refund is not a good thing!** Getting a refund at the end of the year, means that you have given Uncle Sam an interest-free loan for a full year. Most people would be excited get

a \$2,400 Tax Refund, however, what that really means, is that an extra \$200 cash that could have been in your own pocket every single month, instead went to the government as an interest-free loan.

Many people believe that if they claim a high number of Allowances on their W-4 they're more likely to get audited. That just is not true, as long as the number of allowances is appropriate for your circumstances.

In other words, if you *were* claiming 4 Allowances, and then changed your W-4 to claim 8 Allowances, and then, at the end of the year, you ended up owing \$3,000 in additional Income Taxes... well, let's just say **that's not a good thing**. It's called "under-withholding."

The objective is to make the amount of money withheld from your paycheck, come out to almost exactly what your annual tax obligation will be.

If Your Deductions are Going UP
(thanks to running your home-based business)
Your Tax Withholding Could Go DOWN

Nationwide, the average amount of taxes on income (including Federal and State taxes, Social Security and Medicare taxes) approaches 40% (or more!), meaning about \$4 out of every \$10 you

earn gets gobbled up for various taxes, and then you get what's left, in a check called your "take-home pay."

This is VERY Important! You are about to learn how you could increase your take-home pay, easily, legally and quickly -- IF you have a qualifying home-based business or have been receiving large year-end tax refunds (indicating over-payment of taxes). Never file a revised W-4 without first consulting with your tax professional.

To repeat what we said earlier, the amount of money withheld during the course of the year should match your tax obligation for the full year. If this happens, you owe no additional taxes and you get no refund at the end of the year.

But if too *little* was withheld, you'll end up having to send in a check with your Tax Return. And if too *much* was withheld, you'll get a Refund, which we've explained is not a good thing!

If you already have a home-business that will allow you to qualify for the deductions described in this book, and if most of these deductions are **new to you**, you will probably begin owing a **lot less in taxes** than you have been paying.

When less money will be withheld from each paycheck for taxes, it means a larger check on payday!

If you want to get a rough idea of how many additional Allowances you could add to your W-4, you will find a three-page worksheet called a “W-4 Allowance Estimator” in the next Chapter.

Anyone may submit a revised W-4 any time that your tax circumstances have changed. Once your tax advisor has computed how much you will be saving in taxes due to the tax breaks you’ve just learned about, you simply go to your payroll office and fill out a new W-4, claiming the number of allowances you and your tax advisor have determined to be appropriate. Be conservative, but also be realistic.

ALWAYS consult with a professional tax preparer who is experienced in home-business tax law before changing your W-4. If you need a free referral to home-business tax-law specialists, go online to www.HomeBusinessTaxSavings.com, and click on the tab labeled “Getting Honest Help from Real Experts.”

You and your tax advisor should reassess your withholding requirements every 90 days, and make adjustments to your W-4 as necessary to account for changes in business income or business expenses.

Chapter 13

Putting It All Together

What have we learned, and what does it mean **to YOU?**

First, we have learned that America has two tax systems, and either you have been in the wrong one or you have been in the right one, but still have not been getting all the tax-reduction benefits for which you could qualify.

Either way, you will no longer lose out on legitimate tax breaks just because no one ever told you about them.

Before you read this book, if I had asked you, “Who in America gets the most tax breaks?” what would you have replied? Most people would have said, “The wealthy people who can afford good tax lawyers to find them all the loopholes.”

But that really isn't true, is it? It's the people who establish and run a legitimate small or home-based business with the intent to make a profit, *and* understand the tax laws that were enacted by Congress to encourage them to do just that. ***That's*** who gets the greatest number of legitimate tax breaks!

The Home-Business Tax Breaks

Passed by Congress Were

NOT Accidental

Congress didn't unintentionally create laws that ended up decreasing Federal tax revenues. They did it on purpose, and for good reasons.

Look, why do banks often offer small-business customers exceptionally low rates on loans for business expansion? It's because, when the business does expand, the customer

- Will have lots more money to put in their bank,
- Will become a loyal long-term customer, grateful for the help the bank provided in their early-growth stages,
- Will go back to the same bank for even larger (and probably higher interest) loans as they continue expanding their business even further, and
- Will likely generate dozens or hundreds of new banking customers from the business's employee base.

So, was the bank altruistic in providing a low-interest, collateral-free business expansion loan? Hardly! They simply made a smart business decision. They helped the small customer in the short-run, so that the bank would have a large, financially strong customer in the long-run.

That is exactly why the United States Congress passed an array of tax incentives to encourage taxpayers to operate home-based businesses – to keep our economy strong.

This is why these tax breaks can help “subsidize” your business in its start-up years. Hopefully your *little* start-up business will thrive and grow and become a **BIG business** – because then you will be paying far more in taxes. But at that point, you won’t mind, because you’ll also be keeping far more!

It’s just like investors buying stock in tiny start-up companies that have little or no net worth. Why do they do it? Because they’re hoping their \$1 per share investment will enable the company to grow big and profitable, increasing the worth of their investment to \$20 or \$200 or \$2,000.

Believe me, the government **wants** your tax money! They’re simply risking a short-term decrease in tax revenue from you for now, in hopes of a dramatic increase in tax revenues from you when your business is financially successful.

The second reason is that it’s good for the national economy. Why?

Take a look at this...

Consider these Census Bureau statistics:

- **Small Businesses in the U. S. total approximately 22.9 million (and growing rapidly)**
- **Of those, 12.1 million (53%) are home-based**
- **Small businesses with employees, start-up at a rate of more than 500,000 per year**
- **Small businesses make up more than 99.7% of all employers**
- **Small businesses employ about 50 percent of all private sector workers**
- **Small businesses create 75 percent of all new jobs in our national economy**
- **4 years after start-up, 50% of all small businesses with employees remain open.**

That set of statistics paints an amazing picture, doesn't it?

President George W. Bush summarized it with these few words:

“Small business is the backbone of the American economy,”

How Much Could YOU Save in Taxes?

Let's add up all the new tax-deductions you could qualify for:

- Flip back to Chapter IV. How many dollars worth of expenses did you calculate you'll be able to qualify as tax-deductible business expenses? Remember, there are tax-deduction limits in the category called Indirect Expenses. See last page of Chapter IV. **Record this number on line "A" on the following worksheet.**
- Will you hire your children as employees of your home-based business? If so, how many kids, and how much will you pay them? Remember, you can pay each child up to \$5,000 in 2005. This is tax-deductible to you and tax-free to them. **Put this number on line "B" on the following worksheet.**
- Will you be employing a spouse in your business, and giving him/her self-insured medical/dental benefits as discussed in Chapter VI? This strategy lets you tax-deduct all the out-of-pocket medical related expenses you now pay in after-tax dollars. Expenses like annual deductibles, co-pays, non-covered medications, medical devices and procedures, etc. **Put that amount, plus any employer payroll tax costs, on line "C" on the following worksheet.**

- Look back at Chapter VII again. How much do you estimate you will be able to write-off for business use of your vehicle(s)? At a bare minimum, it will be the number of business miles times 40.5¢/mile (in 2005). Depending on your business vehicle use, this might come out somewhere between \$3,500 and \$5,000 – maybe more, maybe less. **Put that amount on line “D.”**
- How much do estimate you’ll spend on business travel (including business trips with some ‘personal days’)? See Chapter VIII. **Record that number on line “E” on the following worksheet.**
- Will you entertain business associates outside your home? Will you qualify to write-off meal and entertainment expenses? **50% of that number goes on line “F.”**
- Finally, add up all other deductions that didn’t fall into one of these six categories, and **record the total on line “G.”**

Let’s add them up...

YOUR Estimated Deductions Due to Operating a Home-Business

- A. Home-related Business expenses: \$ _____
(See Chapter IV for **limits on deducting** Indirect Expenses.)
- B. Wages for hiring children: \$ _____
- C. Family's non-reimbursed medical costs: \$ _____
- D. Vehicle Business Miles x 40.5¢/mile: \$ _____
- E. Business Travel: \$ _____
- F. 50% of Business Meals/Entertainment: \$ _____
- G. Other Deductions: (business equipment,
loss on sale of home/car, depreciation, etc.) \$ _____
-

Estimated Total Deductions: \$ _____

Are you shocked at that number? Most people are totally blown-away!

With all these new tax deductions, should you add more Allowances to your W-4 so that more money shows up in your paycheck?

Let's take a look ▼ ▼ ▼

W-4 ALLOWANCE ESTIMATOR

(ALWAYS get advice of a tax professional before changing your W-4.)

If you have a traditional “W-2 job” and are paid wages from an employer, you have a Form W-4 on file in your employer’s payroll office. The number of “Allowances” you wrote on this form (which you filled out on your first day of employment) tells your employer how much of your wages to withhold for taxes.

The Internal Revenue Code (IRC § 3402 and related regulations) authorizes any employee to revise his/her W-4 whenever his/her tax situation changes. The IRS does not limit the number of times a taxpayer may change his/her W-4, nor how frequently it may be changed. It does, however, **require your employer to process the revised W-4 AND to adjust the amount withheld from your wages for taxes, effective with the very next pay period.**

Increasing the number of Allowances results in a **larger** paycheck!

Decreasing the number of Allowances results in a **smaller** paycheck!

If you actively operate a small or home-based business (even on a part time basis) with the intent to produce a profit, you may qualify for many deductions for which other taxpayers may not be eligible. **Since more Deductions means paying less in taxes, you may be eligible to increase your number of allowances, putting much more of your wages into your take-home pay.**

This **W-4 Allowance Estimator** will take you through a process of determining the **approximate** number of Allowances you **could** claim on your own W-4. If this number is higher or lower than the number on your current W-4, you may wish to consider submitting a revised W-4.

It is *highly recommended* that you have a Tax Professional who *specializes in Small-Business Tax Law*, review your worksheet and your conclusions. Ask for his/her Professional Opinion prior to submitting a revised W-4. It is further recommended that you perform this calculation every 90 days and make W-4 revisions whenever necessary.

Now let’s see if **YOUR** Small-Business/Home-Business Tax Deductions will affect the number of Allowances on **YOUR** Form W-4...

'DIRECT EXPENSE DEDUCTIONS'

A. Estimated total **Gross Business Income** for this year: ▶ \$ _____

B. a. How many **DEPENDENT CHILDREN** age 7+ will you employ? _____ children

b. How much will you pay each child this year? \$ _____/year
(In 2005, the first \$5,000 is tax-free to them.)

c. **Multiply (a) x (b):** \$ _____

C. a. How many **BUSINESS MILES** will you drive your vehicle(s)? _____ mi./year

b. **Multiply the above number x \$0.405/mile :** \$ _____

D. Will you **EMPLOY YOUR SPOUSE?** YES / NO

If YES, how much does your family spend annually on **Health Costs** \$ _____
that are not reimbursed under any health insurance plan, and not reimbursable
under an employer's cafeteria plan [also known as 'Section 125 plan' or
'Flexible Spending Arrangements']

E. a. What is your total of your **TELEPHONE COSTS** for the year? \$ _____

b. What is your monthly rate for **1-line Basic Service only:** \$ _____

c. Multiply "**b**" x 12 = \$ _____

d. Compute ["a" minus "c"] = **Deductible Telephone Costs:** \$ _____

F. What is estimate of all other annual **Business Operating Costs:** \$ _____

G. Estimate your total expenses for **Overnight Business Travel this year** \$ _____
(including travel costs for employees)

H. Add '**B**' through '**G**' and record the total here ▶ ▶ \$ _____

I. Subtract line '**H**' from line '**A**' and Record the **RESULT:** \$ _____

If RESULT shown on line 'I' is a "LOSS:"
(i.e., line A is smaller than line H)
Divide line 'I' by \$3,200.
The result is Number of Additional Allowances to
Add to the number on your Current W-4.
== OR ==
If RESULT shown on line 'I' is a "PROFIT:"
(i.e., line A is larger than line H)
Divide line 'I' by \$3,200.
Record that number here: _____ and
... PROCEED TO NEXT PAGE ...

If the calculation on the previous page resulted in a PROFIT on line 'I', you may ALSO claim Indirect Expense Deductions, but ONLY up to the amount of your Profit. However, if your Indirect Expense deduction total, is greater than your profit total, you do not "lose" the remaining deductions -- you may 'carry forward' any remaining Indirect Expense Deductions for use on your future Tax Returns.

Estimating Your 'INDIRECT EXPENSE' DEDUCTIONS

First, calculate the "BUSINESS USE PERCENTAGE" of your home:

What is the total square-footage of the finished area of you're your home? _____sq. ft.

What is the total square-footage of all areas of your home that you will use "Regularly and Exclusively" for business purposes? _____sq. ft.

Bottom line divided by Top line = "Business Use Percentage" (BUP).
Your BUP = _____%

J. Estimate your annual total cost of ALL Utilities: \$ _____
Multiply the above number by your BUP % = \$ _____

K. Annual Homeowner's or Renter's Insurance: \$ _____
Multiply the above number by your BUP % = \$ _____

L. Annual estimated Repair & Maintenance costs: \$ _____
Multiply the above number by your BUP % = \$ _____

M. If you RENT, your rent for the entire year = \$ _____
Multiply the above number by your BUP % = \$ _____

N. TOTAL of lines 'A' through 'D' = ► ► ► \$ _____

HOW TO ESTIMATE YOUR W-4 ALLOWANCE CHANGES:

Divide the *smaller* of line 'N' or line 'I' by \$3,200, and add that number to the total you filled-in on the line at the very bottom of the previous page. The total of those two numbers represents the additional Allowances you could add to the number on your current W-4. **BUT CONSULT WITH A TAX PRO FIRST!**

Chapter 14

You Could Get
ANOTHER, Even BIGGER REFUND
on Tax Returns You've Already Filed!

*This Chapter Could Help You Get a Mid-Year Tax Refund,
Potentially Worth Thousands of Dollars.*

Did you have a home-based business prior to this year? Are you kicking yourself because you could have paid a LOT LESS in taxes if you had known then about the tax deductions you learned about now?

Does it make you angry to think of all the extra money that you gave Uncle Sam, just because you didn't know the things you've learned from this book? **Don't get angry, get even!**

Here is some good news! You have up to three years to file an Amended Tax Return (Form 1040X) any time you discover errors or oversights on a previous year's Tax Return! That includes deductions you missed out on!

You have until April 15, 2006 to file an Amended Return (Form 1040X) for tax-year 2002, for example, or April 15, 2007 to amend

your 2003 return, since those dates are three years after the deadline for filing those tax returns. And you can file Amended Returns for 2004 anytime before April 15, 2008. Your deadlines may be even later if you got an extension and filed your tax Return later than April 15th.

Guess what? If the IRS ends up owing you a refund (as they probably will), **they'll also pay you interest** (about 6%) for the time they had your money! So, if you overpaid by \$1,000 in each of those years, for example, the IRS will send you a refund check for \$3,000 *plus interest*. Cool, huh!

If you had a home-based business in the past three years, have your prior years' returns reviewed by a tax professional who is a seasoned expert in home-business tax law.

Put that little item at the very top of your To-Do list! It may just put thousands of dollars of extra cash in your pocket, *quickly!*

For a referral to a small business tax specialist who will review all of your past three years' Federal Tax Returns for absolutely ZERO COST visit our web site at www.HomeBusinessTaxSavings.com, and click on the tab labeled "Getting Honest Help from Real Experts."

A Few Final Thoughts from the Author

Congratulations on reading this book from start to finish. **YOU now know more about home-business tax law than most tax advisors in this country!** But Congress is changing tax laws, the IRS is publishing clarifications, and Federal Tax Courts are issuing rulings *constantly!*

Don't worry about that because I will be keeping an eye on all of that for you! All *you* need to do is subscribe to my email newsletter, "**Tax Tips You Ban Bank On.**" That's how I will keep you up-to-date on every important change that could impact your taxes. I'll even interpret what it means and what you should do about it.

You may be thinking, it's hard to imagine anyone going into business for themselves without first getting a good understanding of the laws they will be operating under – including Income Tax laws.

But you did it, and so did I. Why? **Because we didn't know what we didn't know.**

The same thing is happening right now – today – to *thousands* of others, probably **including people you know!** Now that you

understand the tremendous value of this easy-to-use information, please accept the challenge – maybe even the *obligation* – to help “spread the word” to the millions of others who need it also.

Protect your friends from “what they don’t know.” Tell them to get this book, or loan them yours. But don’t let them blindly overpay their taxes the way you and I did.

As my friend and mentor Robert Allen said in the Foreword to this book, “Everyone with a home-based business needs this information.”

May God bless You and your Business!

Ron Mueller, author

FOR MORE INFORMATION

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