Tax Tips

Summer 2003

Business

Deducting Expenses for Business Vehicles

Can I write off my SUV?

If you use a vehicle for business purposes, you need to decide which would be more advantageous – deducting the standard mileage rate or your actual expenses. That question can easily be answered by the type of vehicle you drive.

If your business vehicle weighs over 6,000 pounds, it is often more advantageous to use the actual expenses when computing your allowable deduction because the depreciation deduction is not limited as it is for vehicles weighing less. +You can also expense up to $100,000 of the cost in the first year the vehicle is used for business.

The standard mileage rate for business use is 36 cents per mile for 2003. If you bought a vehicle in 2003 that is eligible for the special 50% depreciation allowance, the actual expense method may be more advantageous. When making this choice, it's smart to estimate the amount of your vehicle deductions for the current year and future years, and make the choice based on your estimated expenses for the entire time you expect to keep the vehicle.

Recordkeeping

What records should I keep?

Except in a few cases, the law does not require that you keep any special type of records. You may choose any suitable business recordkeeping system that clearly shows your income and expenses. Your recordkeeping system should include a summary of your business transactions. This summary is ordinarily created in business books such as your accounting journals and ledgers. The books must show your gross income, as well as your deductions and credits. For most small businesses, the business checkbook is the main source for entries in the business books.

Purchases, sales, payroll, and other transactions you make in your business will generate supporting documents such as invoices and receipts. These documents contain the information you need to record in your books. It is important to keep these documents in an orderly fashion and in a safe place because they support the entries on your tax return. Following are some of the types of records you should keep:

- **Gross receipts** are the income you receive from your business. You should keep supporting documents that show the amounts and sources of your gross receipts.

- **Purchases** are the items you buy and resell to customers. If you are a manufacturer or producer, this includes the cost of all raw materials or parts purchased for manufacture into finished products. Your supporting documents should show the amount paid and indicate that it was for purchases.

- **Expenses** are the costs you incur (other than purchases) to carry on your business. Your supporting documents should show the amount paid and indicate that it was for a business expense.

- **Assets** are the property, such as machinery and furniture, that you own and use in your business. You must keep records to verify certain information about your business assets. You need accurate records for computing the annual depreciation and the gain or loss for any assets you sell.

New Rules for Day Care Providers

IRS now allows standard rate for meals

If you provide day care in your home and offer meals, the IRS has made your recordkeeping easier. Instead of keeping receipts for your food costs, you may now deduct a standard rate for the meals you provide. The election must be made for the entire year. The table below shows the standard rate for meals for 2003.

Meal	Alaska	Hawaii	All Other States
Breakfast	$1.55	$1.13	$0.98
Lunch/Dinner	$2.93	$2.11	$1.80
Snack	$0.87	$0.63	$0.53

You always have the option to deduct the actual cost of the meals. However, sometimes it's difficult to separate the food you purchase for your day care business from the food you purchase for your family. Using the standard meal allowance eliminates that recordkeeping

Starting a Pension Plan

Small employers may qualify for new tax credit

If you are an eligible employer who begins a new pension plan for your employees, you may be eligible for a tax credit. The credit is 50% of the first $1,000 of qualified start-up costs of the plan. The credit is available for each of the first three years of the plan.

You are considered an eligible employer if, during the preceding year, you had 100 or fewer employees who received at least $5,000 in compensation.

Qualified start-up costs are any ordinary and necessary expenses you pay out to begin or administer a plan or to educate your employees about the plan.

Limited Liability Companies

Is this business entity right for me?

Limited Liability Companies (LLCs) have grown in popularity since they first came on the scene a few years ago. If you choose to organize your business as an LLC under state law, you have a few choices as to how you want to report your income.

- The LLC combines most of the favorable aspects of the partnership and corporation.

- An LLC is a business entity, separate from its owners, that provides the LLC member with a limited amount of liability, which is usually only common to corporations.

- In most cases, the LLC is taxed as a partnership, passing its income and losses through to its members, avoiding the double taxation that is applicable to corporations.

- Single member LLCs that do not elect to be taxed as a corporation will report the income from the activity on Schedule C, Schedule F, or Schedule E as appropriate.

- The LLC can alternatively elect to be taxed as a corporation.

- Other attributes of the LLC will be determined by how the LLC is taxed. An LLC taxed as a corporation follows the corporation provisions and an LLC taxed as a partnership follows the partnership provisions.

- The LLC is formed under state law by filing *Articles of Organization* with the state.

- An LLC's *Articles of Organization* usually define who will be responsible for managing the LLC.

- Liquidation of the LLC will depend on whether the organization is taxed as a partnership or corporation.

- There is one major disadvantage of LLCs; they are a relatively new form of organization, which means there are still unresolved issues regarding their operation.

Employing Family Members

How can I reduce my tax burden?

If you are a business owner and you are short of workers this summer, hire your children to help out. One of the key advantages to hiring your children is that you will save on payroll tax. If your children are under the age of 18, you are not required to withhold

social security and Medicare taxes from their wages, nor are you required to pay in the employer's share. You are also not required to pay federal unemployment tax on children's wages until they reach age 21.

This tactic will not work for all parents, however. Only self-employed business owners can hire their children and avoid payroll taxes. This includes businesses operated as a partnership, provided you and your spouse are the only partners. If your business is incorporated, your children will be employees of the corporation, not you. Therefore, the exemption from payroll taxes does not apply and social security and Medicare taxes will be due just as with any other employee.

You can also hire your spouse and save some tax dollars as well. If your spouse is a bona fide employee of your partnership or sole proprietorship and is paid a reasonable wage for the services performed, you can provide health benefits and deduct the cost from your business income. This will save you some self-employment tax.

If you employ your spouse, you must pay social security and Medicare taxes for him or her. The wages for the services of an individual who works for his or her spouse in a trade or business are subject to income tax withholding and social security and Medicare taxes, but not federal unemployment tax.

Business or Hobby?

Be aware of the rules

Expenses connected with your business activities may be tax deductible or limited to the rules for hobby expenses. The limit on hobby losses applies to individuals, partnerships, estates, trusts, and S corporations. It does not apply to corporations other than S corporations. In determining whether you are carrying on an activity for profit, all the facts should be taken into account. No one factor alone is decisive. Among the factors to consider are whether:

- You carry on the activity in a business-like manner.

- The time and effort you put into the activity indicates your intention to make it profitable.
- You depend on income from the activity for your livelihood.
- Your losses are due to circumstances beyond your control (or are normal in the start-up phase of your type of business).
- You change your methods of operation in an attempt to improve profitability.
- You, or your advisors, have the knowledge needed to carry on the activity as a successful business.
- You were successful in making a profit in similar activities in the past.
- The activity makes a profit in some years (and the amount of profit it makes).
- You can expect to make a future profit from the appreciation of the assets used in the activity.