

Tax Tips

For Small Business

Winter
2007/2008

Deducting the Business Use of Your Home

Don't overlook your home office

If you use a portion of your home for business, you may be able to take a home office deduction whether you are self-employed or an employee. Expenses that you may be able to deduct for business use of the home may include the business portion of real estate taxes, mortgage interest, rent, utilities, insurance, depreciation, painting, and repairs.

You may claim this deduction for the business use of part of your home only if you use that part regularly and exclusively:

- As your principal place of business for any trade or business; or
- As a place to meet or deal with your patients, clients, or customers in the normal course of your trade or business.

Generally, the amount you can deduct depends on the percentage of your home that you used for business. Your deduction will be limited if your gross income from your business is less than your total business expenses. The percentage of your home used for business is based on either the total number of rooms or square footage. If you use a separate structure not attached to your home for an exclusive and regular part of your business, you can deduct expenses related to it.

If you are an employee, you have additional requirements to meet. The regular and exclusive business use must be for the convenience of your employer. This means you are not allowed a home-office deduction if your employer does not require you to work at home.



Electing to Expense the Cost of Your Business Assets

Section 179 deduction limits increase

The IRS allows taxpayers the option of either depreciating business assets over a specified number of years or deducting all or a portion of the cost in one year. The expense election, commonly referred to as the Section 179 deduction, is made in the year the asset is placed in service. The benefit is a large deduction in the current year that is not reduced even if the asset is placed in service late in the tax year.

The Section 179 deduction is not without other limits, however. For example, the most you are allowed to expense in 2007 is \$125,000, a \$17,000 increase over last year. If more than \$500,000 of qualifying property is placed in service, the Section 179 deduction is reduced dollar for dollar until the total investment reaches \$625,000, resulting in a deduction of zero. Additionally, your Section 179 deduction is limited to your taxable income from all your active trades or businesses, including wage income reported to you or your spouse on Form W-2.

If you elect to use the Section 179 deduction, you may change your mind and revoke the election. Conversely, if you do not make the election in the year the property was placed in service, you may amend your return and claim the deduction.

Employers of Tipped Employees Allowed a Tax Credit

Are you getting the credit you deserve?

If you are an employer in the food and beverage industry, you may be entitled to a tax credit for the social security and Medicare taxes you pay on your employees' tip income. You must meet both of the following requirements to qualify for the credit:

- You had employees who received tips from customers for providing, delivering, or serving food or beverages for consumption; and
- You paid or incurred employer social security and Medicare taxes on these tips.



The credit applies only to tips received by food and beverage employees. It is not applicable to other tipped employees.

The credit equals the social security and Medicare taxes you paid on the tips received by the employees. However, no credit is given for tips used to meet the federal minimum wage rate of \$5.15 per hour. For example, if you paid the employee \$3.75 per hour and applied tips of \$1.40 per hour to reach the \$5.15 minimum wage, then the \$1.40 per hour in tips cannot be used toward the credit. If, however, you paid each employee an amount equal to or more than the minimum wage without including tips, then you can compute the credit on all reported tips.

Since it is an income tax credit, claimed on an income tax return, you may use it to offset any regular income tax liability, but not employment tax liabilities. A credit is a dollar-for-dollar reduction of your regular tax liability, where an expense deduction only reduces your taxable income. Therefore, this credit can be more beneficial.



Tax Credit Available for Hiring Certain Employees

Work Opportunity Tax Credit saves employers tax dollars

The Work Opportunity Tax Credit (WOTC) is available to employers who hire individuals from one of nine targeted groups. Recent legislation extended the credit through August 31, 2011. To take the credit, the employee(s) you hire must be from one of the following targeted groups:

- Families eligible to receive benefits under the Temporary Assistance for Needy Families program.
- High-risk youths.
- Qualified ex-felons.
- Vocational rehabilitation referrals.
- Qualified summer youth employees.
- Qualified veterans.
- Families receiving food stamps.
- Persons receiving certain Supplemental Security Income (SSI) benefits.
- Qualified long-term assistance recipients.

The credit is generally 40 percent of qualified wages paid in the first year of employment, up to \$6,000 in wages for a maximum credit of \$2,400. The maximum credit for summer youth employees is \$1,200, which is 40 percent of the first \$3,000 of wages. Certain qualified veterans and long-term assistance recipients have higher limits.

New Rules for Spouses Who Operate a Business Together

Do you qualify for simplified reporting?

Spouses who operate a business together have a new option for reporting their business income. In the past, husband and wife joint owners were considered a partnership for reporting purposes. New rules, which took effect this year, give spouses the option of reporting their business income as two separate sole proprietorships.

Filing as two sole proprietorships reduces the number of returns that are required while reporting the income from the business just as before. The income and expenses from the business are allocated to each spouse based

QUIK TIPS

1 Use your credit card to buy equipment and supplies that you will need in the upcoming year. Charges on your credit card for deductible business expenses are allowed in the year you make the purchase, not in the year the charge is paid. Pay off your credit card after the beginning of the year and avoid finance charges.

2 If you are a self-employed taxpayer, you may deduct 100 percent of your health insurance premiums from your income. The deduction for health insurance premiums does not reduce your self-employment tax, however.

3 If you have contributed personal assets, such as a computer or vehicle to your business, the lower of the fair market value or your cost basis of these assets qualifies as a business deduction, subject to depreciation limitations, beginning with the date of conversion.

4 The optional standard mileage rate for the business use of an automobile is 48.5 cents per mile in 2007.

5 Truck drivers and other employees who are subject to the Department of Transportation's "hours of service" rules are allowed to deduct 75 percent of their meals in 2007. In lieu of using actual expenses for meals and incidental expenses, you can deduct the federal rate of \$52 per day.

6 If you are an eligible home builder, you may claim a business credit for each qualified new energy efficient home that you construct and which is acquired from you for use as a personal residence. The credit is either \$2,000 for a 50-percent energy reduction in energy usage, or \$1,000 for a 30-percent energy reduction in energy usage. The credit is extended for one more year through December 31, 2008.

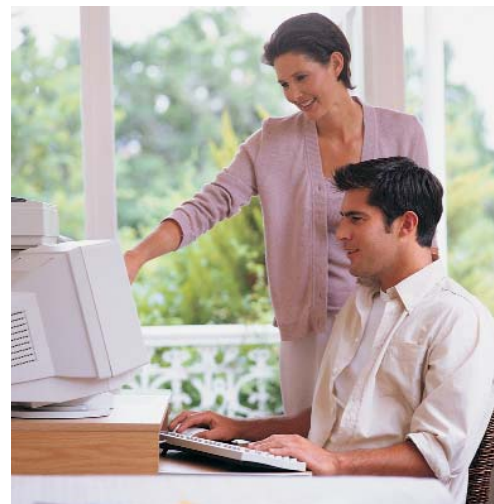


on their respective ownership interest. In most cases, income and expenses are split equally. Each spouse will report their share of the net earnings and pay self-employment tax on the total.

There are a few key points to consider before making this election. First, the spouses must file a joint return. Second, the spouses can be the only owners of the business. Third, each spouse must agree to the treatment as sole proprietorships. And lastly, both spouses must materially participate in the trade or business.

Employee Meals: When Does the 50-Percent Limit Apply?

Don't reduce your deduction if you aren't required to



In most cases, an employer is only allowed to deduct one-half of the expense that is paid to employees for meals. However, in some instances, the full amount is allowed.

If you have an eating facility on your business premises, and you provide meals to at least half of your employees as a convenience to you, then the full amount of the meals is deductible as a business expense.

An allowance you pay to your employees for meals is allowed in full as an expense to you if you include the reimbursement as compensation to your employees.

If you pay a per diem to your employees for meals, and they account to you for the cost, or you pay them a per diem at the federal per diem rate, you are only allowed a deduction for 50 percent of what you pay. The cost is not included on their W-2.

De minimis costs for food or beverages are also allowed in full as a business expense. A de minimis cost is one in which the frequency you provide the benefit is so small that accounting for it would be unreasonable or impractical. De minimis costs for meals include a holiday party, group meals or picnics, traditional holiday gifts of turkeys or hams, or coffee and donuts.

Clothing for Your Job is Not Always Deductible

Understanding the rules

Many taxpayers are required to maintain a certain personal appearance or wear special clothing for work. However, not all your purchases for work-related attire or personal grooming reap a tax deduction. If you are required to wear a uniform or other special clothing that has the name of your employer or some other logo on it,



that cost is deductible as a miscellaneous employee business deduction.

Other employees, such as models, flight attendants, or other professionals who are required to maintain a highly professional, well-groomed appearance, may find that the cost of their expensive clothing and cosmetics will not save tax dollars. Even if your employer tells you that you must wear certain clothing, if it is not in the nature of a uniform, the cost is personal.

Remember, the general rule of thumb is that if the clothing is suitable for every-day wear, it's not deductible.