

THE POWER OF PRO-ACTIVE TAX PLANNING FOR YOUR CLOSELY HELD BUSINESS!

Control - You have no control over the economy, sales volume, interest rates, vendor prices or general overhead cost increases. You can control the line-item dedicated to "income tax expense". Thus, every dollar saved/deferred is a bonus for your pocketbook!

Attitude -

- * Fear of change.
- * Misunderstanding of whom ideas may benefit.
- * Fear of audit (attention).
- * Misunderstanding the degree that ideas can affect your cash flows.
- * Focus on overall family savings.

Myths -

- "Only big companies incorporate."
- "Don't incorporate because of the double taxation!"
- "Everyone should be an LLC."
- "Until I make big money, stay as a proprietorship."
- "My sideline business is only a hobby – thus of no use on taxes".
- "The costs/formalities of new ideas outweigh the benefits."

Pro-active Tax Planning - What is it?

It's a strategy to:

- defer income
- accelerate deductions
- convert capital loss to ordinary
- convert ordinary income to capital gain
- use like-kind exchanges
- switch taxable income to tax-free
- shift income (minor kids, elderly parents, etc.)
- use O.P.M. (debt)
- make a proper entity choice

Plus take advantage of things like:

- 1-person 401-k plans.
- Use non-deductible IRA's (If not qualified for Roth or Traditional).
- Shifting \$1500 of income to kids (under age 14).

- Gifting capital gain property to over age 14 kids prior to its sale.
- Starting Roth IRA's for kids.
- Thinking "out of the box" to avoid AMT traps.
- Unconvert/reconverting Roths.
- Lease vs. buy decisions.
- Using a formal barter group.
- Cash basis vs. accrual basis choices.
- Establishing a Nevada corporation to "manage" your operations.
- Re-evaluating repair vs. capitalize decisions.

Are You in the Right Entity?

Where are you in the life-cycle of your business?

- ▶ Start-Up/Cyclical (Losses).....What are these worth now to you as owner? Can you even deduct them all now (basis limits)?
- ▶ Profitable Years -
 - The "bracket-spread" (C-corp vs. other choices)
 - The self-employment tax monster.
 - Spin-off asset ownership vs. the operations of the business.
 - Split-up ownership within the family.

Conclusion:

It's OK to change numerous times during the lifespan and also OK to create separate entities for certain segments of your operation.

Are You Taking Out Compensation in the Best Way?

- Draining all from entity bank accounts.
- Leaving all cash in the accounts.
- Calling everything a wage/bonus.
- Use of rent, fringes, "controlled" loans and the like.
- In-kind (Trips, annual meetings, etc.)

Conclusion:

Make fringes a bigger part of your rewards. It can be like free money (if set up properly).

WHAT FORM OF BUSINESS?

Choosing the proper entity to utilize for your business venture is as important of a choice as the business itself. The proper entity upon inception may be valid for the lifetime of the venture, but likely new circumstances and laws will inspire you to alter the entity choice numerous times throughout its career.

The usual choices are from among the following (though there may sometime be a need for sophisticated choices such as family limited partnerships, personal holding companies, etc.).

- * Sole Proprietorship
- * Partnership
- * S Corporation
- * C Corporation
- * Limited Liability Company

These all have differences on various characteristics that may have different priorities to different folks. These main categories are:

- * Liability of Business Owners
- * Tax Consequences
- * Fringe Benefits
- * Formalities Required
- * Costs and Miscellaneous Issues

Though specific projections are needed for your situation, a general guideline on the pro/con of each entity on the key issues are:

	<u>Proprietor</u>	<u>Partnership</u>	<u>S-Corp.</u>	<u>C-Corp.</u>	<u>L.L.C.</u>
Personal Liability	-	-	X	X	X
Tax Rates/Control	-	-	X	X	-
Fringes Deductible	-	-	-	X	-
Formalities	X	-	-	-	X
Choices (of yr-end, acctg method, etc.)	-	-	-	X	-
Transferability	-	X	X	X	-

(X = an advantage)

Fringes -

(The pecking order – best to worst.)

- Deductible and tax-free.
- Deductible and tax-deferred.
- Deductible and taxable.
- Non-Deductible and tax-free.
- Non-Deductible and taxable.

Some are for owners only – some can be for all!

(Beware of 2% owner rules if Sub-S, partnership, proprietor, etc.)

Maximize Other Options -

- Business use of home.
- Actual vehicle costs vs. IRS mileage rates.
- Daily meals and entertainment per diem.
- \$75 travel & entertainment limit. (proof)
- Added Sec. 179 expensing opportunities.
- Housing allowances. (farmers, etc.)
- Employee vs. independent contractor choices.
- Hiring kids. (minor)
- “Accountable” plans for vehicles.
- Merit bonuses up to \$1600. (per Section 274j2)
- Educational assistance (up to \$5250/recipient) per Section 132.
- Investing idle money. (Corporate dividend exclusion, full passive loss write-offs, etc.)

POSSIBLE BUSINESS OWNER PERKS

- * \$50,000. of Group Term Life Insurance
- * Pre-Tax Premiums for Whole Life Insurance
- * Key-Man and Split-Dollar Life Insurance
- * Group Medical-Related Coverage
- * Disability Coverage
- * Medical Reimbursement Plans
- * Cafeteria Plan
- * Merit Performance Bonuses (Sec. 274j2) up to \$1,600. per Person.
- * Deferred Compensation
- * Retirement Plans (SEP, SAR-SEP, Profit Sharing, Pension, 401-K, Etc.)
- * V.E.B.A. Plans
- * S.E.R.P.
- * Flex Plans (Childcare, Legal and Other Repayments)
- * Auto Allowance/Company Car
- * Director Fees
- * Pay to Minor Children or Elderly Parents
- * Bargain Loans
- * \$5,000. Death Benefit Payout
- * Moving/Living Costs
- * Educational Assistance
- * Personal Financial Counseling
- * Travel and Entertainment, Recreational Dues, Etc.
- * Family Vacations (Annual Meetings, Etc.)
- * Bargain Discounts on Purchases
- * Phantom Stock Plan

The Proper Retirement Plan -

- For owners or for all workers?
- Annually or only when profitable?
- Qualified vs. non-qualified styles?
- Unique plans (418(i), V.U.L., etc.)

Use of Special Elections?

- 30% front-end depreciation. (Federal only)
- Sec. 179 expensing.
- LLC - Choice of taxation can change.
- Like-kind exchanges.
- Fiscal year-end of business (vs. December 31).

The Advantages of CONTROLLING Your AGI!

It's not just for the obvious tax reduction, but if your AGI is too high, you may not benefit from all/some of your:

- ▶ Dependency exemptions.
- ▶ Medical & miscellaneous deductions.
- ▶ Overall itemized deductions.
- ▶ Traditional/Roth IRA pay-ins.
- ▶ Educational credits, IRA's, & costs.
- ▶ Student loan interest expenses.
- ▶ Childcare & child tax credits.
- ▶ Passive rental losses.
- ▶ Adoption costs.
- ▶ Tax-free Social Security benefits.
- ▶ Retirement savings credit.
- ▶ Earned income credit.
- ▶ AMT protection.

(PLUS, it establishes your starting "base" of income for state purposes.)

Thus, the standard "flow-through" routine of a proprietorship, partnership, S-corp and some L.L.C.'s may be costing you even more tax dollars every year!

(i.e., lost opportunity to claim the above items!)

Hypothetical Example of Tax Savings for:
"A & A Widgetmakers"

Current Scenario:

Sole Proprietor – no other employees.
\$75,000 annual income (their only source) after depreciation.
2 kids (teenagers)
\$5,000 out-of-pocket medical/dental costs annually.
Works out of home (shop/garage) – 25% usage.
New capital equipment purchases of \$40,000/year.
Family needs \$1,000 per week for living costs.

Current Federal Tax:

\$ 75,000.	Schedule C
<u>(5,299.)</u>	- ½ Self-employment tax
\$ 69,701.	AGI
(12,000.)	- Exemptions
<u>(7,850.)</u>	- Standard deduction
<u>\$ 49,851.</u>	Taxable Income
\$ 6,056.	Regular tax – (\$7,256 - \$1,200 child credits)
<u>10,597.</u>	Self-employment tax
<u>\$ 16,653.</u>	Total Federal Taxes

Simple Changes to Make:

- Create a 'C' corporation to operate business.
- Corporation rents use of homestead at \$1,000 per month.
- Parents pay kids each \$4,000 per year for help.
- ½ of new capital items are bought personally (& rented to corp.)
- A medical reimbursement plan is created (for out-of-pocket expenses).
- Parents take out salary of \$27,000 gross.

New Federal Tax Picture:

<u>(Personal)</u>		<u>(C-Corp)</u>	
\$ 27,000.	W-2	\$ 75,000.	Initial income
<u>0</u>	Net Rent (12-4-8)	4,000.	Depreciation adjustment
\$ 27,000.	AGI	(12,000.)	Rentals paid
(12,000.)	Exemptions	(5,000.)	Med. Reimbursement Plan
<u>(7,850.)</u>	Std. Deductions	(27,000.)	Salary
<u>\$ 7,150.</u>	Taxable	<u>(2,500.)</u>	Payroll Taxes
		<u>\$ 32,500.</u>	Taxable

Regular tax \$ 715.
FICA tax 2,066.
\$ 2,781.
- child credits (1,200.)

Net \$ 1,581.

Taxes = \$ 4,875. Income
+ 2,500. Payroll Taxes

Total \$ 7,375.

COMBINED TAX = \$8,956.

= AN ANNUAL SAVINGS OF \$7,697!! (FEDERAL ONLY)