Take a Bite Out of Your Tax Bill

By Geoffrey Goudy, CPA

As a business succeeds its tax bills begin to rise. Over time the dollars and anguish are real. There is no perfect solution yet certain smart options exist even for the smallest of enterprises.

S Corporation

The most onerous tax burden to bear is the Federal self-employment tax for Schedule C filers. Often a hobby turns into a side business and sometimes a career. As a business matures, owners seek liability protection and valid deductions. Once these efforts are achieved or are exhausted, owners turn to their financial advisors for further suggestions.

The simplest and most effective suggestion is to elect S Corporation status for a single-owner limited liability company, which by default is treated as a sole proprietorship that is required to file Schedule C. Yet, the Internal Revenue Service permits this type of entity to be treated as an S Corporation for *tax* purposes while retaining its limited liability company structure for *legal* purposes.

Thus, rather than have the entire amount of business income subject to both self-employment and income tax, the owner can instead determine the appropriate salary and return of capital allocations. And as an S Corporation, expenses such as owner payroll taxes and retirement plan contributions are deducted at the entity level, not at the individual level.

And the most important consideration, under IRS Revenue Procedure 2004-48, a business can make this election up to eight and a half months after the business's year-end. Thus, a sort of "do-over" decision can be made after all business facts and circumstances have been determined for a particular tax year. A smart option indeed should an entity warrant change.

Please note that C Corporations, partnerships, and multi-member limited liability companies can also elect S Corporation status under separate regulation. However, strict sole proprietorships, a non-legal entity, cannot.

Single-Participant 401(k) Plan

Most business owners immediately consider a SEP retirement arrangement for their small business. It's low-cost, simple to set up, and the logical plan for the Schedule C filer. A better plan, in most instances, exists for those business owners who draw W-2 compensation.

The single-participant 401(k) plan is an extremely effective tool to set aside funds for future retirement needs and to reduce current federal and state income taxes. The following example best highlights its effectiveness:

Gross compensation	$16,250
Employee 401(k) contribution	(15,000)
FICA/Medicare withholding (7.65%)	(1,243)
Federal withholding	(7)
State Withholding	( )
Net Compensation	$ 0
Business Return: wage deduction	$16,250
Individual Return: wage income	$ 1,250

Further, the business can contribute an additional 25% of compensation for employer contribution purposes or $4,063 for the example above. Further still, a spouse can also participate under this plan arrangement as long as the spouse is gainfully employed by the business and earns remuneration. Yes, a smart option indeed if maximum plan funding is desired and funds are available.

Please note that a SEP is often the appropriate retirement vehicle if you are unable to max out the 401(k) plan.

Health Savings Account

I hesitate to discuss the next suggestion as the U.S. tax code continues to change significantly with each passing year. Health savings accounts (HSA) are becoming a popular tool to combat the rising cost of health care and poor use of medical services.

At its core, health savings accounts marry a high-deductible health insurance policy with an investment vehicle. Fortunately, amounts permitted for account deposit have risen sharply since its predecessor, medical savings accounts, and insurance agents have wisely suggested GAP protection for those fearful of buying solely a high-deductible arrangement.

Plus the HSA marketplace has made it relatively seamless to report medical charges to and withdraw appropriate funds from your account as insurance and investment can be offered by the same umbrella company. And unused amounts can be set aside for future needs, years down the road. The one drawback is that the HSA is extremely date sensitive due to implementation rules.

The best feature is, however, the tax deduction extended to those participating in an HSA. For a single participate, up to $2,700 can be deposited into the account during the tax year. The entire $2,700 can be withdrawn for medical or dental purposes, yet $2,700 is the allowable tax deduction even though the account balance is $0. A smart option indeed should health conditions permit and risk factors are fully understood.

Facility Ownership

The last suggestion centers on an age-old question: whether to rent or to buy your facility. I'm certain many would advise that it is foolish to throw "rent" money down the drain. Still, you must ask yourself and answer honestly before acquiring real property: Can I handle the debt load? How will I react in a time crisis? Am I really suited to be a landlord or property baron?

I will not argue whether real estate is a great investment or whether asset diversification is wise. Instead, I argue that ownership of real estate, similar to ownership of a small business, permits deductibility of expenditures not otherwise permitted as a renter or employee.

With ownership comes responsibility and independence, and, in many income tax situations, an annual "loss" due to an accounting feature called depreciation. Depreciation is an expense where the cost of the property, excluding land value, is deducted evenly over the estimated life of the asset, generally 39 1/2 years for permanent structures.

Please bear in mind, however, that these depreciation deductions will reduce your cost basis in the property and accordingly, increase your taxable gain upon sale or disposition. Regardless, a smart option indeed should finances permit purchase. And please note much of this same discussion applies to motor homes.

In Closing

I've offered immediate, near- and long-term suggestions to take a bite out of your tax bill. Just as they're no two similar businesses, these suggestions are not designed to fit every need and circumstance. Therefore, please actively engage your financial advisor as questions and concerns arise. Remember, your dog jumps through hoops, shouldn't your accountant?

Geoffrey Goudy is a certified public accountant, has been in practice for 16 years, and has participated in canine sporting events since the mid-90s. Go to CSpotCount.com/CanineSport.asp to learn more about or to direct questions to Geoffrey and his practice.

Retirement Plans

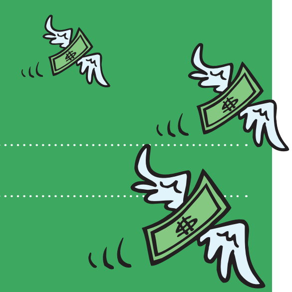
	SEP	Solo 401k
Ideal for Business with	variable cash flows	stable cash flows
IRS Return Requirement	none	Form 5500-EZ if assets > $100K
Age 50+ Catchup	no	yes
Permitted Participation	owner only	owner + spouse
Set-up Deadline	tax return filing due date	business's year-end
Contribution Deadline	tax return filing due date	employee - 15 days after deferral employer - tax return filing due date

Health Savings Accounts

Tax Year: 2006

Coverage	Minimum Deductible	Maximum Out-of-Pocket	Maximum Contribution
Single	1,050	5,250	2,700
Family	2,100	10,500	5,450

Facility Ownership



Structure	100,000
Land	25,000
Acquisition Cost	125,000

Depreciation: $100,000 / 39 years = $2,564/yr

Sales Price	250,000
Less Acquisition Cost	(125,000)
Add Accumulated Depreciation	25,640
Realized Gain	150,640