

Tax Tips

Summer 2004

For Small Business

Deduction Limits for Business Automobiles

The truth about sport-utility vehicles (SUVs)

Depreciation deductions for automobiles with an unloaded gross vehicle weight rating of 6,000 pounds or less are limited under the tax rules (for trucks or vans, the IRS allows a gross vehicle weight rating of 6,000 pounds or less). If you place a four-wheel passenger vehicle in service for use in a trade or business in 2004, the depreciation allowance in the first year is limited to \$2,960. If you purchase and place in service a light truck or a van, the limitation increases to \$3,260. These amounts increase if you're eligible to take the 30% or 50% bonus depreciation.

The deduction limits are a bit higher if you purchase an SUV for use in your trade or business. Typically, an SUV has a loaded gross vehicle weight rating in excess of 6,000 pounds. Several of the more popular SUVs such as the Chevrolet Suburban, Toyota Land Cruiser, Ford Excursion, etc. are heavy enough to be rated for gross vehicle weight in excess of 6,000 pounds. These vehicles are eligible for the higher depreciation deductions, including the section 179. What this means is that if you purchase a Cadillac Escalade for \$60,000 and use it 100% in your business, you can essentially deduct the entire cost. Other rules for claiming the section 179 deduction also apply.

New Rules for Claiming the Standard Mileage Rate

More taxpayers are eligible

If you in use no more than four vehicles at the same time for business purposes, you may use the standard mileage rate of 37.5¢, starting 2004. In prior years, if you used more than one

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vehicle at a time, you could not use the standard rate at all, leaving you to track the actual expenses for each vehicle. You may not use the standard mileage rate for any vehicle if any of the following apply:

- You used any depreciation method under the Modified Accelerated Cost Recovery System (MACRS);
- You claimed a section 179 deduction for that vehicle; or
- You used the vehicle for hire.



Looking for a New Employee?

The answer may be in your own home

Here are six outstanding tax-related reasons to consider placing your spouse on the company payroll:

Medical Insurance. If your business is operated as a sole proprietorship, employing your spouse and providing family health insurance coverage as a tax-free fringe benefit will allow you to fully deduct the health insurance premiums from your business income. This will reduce the amount of self-employment tax you pay. Generally, self-employed taxpayers deduct 100% of medical insurance premiums as an adjustment to income, which will have no effect on the self-employment tax you pay. With this arrangement, sole proprietors are covered under their spouse's family plan and will benefit from a savings in self-employment tax.

Increased Pension Contributions. Generally, only the first \$205,000 (for 2004) of salary can be taken into account when computing allowable contributions to

most qualified retirement plans. If your salary is more than that, putting your spouse on the payroll and shifting some of your salary in excess of \$205,000 to your spouse will increase your combined retirement contributions.

Child Care Deduction. Putting your spouse on the payroll will make you eligible to claim a credit for expenses incurred for child care. The size of the credit depends on two things – how much you pay for child care and your adjusted gross income. The maximum allowable credit for two or more children can be computed using up to \$6,000 of qualified expenses. If only one spouse earns a wage, with a few exceptions, no credit for child care is allowed.

Business Trips. If you take business trips, you are not allowed to deduct your spouse's expenses if he or she accompanies you. If your spouse is a bona fide employee, you have just turned nondeductible personal expenses into deductible business expenses.

Avoid Double Tax. If you operate your business as a C corporation, paying a salary to your spouse allows you to take earnings out of the corporation without paying a double tax. For example, if you take money out of a C corporation as a dividend, you'll pay a tax on the original earnings by the C corporation and then another tax on the shareholder's return when you receive the dividend. Money you take out of a C corporation for salary is taxed only once – to the employee.

Social Security. If your spouse isn't currently employed, or is not earning enough wages to reach the social security maximum, collecting a salary from your business may increase his or her future social security benefits.

However, a word of caution – if you employ your spouse, you have to pay payroll taxes on the additional salary. Payment of the payroll taxes may offset some of the benefits gained by putting your spouse on the payroll. Also, your spouse must be a bona fide employee who performs legitimate work for the business and collects a reasonable wage for the services performed.

Did You Close a Business This Year?

**Expenses you continue to pay
may be deductible**

Just because you closed your business doesn't mean you are finished paying the expenses. Often, all the expenses of operating a business continue long after the business has stopped operating. You are allowed to deduct all the ordinary and necessary expenses of operating a business even though you no longer have income from that business. The most common expenses are interest and taxes.

If you are still paying expenses of a former business, these costs are generally deducted on the same business form where you reported the income. Make certain your tax preparer is aware of these expenses.

Should You Contribute Property to Your Business?

**Tax treatment varies depending on the type
of business entity**

Regardless if you operate a sole proprietorship, partnership, or corporation, the nagging question of whether to retitle and contribute property to the business prevails. The type of business entity you operate may make a difference in the decision you make. Here are some points to consider:

If you are operating a sole proprietorship, converting personal property to business

QUICK TIPS

1 For 2004, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck increases from 36 cents a mile to 37½ cents a mile for all business miles.

2 The maximum section 179 deduction you can elect for property you place in service in 2004 has increased to \$102,000 for qualified section 179 property. This limit is reduced by the amount of eligible section 179 property placed in service during the tax year that exceeds \$410,000.

3 The self-employment tax rate on net earnings remains the same for 2004. This 15.3% rate is the total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance). The maximum amount subject to the social security portion for tax years beginning in 2004 increases to \$87,900. All net earnings of at least \$400 are subject to Medicare.

4 Beginning in 2004, environmental cleanup costs must be capitalized. You cannot choose to deduct environmental cleanup costs paid or incurred after December 31, 2003, as a current business expense.

5 Generally, you can deduct only 50% of your business-related meal expenses while traveling away from your tax home for business purposes. Also, you can generally deduct only 50% of certain reimbursements you make to your employees for meal expenses they incur while traveling away from home on business. You can deduct a higher percentage if the meals take place during or incident to any period subject to the Department of Transportation's "hours of service" limits. These limits apply to workers who are under certain federal regulations. The percentage increases to 70% for 2004.

6 Travel expenses to a temporary work site are deductible if the assignment is reasonably expected to last one year or less, and actually does. Deductible expenses include costs incurred for travel, meals, and lodging. If the temporary job assignment is expected to last less than a year and actually lasts longer than one year, only the expenses incurred up to the time it is determined that the job will last longer than one year are allowed. If the assignment is expected to last longer than one year, but you finish the assignment in less than one year, none of the expenses are allowed. The key factor for determining the deductibility of expenses is how long the assignment is expected to last.

property is a reasonably simple and tax-free event. You do not necessarily need to retitle the property because a sole proprietorship is not a separate entity from yourself.

Different rules apply to a contribution of property versus a sale or exchange of property between a partnership and its partners. A partner should attach a disclosure statement to his or her return if the partner contributes property to a partnership and, within two years (before or after the contribution), the partnership transfers money or other consideration to the partner.

There is an important tax consequence for shareholders who contribute property to their corporation. Property such as real estate may appreciate in value. If it does, the resulting gain distributed to the shareholders is taxable to them and the corporation. This is known as double taxation because both the corporation and the shareholders are taxed on the gain.

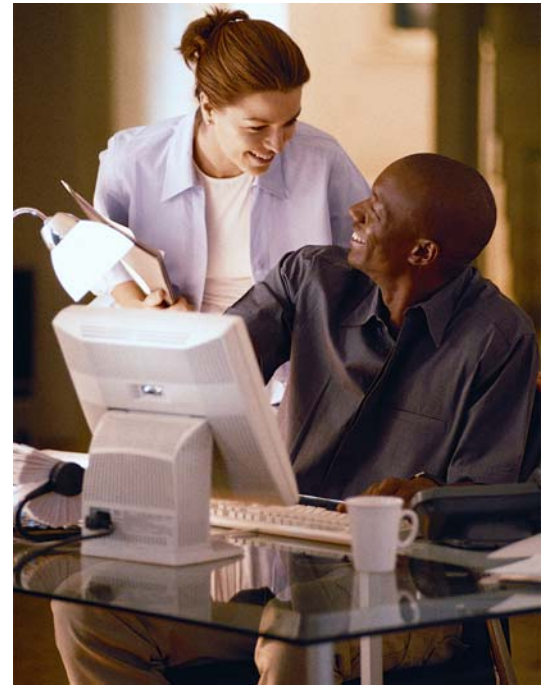
Employer Identification Numbers

When do you need one?

There are several instances when you will need to apply for a federal employer identification number. The most common instance is when you are operating a business and you have employees. If you are operating a sole proprietorship and you do not have any employees, your social security number is all that is necessary.

If you are a sole proprietor and you currently have an employer identification number, you will need to get a new one if you convert to a partnership or corporation. If you convert to a limited liability company, you will only need a new employer identification number if you choose to be taxed as a corporation or partnership.

You will not need a new employer identification number if you only change the name or location of your business, or if you operate at more than one business location. You may not transfer or sell your employer identification number, even if you are transferring your business to a spouse or other family member.



Meal Rates for Day Care Providers

Keeping track of meal expenses is easier than ever

If you provide day care services in your home, some of the most difficult expenses to track are meals. The IRS has made it easier for you by allowing a standard meal rate that you can use in lieu of actual expenses. The following meal rates are allowed for 2004:

Meal	Alaska	Hawaii	All Other States
Breakfast	\$1.57	\$1.15	\$0.99
Lunch/Dinner	\$2.97	\$2.141	\$1.83
Snack (2)	\$0.88	\$0.63	\$0.54