TAX STRATEGIES FOR BUSINESS OWNERS

Tax Planning For Small Business Owners

Tax planning is the process of looking at various tax options to determine when, whether, and how to conduct business and personal transactions to reduce or eliminate tax liability.

Many small business owners ignore tax planning. They don't even think about their taxes until it's time to meet with their accountants, but tax planning is an ongoing process, and good tax advice is a valuable commodity. It is to your benefit to review your income and expenses monthly and meet with your CPA or tax advisor quarterly to analyze how you can take full advantage of the provisions, credits, and deductions that are legally available to you.

Although tax avoidance planning is legal, tax evasion - reducing the amount of tax owed through deceit, fraud, or concealment - is not. Frequently what sets tax evasion apart from tax avoidance is the IRS's finding that there was fraudulent intent on the part of the business owner. The following are four of the areas the IRS examiners commonly focus on as pointing to possible fraud:

1. Failure to report substantial amounts of income such as a shareholder's failure to report dividends or a store owner's failure to report a portion of the daily business receipts.
2. Claims for fictitious or improper deductions on a return, such as a sales representative's substantial overstatement of travel expenses or a taxpayer's claim of a large deduction for charitable contributions when no verification exists.
3. Accounting irregularities such as a business's failure to keep adequate records or a discrepancy between amounts reported on a corporation's return and amounts reported on its financial statements.
4. Improper allocation of income to a related taxpayer in a lower tax bracket, such as where a corporation makes distributions to the controlling shareholder's children.

Tax Planning Strategies

Countless tax planning strategies are available to small business owners. Some tax strategies target the owner's individual tax situation, and some target the business itself.

Regardless of how simple or how complex a tax strategy is; however, it will be based on structuring the tax strategy to accomplish one or more of these often-overlapping goals:

- Reducing the amount of taxable income
- Lowering your tax rate
- Controlling the time when the tax must be paid
- Claiming any available tax credits and deductions
- Controlling the effects of the Alternative Minimum Tax
- Avoiding the most common tax planning mistakes

To plan effectively, you'll need to estimate your personal and business income for the next few years. Many tax planning strategies will save tax dollars at one income level but create a larger tax bill at other income levels. You will want to avoid having the "right" tax plan made "wrong" by erroneous income projections. Once you know your approximate income, you can take the next step: estimating your tax bracket.

You should already be projecting your sales revenues, income, and cash flow for general business planning purposes. The better your estimates are, the better the odds that your tax planning efforts will succeed.

Maximizing Business Expenses

Business meal expenses are legitimate deductions that can lower your tax bill and save you money, provided you follow certain guidelines. Business must be discussed before, during, or after the meal to qualify as a deduction. Furthermore, the surroundings must be conducive to a business discussion. For instance, a small, quiet restaurant would be an ideal location for a business dinner. A nightclub would not.

Under the Tax Cuts and Jobs Act of 2017, the deduction remains at 50 percent for taxpayers who incur food and beverage expenses associated with operating a trade or business. Employee meals while on business travel also remain deductible at 50 percent. For tax years 2018 through 2025, the 50 percent deduction expands to include expenses incurred for meals furnished to employees for the employer's convenience. Amounts after 2025 are not deductible, however.

> In 2021 and 2022, food and beverages are 100% deductible if purchased from a restaurant (Consolidated Appropriations Act of 2021).

Under the TCJA, the deduction for business entertainment expenses was eliminated. Meals still qualify at 50 percent (except for tax years 2021 and 2022, as noted above), but costs must be listed separately.

Important Business Automobile Deductions

If you use your car for business, such as visiting clients or going to business meetings away from your regular workplace, you may be able to take certain deductions for the cost of operating and maintaining your vehicle. You can deduct car expenses by taking either the standard mileage rate or using actual expenses. The mileage reimbursement rate for 2022 is 58.5 cents per business mile (up from 56 cents per business mile in 2021).

If you own two cars, another way to increase deductions is to include both cars in your deductions. This deduction works because business miles driven is determined by business use. To figure business use, divide the business miles driven by the total miles driven. This strategy can result in significant deductions. Whichever method you decide to use to take the deduction, always keep accurate records such as a mileage log and receipts.

Increase Your Bottom Line When You Work At Home

The home office deduction is quite possibly one of the most difficult deductions ever to come around the block. Yet, there are so many tax advantages it becomes worth the navigational trouble. Here are a few common tips for home office deductions that can make tax season significantly less traumatic for those of you with a home office.

Strategies such as prominently displaying your home phone number and address on business cards, having business guests sign a guest log book when they visit your office, as well as deducting long-distance phone charges, keeping a time and work activity log, retaining receipts, and paid invoices all help make a case for a home office. Keeping these receipts makes it so much easier to determine percentages of deductions later on in the year.

Section 179 expensing for tax year 2022 allows you to immediately deduct, rather than depreciate over time, $1.08 million of the first $2.70 million of qualifying equipment placed in service during the current tax year. Equipment can be new or used and includes certain software. All depreciable equipment in a home office meets the qualification. Indexed to inflation for tax years after 2018, the deduction was enhanced under the Tax Cuts and Jobs Act of 2017 to include improvements to nonresidential qualified real property such as roofs, fire protection, alarm systems, security systems, and heating, ventilation, and air-conditioning systems.

The "Bonus Depreciation" for qualified assets (new equipment only - no used equipment and no software) placed in service for tax years 2015, 2016, and through September 26, 2017, is 50 percent. Businesses with eligible property placed in service after September 27, 2017, and before January 1, 2023, are allowed to deduct 100 percent of the cost immediately. The bonus depreciation will be phased downward over four years: 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026.

Some deductions can be taken whether or not you qualify for the home office deduction itself. Consider meeting with a tax professional to learn more about home office deductions.

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7 Biggest Misconceptions Business Owners Have About Their Returns

One of the biggest hurdles you'll face in running your own business is staying on top of your numerous obligations to federal, state, and local tax agencies. Tax codes seem to be in a constant state of flux, making the Internal Revenue Code barely understandable to most people.

The old legal saying that "ignorance of the law is no excuse" is perhaps most often applied in tax settings. It is safe to assume that a tax auditor presenting an assessment of additional taxes, penalties, and interest will not look kindly on an "I didn't know I was required to do that" claim. On the flip side, it is surprising how many small businesses overpay their taxes, neglecting to take deductions they're legally entitled to that can help them lower their tax bill.

Preparing your taxes and strategizing as to how to keep more of your hard-earned dollars in your pocket becomes increasingly difficult with each passing year. Your best course of action to save time, frustration, money, and an auditor knocking on your door, is to have a professional accountant handle your taxes.

Tax professionals have years of experience with tax preparation, religiously attend tax seminars, read scores of journals, magazines, and monthly tax tips, among other things, to correctly interpret the changing tax code.

When it comes to tax planning for small businesses, the complexity of tax law generates a lot of folklore and misinformation that also leads to costly mistakes. With that in mind, here is a look at some of the more common small business tax misperceptions.

1. All Start-up Costs Are Immediately Deductible

Business start-up costs refer to expenses incurred before you begin operating your business. Business start-up costs include both start-up and organizational costs and vary depending on the type of business. Examples of these types of costs include advertising, travel, surveys, and training. These start-up and organizational costs are generally called capital expenditures.

Costs for a particular asset (such as machinery or office equipment) are recovered through depreciation or Section 179 expensing. When you start a business, you can elect to deduct or amortize certain business start-up costs.

You can elect to deduct up to $5,000 of business start-up and $5,000 of organizational costs paid or incurred; however, the $5,000 deduction is reduced by the amount your total start-up or organizational costs exceed $50,000, and any remaining costs must be amortized.

2. Overpaying the IRS Makes You "Audit Proof"

The IRS doesn't care if you pay the right amount of taxes or overpay your taxes. They do care if you pay less than you owe and you can't substantiate your deductions. Even if you overpay in one area, the IRS will still hit you with interest and penalties if you underpay in another. It is never a good idea to knowingly or unknowingly overpay the IRS. The best way to "Audit Proof" yourself is to properly document your expenses and make sure you are getting good advice from your tax accountant.

3. You Can Take More Deductions if You Are Incorporated

Self-employed individuals (sole proprietors and S Corps) qualify for many of the same deductions that incorporated businesses do, and for many small businesses, being incorporated is an unnecessary expense and burden. Start-ups can spend thousands of dollars in legal and accounting fees setting up a corporation, only to discover soon thereafter that they need to change their name or move the company in a different direction. In addition, plenty of small business owners who incorporate don't make money for the first few years and find themselves saddled with minimum corporate tax payments and no income.

4. The Home Office Deduction Is a Red Flag for an Audit

While it used to be a red flag, this is no longer true as long as you keep excellent records that satisfy IRS requirements. Because of the proliferation of home offices, tax officials cannot possibly audit all tax returns containing the home office deduction. In other words, there is no need to fear an audit just because you take the home office deduction. A high deduction-to-income ratio, however, may raise a red flag and lead to an audit.

5. Business Expenses Are Not Deductible if You Don't Take the Home Office Deduction

You are still eligible to take deductions for business supplies, business-related phone bills, travel expenses, printing, wages paid to employees or contract workers, depreciation of equipment used for your business, and other expenses related to running a home-based business, whether or not you take the home office deduction.

> Tax reform legislation passed in 2017 repealed certain itemized deductions on Schedule A, *Itemized Deductions* of Form 1040 for tax years 2018 through 2025, including employee business expense deductions related to home office use.

6. Requesting an Extension on Your Taxes Is an Extension To Pay Taxes

Extensions enable you to extend your filing date only. Penalties and interest begin accruing from the date your taxes are due.

7. Part-Time Business Owners Cannot Set Up Self-Employed Pension Plans

If you start up a company while you have a salaried position complete with a 401K plan, you can still set up a SEP-IRA for your business and take the deduction.

Understanding how the tax system works is beneficial to any business owner, whether you run a small to medium-sized business or are a sole proprietor. Whether it is a missed payment or filing deadline, an improperly claimed deduction, or incomplete records, a tax headache is only one mistake away. Furthermore, even if you delegate the tax preparation to someone else, you are still liable for the accuracy of your tax returns.

Travel and Entertainment: Maximizing the Tax Benefits

Don't overpay your income taxes by overlooking expenses that you are entitled to deduct. Use this Financial Guide to ensure you are handling your business travel and meal costs in a tax-wise manner.

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This Financial Guide shows you how to take advantage of all of the travel and entertainment expenses you're legally entitled to and offers guidance on which expenses are deductible and what percentage of them you can deduct. It also discusses the importance of following IRS rules for keeping records and substantiating your expenses in order to avoid an audit.

Travel Expenses

Tax law allows you to deduct two types of travel expenses related to your business, local and what the IRS calls "away from home."

1. First, local travel expenses. You can deduct local transportation expenses incurred for business purposes, for example, the cost of getting from one location to another via public transportation, rental car, or your own automobile. Meals and incidentals are not deductible as travel expenses, although as you will read later in this guide, you can deduct meals as an entertainment expense as long as certain conditions are met.
2. Second, you can deduct away from home travel expenses-including meals and incidentals; however, if your employer reimburses your travel expenses, your deductions are limited.

Local Transportation Costs

The cost of local business transportation includes rail fare and bus fare, as well as the costs of using and maintaining an automobile used for business purposes. For those whose main place of business is their personal residence, business trips from the home office and back are considered deductible transportation and not non-deductible commuting.

You generally cannot deduct lodging and meals unless you stay away overnight. Meals may be partially deductible as an entertainment expense as discussed below.

Away From-Home Travel Expenses

Due to the economic devastation caused by the coronavirus pandemic, in 2021 and 2022, you are able to deduct 100 percent of the cost of business meals and beverages purchased from restaurants. Typically, you can only deduct one-half of the cost of meals (50 percent). Lodging expenses incurred while traveling away from home are fully deductible (no pandemic-related change). The IRS also allows you to deduct 100 percent of your transportation expenses as long as business is the primary reason for your trip.

> You do not need to eat the food at the restaurant; you can order take-out and still take the 100 percent deduction.

To be deductible, travel expenses must be "ordinary and necessary", although "necessary" is liberally defined as "helpful and appropriate," not "indispensable." The deduction is also denied for that part of any travel expense that is "lavish or extravagant," though this rule does not bar deducting the cost of first-class travel or deluxe accommodations or (subject to percentage limitations below) deluxe meals.

What does "away from home" mean?

To deduct the costs of lodging and meals (and incidentals-see below) you must generally stay somewhere overnight. In other words, away from your regular place of business longer than an ordinary day's work and you need to sleep or rest to meet the demands of your work while away from home. Otherwise, your costs are considered local transportation costs and the costs of lodging and meals are not deductible.

Where is your "home" for tax purposes?

The general view is that your "home" for travel expense purposes is your place of business or your post of duty. It is not where your family lives (some courts have stated that it's the general area of your residence). Here is an example:

> George's family lives in Boston and George works in Washington, DC. George spends the weekends in Boston and the weekdays in Washington, where he stays in a hotel and eats out. For tax purposes, George's "home" is in Washington, not Boston, therefore, he cannot deduct any of the following expenses: cost of traveling back and forth between Washington and Boston, cost of eating out in Washington, cost of staying in a hotel in Washington, or any costs incurred traveling between his hotel in Washington and his job in Washington (the latter are considered non-deductible commuting costs).

There are some rules in the tax law concerning where a taxpayer's "home" is for purposes of deducting travel expenses that are less clear such as when a taxpayer works at a temporary site or works in two different places.

We'll cover these rules briefly in these two examples:

> **Example #1:** Joe, who lives in Connecticut, works eight months out of the year in Connecticut (from which he usually earns about $50,000) and four months out of the year in Florida (from which he usually earns about $15,000). Joe's "tax home" for travel expense purposes is Connecticut. Therefore, the costs of traveling to and from the "lesser" place of employment (Florida), as well as meals and lodging costs incurred while working in Florida, are deductible.
>
> **Example #2:** Susan works and lives in New York. Occasionally, she must travel to Maryland on temporary assignments, where she spends up to a week at a time. Assuming Susan's employer does not reimburse her for travel expenses, she can deduct the costs of meals and lodging while she's in Maryland, as well as the costs of traveling to and from Maryland. This holds true because her work assignments in Maryland are considered temporary since they will end within a foreseeable time. If an assignment is considered indefinite, that is, expected to last for more than a year, under the tax law, travel, meal, and lodging costs are not deductible.

Here's a list of some deductible away-from-home travel expenses:

- Meals (100 percent in 2021 and 2022; limited to 50 percent in other years) and lodging while traveling or once you get to your away-from-home business destination.
- The cost of having your clothes cleaned and pressed away from home.
- Costs for telephone, fax or modem usage.
- Costs for secretarial services away-from-home.
- The costs of transportation between job sites or to and from hotels and terminals.
- Airfare, bus fare, rail fare, and charges related to shipping baggage or taking it with you.
- The cost of bringing or sending samples or displays, and of renting sample display rooms.
- The costs of keeping and operating a car, including garaging costs.
- The cost of keeping and operating an airplane, including hangar costs.
- Transportation costs between "temporary" job sites and hotels and restaurants.
- Incidentals, including computer rentals, stenographers' fees.
- Tips related to the above.

However, many away-from-home travel expenses are not deductible or are restricted in some way. These include:

Commuting expenses. The costs of traveling between your home and your job are not deductible.

Travel as a form of education. Trips that are educational in a general way, or improve knowledge of a certain field but are not part of a taxpayer's job, are not deductible.

Job search expenses. Tax reform eliminated miscellaneous deductions for tax years 2018 through 2025.

Seeking a new location. Travel costs (and other costs) incurred while you are looking for a new place for your business (or for a new business) must be capitalized and cannot be deducted currently.

Luxury water travel: If you travel using an ocean liner, a cruise ship, or some other type of "luxury" water transportation, the amount you can deduct is subject to a per-day limit.

Seeking foreign customers: The costs of traveling abroad to find foreign markets for existing products are not deductible.

> Starting in 2008, travel (and other) costs incurred in unsuccessfully trying to acquire a specific business are currently deductible.

Meal and Entertainment Expenses

Prior to tax reform, there were limits and restrictions on deducting meal and entertainment expenses, with most deductible at 50 percent. Due to COVID-19 legislation, for tax years 2021 and 2022, the deductible amount for business-related meals is 100 percent. Meal costs must be "ordinary and necessary" and not "lavish or extravagant" and directly related to or associated with your business. They must also be substantiated.

Under tax reform, there were a number of changes, the most notable being that entertainment expenses paid or incurred after December 31, 2017, are not deductible unless they fall under specific exceptions, for example, expenses incurred for social activities primarily for the benefit of your employees. As such, reasonable costs for food and refreshments for year-end parties for employees are 100 percent deductible.

Prior to 2018, if you rented a skybox or other private luxury box for more than one event, say for the season, at the same sports arena, you generally could deduct more than the price of a non-luxury box seat ticket. Each game or other performance counted as one event, and the deduction for those seats was subject to the 50 percent entertainment expense limit. Starting January 1, 2018, however, that deduction is eliminated. Furthermore, even if the costs of food and beverages are separately stated, you cannot deduct these expenses.

Deductions are still disallowed for depreciation and upkeep of "entertainment facilities" such as yachts, hunting lodges, fishing camps, swimming pools, and tennis courts. However, the costs of entertainment provided at such facilities are no longer deductible. Prior to 2018, these expenses were deductible at 50 percent, subject to entertainment expense limitations.

Dues paid to country clubs or social or golf and athletic clubs are not deductible nor are dues that you pay to professional and civic organizations. Prior to 2018, these dues were deductible at 50 percent as long as your membership has a business purpose. Such organizations included business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards.

How Do You Prove Expenses Are "Directly Related?"

The following section applies only to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. Expenses are directly related if you can show:

- There was more than a general expectation of gaining some business benefit other than goodwill.
- You conducted business during the entertainment.
- Active conduct of business was your main purpose.

There is a presumption (in the eyes of the IRS) that events that take place in what it considers places non-conducive to doing business are not directly related to your business. These places include nightclubs, theaters, sporting events or cocktail parties. It also includes meetings with a group of people who are not business associates, at cocktail lounges, country clubs, or athletic clubs. However, you can overcome the presumption by showing that you engaged in a business discussion or otherwise conducted business during the event.

How Do You Meet The "Associated With" Test?

The following section applies only to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. Even if you can't show that the entertainment was "directly related" as discussed above, you can still deduct the expenses as long as you can prove the entertainment was "associated" with your business. To meet this test, the entertainment must directly precede or come after a substantial business discussion. Further, you must have had a clear business purpose when you took on the expense.

For Whom Can You Get The Deduction?

The following section applies <u>only</u> to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. The person entertained must be a business associate. That is, someone who could reasonably be expected to be a customer or conduct business with you, including an employee or professional advisor.

In circumstances where it's customary to entertain a business associate with his or her spouse, and your spouse also attends, entertainment of both spouses is deductible, thanks to the "closely connected rule."

Recordkeeping and Substantiation Requirements

Tax law requires you to keep records that will prove the business purpose and amounts of your business travel, entertainment, and local transportation costs.

Which Records You Must Keep

You must substantiate the following business expenses:

- Travel expenses while away from home (including meals and lodging).
- Business meals and entertainment if allowed under a tax code exception, and
- Business gifts.

To substantiate these items, you must prove:

- The amount.
- The time and place of the travel, entertainment, or recreation, or the date and a description of the business gift.
- The business purpose, and
- The business relationship of the recipient of entertainment or gifts.

> The most frequent reason for IRS's disallowance of travel and entertainment expenses is the failure to show the place and business purpose of an item. Therefore, pay special attention to these aspects of your record-keeping.
>
> Keeping a diary or logbook and recording your business-related activities at or close to the time the expense is incurred is one of the best ways to document your business expenses.

Here's how these rules apply to your record-keeping for travel expenses, entertainment expenses, and business gifts.

Away-from-home travel expenses. You must document the following for each trip:

- The amount of each expense, e.g., the cost of each transportation, lodging and meal. You can group similar types of incidentals together, i.e., "meals, taxis."
- The dates of your departure and return and the number of days you spent on business.
- Your destination.
- The business reason for the travel or the business benefit you expect.

Entertainment expenses (exceptions allowed under the tax code) for tax years before 2018. You must prove the following for each claimed deduction for entertainment expenses:

- The amount of each separate expense, though incidentals may be totaled on a daily basis.
- The date of the entertainment.
- The name, title, and occupation (showing business relation) of the people you entertained.

Business gifts. You must keep the following documentation for a business gift to substantiate the deduction:

- The cost of the gift and the date it was made.
- The business reason for the gift.
- The name, title, and occupation of the recipient.
- A description of the gift.

Employees "Fully Reimbursed"

Employees who are "fully reimbursed" by their employer must:

- Adequately account to their employer.
- Receive full reimbursement.
- Return any excess reimbursement.

As a fully reimbursed employee, you must adequately account to your employer by means of an expense account statement. If you are covered by (and follow) an "accountable plan," and your reimbursements don't exceed your expenses, you won't have to report the reimbursements as gross income. Some per diem arrangements (by which you receive a flat amount per day) and mileage allowances can avoid detailed expense accounting to the employer, but proof of time, place, and business purpose is still required.

However, if your employer's reimbursement plan is not "accountable," you must report the reimbursements as income. Prior to 2018, you could deduct these expenses on your tax return as miscellaneous itemized deductions on Form 1040 Schedule A, subject to the two percent-of-adjusted-gross-income floor. Tax reform, however, eliminated miscellaneous deductions for tax years 2018 through 2025.

Auto Expenses

If you are self-employed and use a car for business, you have two choices as to how to claim the deduction for auto expenses. Parking fees and tolls may be deducted no matter which method you use.

1. You can deduct the actual business-related costs of gas, oil, lubrication, repairs, tires, supplies, parking, tolls, chauffeur salaries, and depreciation, or
2. You can use the standard mileage deduction, which is an inflation-adjusted amount that is multiplied by the number of business miles driven.

   From 2018 through 2025, employees who use their cars for business but either don't get reimbursed or are reimbursed under an employer's "non-accountable" reimbursement plan can no longer deduct auto expenses on Form 1040 Schedule A.

The standard mileage rate produces a larger deduction for some business owners, while others fare better (tax-wise) by deducting actual expenses. Figuring your deduction using both methods tells you which method is better for you tax-wise.

Expensing and depreciating vehicle costs. Deduction options and amounts depend on the percentage used for business. Also, if the car is used more than 50 percent for business, it can be included as business property and qualify for Section 179 expensing in the year of purchase. The deduction is reduced proportionately to the extent the car is used for personal purposes. If you take this deduction, you can't use the actual mileage for that vehicle in any year.

Depreciation. Assuming the car cost more than the Section 179 limit, or Section 179 is not available or is not claimed, depreciation is also allowed. Several depreciation options are available, but there are limits to the amount of depreciation that can be claimed per year. Depreciation otherwise allowable is reduced by the proportion of personal use. For example, a car used 20 percent for personal use is depreciated at 80 percent of the amount otherwise allowed.

Accelerated depreciation is defined as depreciation that is at a rate higher than normal that results from dividing the vehicle's cost by the number of years it will be used. It is not allowed where personal use is 50 percent or more. If you claimed accelerated depreciation in a prior year and your business use then falls to 50 percent or less, you become subject to "recapture" of the excess depreciation (i.e., it's included in income). Of course, using the standard mileage deduction described below allows you to avoid these limits.

Determining whether to use the standard mileage deduction. If you opt for the standard mileage rate, you simply multiply the current cents-per-mile rate by the number of business miles you drive for the year. Be aware, however, that the standard mileage deduction may understate your costs. This is especially true for taxpayers who use the car 100 percent for business, or close to that percentage.

> Once you choose the standard mileage rate, you cannot use accelerated depreciation even if you opt for the actual cost method in a later year. You may use only straight line.
>
> The standard mileage method usually benefits taxpayers who have less expensive cars or who travel a large number of business miles. To determine which method is better for you, make the calculations each way during the first year you use the car for business.

You may use the standard mileage for leased cars if you use it for the entire lease period. Or, you can deduct actual expenses instead, including leasing costs.

Recordkeeping. Tax law requires that you keep travel expense records and that you give information on your return showing business versus personal use. Not only is keeping good records essential in case of an audit, but it also allows you to make the most of your auto deductions. For example, you won't be able to determine which of the two options is better if you don't know the number of miles driven and the total amount you spent on the car. If you use the actual cost method, you'll have to keep receipts as well. For many business owners, using a separate credit card for business simplifies your record-keeping.

> Don't forget to deduct the interest you pay to finance a business-use car if you're self-employed.

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7 Ways To Save Even More Income Taxes

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1. IRA Funding Trick

If you don't have enough cash to make a deductible contribution to your IRA by April 15th, here is how you can still take the tax deduction for that tax year. To get started, all you need is an existing IRA.

Begin by having $6,000 distributed to you from your IRA. Once you have the $6,000, immediately deposit it back into your IRA. If you do this before April 15th, this counts as your deductible contribution for the year. The best part of this is that you have 60 days to "make up" the $6,000 withdrawal (and avoid penalties and taxes). To do this, simply deposit a $6,000 "rollback" into the same IRA account within 60 days and you will be able to avoid taxes and penalties on the original $6,000 distribution made to you.

This is a type of short-term loan from your IRA to make this year's deductible contribution before the April 15th due date; however, you can only do this once in a 12-month period. If you don't replace the money within 60 days, you may owe income tax and a 10 percent withdrawal penalty if you're under the age of 59 1/2.

> A 2014 Tax Court opinion, Bobrow v. Commissioner, T.C. Memo. 2014-21 held that the limitation applies on an aggregate basis, meaning that an individual could not make an IRA-to-IRA rollover if he or she had made such a rollover involving any of the individual's IRAs in the preceding 1-year period. The IRS issued a revised regulation regarding this decision, which became effective on January 1, 2015.
>
> The ability of an IRA owner to transfer funds from one IRA trustee directly to another is not affected because such a transfer is not a rollover and, therefore, is not subject to the one-rollover-per-year limitation.

2. Determine the "Best" Retirement Plan Option

As a self-employed small business owner, there are several retirement plan options available to you, but understanding which option is most advantageous to you can be confusing. The "best" option for you may depend on whether you have employees and how much you want to save each year.

There are four basic types of plans:

- Traditional and Roth IRAS
- Simplified Employee Pension (SEP) Plan and Savings Incentive Match Plan for Employees (SIMPLE)
- Self-employed 401(k)
- Qualified and Defined Benefit Plans

To make sure you are getting the most out of your financial future, contact the office to determine your eligibility and to figure out which plan is best for your tax situation.

3. Make Your Landlord Pay for Improvements

Instead of paying for leasehold improvements at your place of business, you can ask your landlord to pay for them. In return, you offer to pay your landlord more in rent over the term of the lease. By financing your leasehold improvements this way, both you and your landlord can save money on taxes.

Under the Tax Cuts and Jobs Act of 2017 (i.e., tax reform), qualified leasehold improvement was superseded by qualified improvement property (QIP). Ordinarily, you must deduct the cost of qualified improvements made to your place of business over a 39-year period (similar to that of depreciating real estate); however, up to $1,000,000 in qualified leasehold (as well as restaurant and retail) improvements can be expensed using the Section 179 deduction (subject to certain rules), thanks to tax reform legislation passed in late 2017. Improvements must be interior, that is, roof HVAC systems, façade work and other exterior improvements such as on the roof do not qualify.

> Per the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Qualified Improvements to Property placed in service after 2017 are allowed over a 15-year period (vs. 39 years). In most cases, post-2017 QIP retroactively qualifies for the bonus depreciation deduction as well.

The PATH Act changed the definition of qualified property from qualified leasehold improvements to qualified improvement property. The rules regarding qualified improvement property differ from those for qualified leasehold improvement property in that the improvement does not have to be made pursuant to a lease and does not have to be made to a building more than three years old. For tax years 2016 and 2017, the rules still apply for defining qualified leasehold improvements. In addition, the 15-year recovery period for leasehold, retail, and restaurant improvements was made permanent by the PATH Act as well.

Qualified leasehold improvements completed before 2008 were eligible for a special 15-year recovery period. If in the year your lease term ends you move to another location, you can deduct the portion of the improvement cost that you have not previously deducted. This normal scenario won't save you tax in the earlier years of the lease. Your landlord will have to put up the initial cash for the improvements, but you will cover that over time with increased payments in your rent. Since your landlord will be paying for the improvements, you will save tax early in the lease and your landlord will benefit as well!

At the same time, your landlord will gain depreciation deductions for the cost of the leasehold improvements. When you leave, your landlord will still have the improved property to offer other future tenants. It is a great opportunity for a win-win situation giving you faster access to invested monies.

4. Deduct Home Entertainment Expenses

If you host a company picnic or holiday party at your home, then the cost of meals at your home is a deductible expense and you can deduct 100% of your meal expenses. However, under tax reform, and starting in 2018, entertainment-related expenses are no longer deductible.

Prior to tax reform, 50 percent of your business-related entertainment expenses (with some exceptions) were generally deductible.

5. Deduct Holiday Gifts Without Receipts

Don't overlook the deductible benefit of business gifts during the holidays or at any other time of the year. Whether you are a rank-and-file employee, a self-employed individual, or even a shareholder-employee in your own corporation, you can deduct the cost of gifts made to clients and other business associates as a business expense. The law limits your maximum deduction to $25 in value for each recipient for which the gift was purchased with cash.

6. Deduct Your Home Computer.

> Tax reform legislation passed in 2017 repealed certain itemized deductions on Schedule A, *Itemized Deductions* for tax years 2018 through 2025, including employee business expense deductions related to home office use. Prior to 2018, If you purchased a computer and used it for work-related purposes as an employee, you were able to deduct the cost as long as you met certain requirements such as your computer must be used for convenience and as a condition of your employment, for instance, or if you telecommute two days a week and work in the office the other three days.

If you are self-employed, you can take advantage of Section 179 expensing even if you don't claim the home office deduction. Section 179 allows you to write off new equipment (including computers) in the year it was purchased as long as it is used for business more than 50 percent of the time (subject to certain rules).

7. Have Your Company Buy You Dinner

Prior to tax reform, i.e., for tax years before 2018, this expense was 100 percent deductible. Furthermore, per tax reform legislation, this expense is nondeductible after 2025. However, for tax years prior to 2018 the following was allowed:
If you are in a partnership or a shareholder-employee in a regular C or S corporation, and you have to work overtime, your company can, on occasion, provide you with meal money for dinner. The cost of this "fringe benefit" is 50 percent deductible for your company under Section 132 of the Internal Revenue Code and you don't have to pay personal income tax on the value of the meal.

Your company can pay directly for the meal or can instead, provide you with dinner money. But, in order for this to work, the amount of money you receive for your meal must be reasonable. If the IRS decides that the amount of money you received from your employer was unreasonable, the entire amount will be considered taxable personal income and will not be deductible.

The Home Office Deduction

Under the IRS rules, a taxpayer is allowed to deduct expenses related to business use of a home, but only if the space is used "exclusively" on a "regular basis." To qualify for a home office deduction you must meet one of the following requirements:

1. Exclusive and regular use as your principal place of business
2. A place for meeting with clients or customers in the ordinary course of business
3. A place for the taxpayer to perform administrative or management activities associated with the business, provided there is no other fixed location from which the taxpayer conducts a substantial amount of such administrative or management activities

A separate structure not attached to your dwelling unit that is used regularly and exclusively for your trade or profession also qualifies as a home office under the IRS definition.

The exclusive-use test is satisfied if a specific portion of the taxpayer's home is used solely for business purposes or inventory storage. The regular-basis test is satisfied if the space is used on a continuing basis for business purposes. Incidental business use does not qualify.

In determining the principal place of business, the IRS considers two factors: Does the taxpayer spend more business-related time in the home office than anywhere else? Are the most significant revenue-generating activities performed in the home office? Both of these factors must be considered when determining the principal place of business.

Employees

> Tax reform legislation passed in 2017 repealed certain itemized deductions on Schedule A, *Itemized Deductions* for tax years 2018 through 2025, including employee business expense deductions related to home office use.

For tax years prior to 2018, employees could claim home office expenses as deductions provided they met additional rules such as business use must also be for the convenience of the employer (not just the employee). To qualify for the home-office deduction, an employee must satisfy two additional criteria.

First, the use of the home office must be for the convenience of the employer (for example, the employer does not provide a space for the employee to do his/her job). Second, the taxpayer does not rent all or part of the home to the employer and use the rented portion to perform services as an employee for the employer. Employees who telecommute may be able to satisfy the requirements for the home-office deduction.

To qualify for the home-office deduction, an employee must satisfy two additional criteria. First, the use of the home office must be for the convenience of the employer (for example, the employer does not provide a space for the employee to do his/her job). Second, the taxpayer does not rent all or part of the home to the employer and use the rented portion to perform services as an employee for the employer. Employees who telecommute may be able to satisfy the requirements for the home-office deduction.

Expenses

Home office expenses are classified into three categories:

> **Direct Business Expenses** relate to expenses incurred for the business part of your home such as additional phone lines, long-distance calls, and optional phone services. Basic local telephone service charges (that is, monthly access charges) for the first phone line in the residence generally do not qualify for the deduction.
>
> **Indirect Business Expenses** are expenditures that are related to running your home such as mortgage or rent, insurance, real estate taxes, utilities, and repairs.
>
> **Unrelated Expenses** such as painting a room that is not used for business or lawn care are not deductible.

Deduction Limit

You can deduct all your business expenses related to the use of your home if your gross income from the business use of your home equals or exceeds your total business expenses (including depreciation). But, if your gross income from the business use of your home is less than your total business expenses, your deduction for certain expenses for the business use of your home is limited.

Nondeductible expenses such as insurance, utilities, and depreciation that are allocable to the business are limited to the gross income from the business use of your home minus the sum of the following:

- The business part of expenses you could deduct even if you did not use your home for business (such as mortgage interest, real estate taxes, and casualty and theft losses that are allowable as itemized deductions on Schedule A (Form 1040)). These expenses are discussed in detail under Deducting Expenses, later.
- The business expenses that relate to the business activity in the home (for example, business phone, supplies, and depreciation on equipment), but not to the use of the home itself.

If your deductions are greater than the current year's limit, you can carry over the excess to the next year. They are subject to the deduction limit for that year, whether or not you live in the same home during that year.

Sale of Residence

If you use property partly as a home and partly for business, tax rules generally permit a $500,000 (married filing jointly) or $250,000 (single or married filing separately) exclusion on the gain from the sale of a primary residence provided certain ownership and use tests are met during the 5-year period ending on the date of the sale:

- You owned the home for at least 2 years (ownership test), and
- You lived in the home as your main home for at least 2 years (use test).

If the part of your property used for business is within your home, such as a room used as a home office for a business there is no need to allocate gain on the sale of the property between the business part of the property and the part used as a home. However, if you used part of your property as a home and a separate part of it, such as an outbuilding, for business other rules apply such as whether the use test was met (or not met) for the business part and whether or not there was business use in the year of the sale.

If you need more information about whether you qualify for the exclusion, please don't hesitate to call us.

Simplified Home Office Deduction

If you're one of the more than 3.4 million taxpayers claimed deductions for business use of a home (commonly referred to as the home office deduction), don't forget about the new simplified option available for taxpayers starting with 2013 tax returns. Taxpayers claiming the optional deduction will complete a significantly simplified form.

The new optional deduction is capped at $1,500 per year based on $5 a square foot for up to 300 square feet. Though homeowners using the new option cannot depreciate the portion of their home used in a trade or business, they can claim allowable mortgage interest, real estate taxes and casualty losses on the home as itemized deductions on Schedule A. These deductions need not be allocated between personal and business use, as is required under the regular method. Business expenses unrelated to the home, such as advertising, supplies and wages paid to employees are still fully deductible.

Current restrictions on the home office deduction, such as the requirement that a home office must be used regularly and exclusively for business and the limit tied to the income derived from the particular business, still apply under the new option.

Tax Deductions

The "home office" tax deduction is valuable because it converts a portion of otherwise nondeductible expenses such as mortgage, rent, utilities and homeowners insurance into a deduction.

Remember however, that an individual is not entitled to deduct any expenses of using his/her home for business purposes unless the space is used exclusively on a regular basis as the "principal place of business" as defined above. The IRS applies a 2-part test to determine if the home office is the principal place of business.

- Do you spend more business-related time in your home office than anywhere else?
- Are the most significant revenue-generating activities performed in your home office?

If the answer to either of these questions is no, the home office will not be considered the principal place of business, and the deduction cannot be taken.

A home office also increases your business miles because travel from your home office to a business destination--whether it's meeting clients, picking up supplies, or visiting a job site--counts as business miles. And, you can depreciate furniture and equipment (purchased new for your business or converted to business use), as well as expense new equipment used in your business under the Section 179 expense election.

Taxpayers taking a deduction for business use of their home must complete Form 8829. If you have a home office or are considering one, please call us. We'll be happy to help you take advantage of these deductions.

Turn your Vacation Into a Tax Deduction

How would you like to legally deduct every dime you spend on vacation this year? This financial guide offers strategies that help you do just that.

Tim, who owns his own business, decided he wanted to take a two-week trip around the US. So he did - and was able to legally deduct every dime that he spent on his "vacation." Here's how he did it.

1. Make all your business appointments before you leave for your trip.

Most people believe that they can go on vacation and simply hand out their business cards in order to make the trip deductible.

Wrong.

You must have at least one business appointment before you leave in order to establish the "prior set business purpose" required by the IRS. Keeping this in mind, before he left for his trip, Tim set up appointments with business colleagues in the various cities that he planned to visit.

Let's say Tim is a manufacturer of green office products looking to expand his business and distribute more product. One possible way to establish business contacts - if he doesn't already have them - is to place advertisements looking for distributors in newspapers in each location he plans to visit. He could then interview those who respond when he gets to the business destination.

> Tim wants to vacation in Hawaii. If he places several advertisements for distributors, or contacts some of his downline distributors to perform a presentation, then the IRS would accept his trip for business.

It would be vital for Tim to document this business purpose by keeping a copy of the advertisement and all correspondence along with noting what appointments he will have in his diary.

2. Make Sure your Trip is All "Business Travel."

In order to deduct all of your on-the-road business expenses, you must be traveling on business. The IRS states that travel expenses are 100 percent deductible as long as your trip is business related and you are traveling away from your regular place of business longer than an ordinary day's work *and* you need to sleep or rest to meet the demands of your work while away from home.

Tim wanted to go to a regional meeting in Boston, which is only a one-hour drive from his home. If he were to sleep in the hotel where the meeting will be held (in order to avoid possible automobile and traffic problems), his overnight stay qualifies as business travel in the eyes of the IRS.

Remember: You don't need to live far away to be on business travel. If you have a good reason for sleeping at your destination, you could live a couple of miles away and still be on travel status.

3. Make sure that you deduct all of your on-the-road-expenses for each day you're away.

For every day you are on business travel, you can deduct 100 percent of lodging, tips, car rentals, and 50 percent of your food. Tim spends three days meeting with potential distributors. If he spends $50 a day for food, he can deduct 50 percent of this amount, or $25. The IRS doesn't require receipts for travel expense under $75 per expense - except for lodging.

For 2021 and 2022 only, business-related meals purchased from a restaurant (for eat-in or take-out) are deductible at 100 percent.

Let's look at an example:

If Tim pays $6 for drinks on the plane, $6.95 for breakfast, $12.00 for lunch, $50 for dinner, he does not need receipts for anything since each item was under $75. He would, however, need to document these items in a diary. A good tax diary is essential in order to audit-proof your records. Adequate documentation shall consist of amount, date, place and business reason for the expense.

If, however, Tim stays in the Bates Motel and spends $22 on lodging, will he need a receipt? The answer is yes. You need receipts for all paid lodging.

Not only are your on-the-road expenses deductible from your trip, but also all laundry, shoe shines, manicures, and dry-cleaning costs for clothes worn on the trip. Thus, your first dry cleaning bill that you incur when you get home will be fully deductible. Make sure that you keep the dry cleaning receipt and have your clothing dry cleaned within a day or two of getting home.

4. Sandwich weekends between business days.

If you have a business day on Friday and another one on Monday, you can deduct all on-the-road expenses during the weekend.

> Tim makes business appointments in Florida on Friday and one on the following Monday. Even though he has no business on Saturday and Sunday, he may deduct on-the-road business expenses incurred during the weekend.

5. Make the majority of your trip days business days.

The IRS says that you can deduct transportation expenses if business is the primary purpose of the trip. A majority of days in the trip must be for business activities, otherwise, you cannot make any transportation deductions.

> Tim spends six days in San Diego. He leaves early on Thursday morning. He had a seminar on Friday and meets with distributors on Monday and flies home on Tuesday, taking the last flight of the day home after playing a complete round of golf. How many days are considered business days?

All of them. Thursday is a business day since it includes traveling - even if the rest of the day is spent at the beach. Friday is a business day because he had a seminar. Monday is a business day because he met with prospects and distributors in pre-arranged appointments. Saturday and Sunday are sandwiched between business days, so they count, and Tuesday is a travel day.

Since Tim accrued six business days, he could spend another five days having fun and still deduct all his transportation to San Diego. The reason is that the majority of the days were business days (six out of eleven). However, he can only deduct six days worth of lodging, dry cleaning, shoe shines, and tips. The important point is that Tim would be spending money on lodging, airfare, and food, but now most of his expenses will become deductible.

With proper planning, you can deduct most of your vacations if you combine them with business. Bon Voyage!

Form of Business Organization: Which Should You Choose?

The decision as to which type of business organization to use when starting a business is a major one. And, it's a decision to be revisited periodically as your business develops. While professional advice is critical in making this decision, it's also important to have a general understanding of the options available. This Financial Guide provides just such an overview.

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Businesses fall under one of two federal tax systems:

1. **Taxation of both the entity itself (on the income it earns) and the owners (on dividends or other profit participation the owners receive from the business).** This system applies to the business S-corporation-called the "C-corporation" (C-corp) for reasons we'll see shortly and the system of taxing first the corporation and then its owners is called the "corporate double tax."
2. **Pass-through taxation.** This type of entity is in itself not taxed; however, each owner is each taxed on their proportionate shares of the entity's income. The leading forms of pass-through entity (further explained below) are:
    - Partnerships, of various types.
    - S-corporations (S-corps), as distinguished from C-corps.

- Limited liability companies (LLCs).

A sole proprietorship such as John Doe Plumbing or Marcus Welby, M.D. is also considered a pass-through entity even though no "organization" may be involved.

The first major consideration (in this case, a tax consideration) in choosing the form of doing business is whether to choose an entity (such as a C-corp) that has two levels of tax on income or a pass-through entity that has only one level (directly on the owners).

> Co-owners and investors in pass through entities may need to have their operating agreements require a certain level of cash distributions in profit years, so they will have funds from which to pay taxes.

Losses are directly deductible by pass-through owners while C-corp losses are deducted only against profits (past or future) and don't pass through to owners.

> Business and tax planners therefore typically advise new businesses-those expected to have startup losses-to begin as pass through entities, so the owners can deduct losses currently against their other income, from investments or another business.

The major business consideration (as opposed to tax consideration) in choosing the form of business is limitation of liability, that is, to protect your assets from the claims of business creditors. State law grants limitation of liability to corporations (C and S-corps), LLCs, and partners in certain forms of partnership. Liability for corporations and LLCs is generally limited to your actual or promised investment in the business.

Types of Business Entities

C and S-Corps

The S-Corp (so named from a chapter of the tax code) is a tax device created by federal law in 1958. It is a regular corporation with regular limited liability under state law, whose owners elect pass through status for federal tax purposes. That status requires compliance with a number of often constricting rules but, with some exceptions, complying corporations escape federal corporate tax. As regular business S-corporations under state law, they may be taxed under state tax law as regular corporations, or in some other way. Corporations whose owners don't choose to make the federal S-corp election are called C-corps (after another chapter of the tax code).

Partnerships

Ordinary partnerships, called "general partnerships," do not have limited liability under state law.

Limited partnerships limit liability for some partners but not others. A limited partnership has both general partners (who manage the business) and limited partners (who, in essence, are passive investors). The liability of limited partners is generally limited to their investments. The liability of general partners is theoretically unlimited, but can be limited in practice where the general partner is an entity, such as a corporation, with limited liability. A limited partner who takes on what state law considers "too much" management participation is treated as a general partner, losing limited liability.

Both general and limited partnerships are treated as pass-through entities under federal tax law, but there are some relatively minor differences in tax treatment between general and limited partners.

A still more recent development, not yet adopted everywhere, is the limited liability partnership (discussed below) which was designed for professional practices.

Other partnership forms are the giant "publicly traded partnerships" (treated as C-corps for tax purposes) and limited liability limited partnerships (adopted in only a few states) which limit the liability of general partners (where two or more) as well as of limited partners.

Limited Liability Companies (LLCs)

LLCs have become the most popular business form for new entities, and many existing entities have converted to this form. They exist in some form in every state. They embody limited liability features of corporations and pass-through characteristics of partnerships and S-corps, but are more flexible than S-corps.

For business law purposes, LLC members may be either passive investors or active investor-managers. Unlike with limited partnerships, active management won't affect limitation of liability. For federal tax purposes, LLCs are treated as partnerships (unless they elect otherwise).

> Since LLC rules vary from state to state, a characteristic, power or rule in the state where an LLC was created may not apply in some other state where it does business.
>
> Some states do, and some states do not, authorize LLCs with only one member.
>
> Where one becomes the sole surviving LLC member in a state that doesn't allow single member LLCs, consider quickly incorporating (to regain limited liability) and electing S-corp status (to retain pass through treatment).

Choosing the Tax Treatment

Since 1997, the IRS has allowed business owners a previously unheard-of measure of choice as to how the entity will be federally taxed. It allows you to choose between C-corp and pass through treatment (universally called "check-the-box").

A few choices are *not* allowed. If the entity is incorporated, it must be treated as a corporation (which doesn't preclude an S-corp election if otherwise available). *Publicly traded* partnerships and *publicly traded* LLCs must be treated as C-corps.

Special rules apply to foreign entities.

All other forms of partnership may be taxed either as C-corps or as pass-through entities (either as partnerships or, if S-corp status is available and elected, as an S-corp.)

An LLC with two or more members may choose to be taxed as a C-corp, a partnership or an S-corp (if elected). An LLC with a single member (where this is allowed) may choose either to be taxed as a C-corp or an S-corp (if elected) or to have the entity disregarded. In this case, if the LLC is owned by an individual, the individual is taxed directly (and can deduct losses) as with a sole proprietorship.

Typically, partnerships and multimember LLCs choose to be taxed as partnerships while single member LLCs choose to have the entity disregarded. With "check-the-box," the IRS will no longer question your right to combine limited liability with pass through treatment or, if you wish, to waive pass through treatment for an entity otherwise entitled to it (with the exceptions noted above).

Any choice has consequences. For example, if you opted last year for corporate treatment and want partnership treatment this year, you'll be treated as liquidating the corporation, and taxed accordingly (discussed below).

Most-but not all-states that impose corporate taxes follow a taxpayer's federal "check-the-box" choice for state tax purposes. This doesn't necessarily mean that the tax treatment will be the same. For example, a state may accept an LLC's election to be taxed as a partnership and still impose an entity-level tax on the LLC.

An election to be taxed as a certain type of entity for federal tax purposes does not make it such an entity under state business law.

Choosing the Form

Now consider which form will work best for the way you want to run your business and capitalize on its profits or startup losses. "Compared to what?" will be a major consideration so it is necessary to compare a taxable entity (the C-corp) with a pass through entity as well as compare the pass through entity with other types of entities. Tax consequences of changing from one entity to another should also be examined.

A major decision of whether to use a C-corp or some form of pass through C-corp is sometimes necessary from a business standpoint. For example, if interests in the enterprise are to be publicly traded, only the C-corp is appropriate.

> For some activities, states may require the corporate form (banks, for example) and S-corp rules may preclude the S-corp form.

From a tax standpoint, while C-corporations present two levels of tax, the first tax (on the corporation) can be at a rate lower than the tax on the owner and the second tax (on the owner) is usually postponed until the owner receives dividends or other assets from the corporation.

> Distribution of appreciated assets to the owner, or sale of such assets and distribution of the proceeds, are taxable both to the corporation and then to owners. They are no longer opportunities, as they once were, to avoid two levels of tax.
>
> The tax on the owner may be at reduced capital gains rates. This is the case for appreciated assets distributed in corporate liquidation and, after 2002 and before 2009, it's also usually the case for dividends distributed by ongoing corporations.
>
> Funds can build up in the corporation at a relatively low rate until distributed. However, the eventual tax on the owner, plus the corporate tax, may eat up more of the profits than the single (pass through) tax on the owner does.

A C-corp can minimize corporate tax by paying out all or almost all of its income to owners in the form of compensation and fringe benefits. Assuming these payments are deductible as business expenses, this approximates pass through treatment, since the corporation isn't taxed on what it receives and then deducts; the owner-recipients alone are taxed on this. This arrangement works best in personal service businesses, where full business expense deduction is more likely to be allowed.

The IRS and the courts may limit deduction in other settings, finding owner compensation to be "unreasonable" and partly nondeductible where it reflects a distribution of profits from capital or from the efforts of non-owners.

To summarize, some businesses may find C-corp status necessary for business purposes. But only comparatively rarely will it be a preferable tax choice for a new business.

Choosing the Pass through Entity

If you decide on a pass-through entity, which of the several do you choose? The following is a brief discussion of the rules applicable to each.

S-corporation

Limitation of liability gives S-corps the edge-for business reasons-over general partnerships, sole proprietorships, limited partnerships (as to limited partners whose partnership activity might expose them to unlimited liability), and LLCs in states that don't allow single member LLCs.

Limited liability comes at a cost, however, since states may impose a tax on S-corps not imposed on entities with unlimited liability.

S-corps are subject to a number of significant rules and restrictions:

- All owners must agree to S-corp status. This means that one co-owner can exact a price or impose conditions for his or her agreement.
- An S-corp can have only one class of stock, which means that income, losses and other tax attributes are allotted among stockholders in proportion to stock ownership.
- The number of co-owners is limited (to 100, with qualifications, counting members of the same family as one stockholder).
- There are limitations as to who can be co-owners (for example, a nonresident alien cannot) and as to the kind of business that can qualify for as an S-corp (for example, an insurance company cannot).

Failure to meet, or ceasing to meet, these requirements means loss of S status and conversion to C-corp status and C-corp taxes.

These limits and restrictions will be contrasted, below, with the more liberal tax rules for partnerships and LLCs.

S-corps are often preferred because they are simple to operate. However, they are not suitable for many businesses. The much wider range of options for partnerships and LLCs introduces tax planning complexity which may be more than many or most small businesses can effectively use or understand.

LLCs vs. S-corporations

LLCs and S-corps share the same business advantage-limitation of liability. S-corps are a bit better understood by the business community because LLCs are new and vary from state to state.

The *tax* advantages of LLCs, as compared to S-corps, are the tax advantages of *partnerships.* All the points below where LLCs outscore S-corps arise because LLCs can choose *partnership tax status.*

- LLC can to some degree allocate tax attributes, like income or certain kinds of income, depreciation deductions, etc., disproportionately among members to suit their individual tax situations (unlike S-corps limited by the effect of the single-class-of-stock rule).
- S-corp owners can deduct startup or operating losses up to their investment plus any debt that the S-corp owes *them*. LLC members can do the same but can deduct further, up to their share of the debt the LLC owes *others*.
- Adding co-owners after the entity is formed is easier with LLCs. An outsider's transfer of appreciated property for an LLC membership interest is tax-free. A comparable transfer to an S-corp is taxable unless the new co-owner-transferor (or group of transferors) owns more than 80 percent of the S-corp after the transfer.
- Complex tax adjustments ("basis adjustments") can be made by the LLC when LLC interests change hands or LLC property is distributed. These adjustments, unavailable with S-corps, can have the effect of reducing amounts taxable to certain LLC members.
- Distribution of appreciated LLC property to LLC members is not taxable to the LLC. Comparable S-corp distributions to stockholders **are** taxable to the S-corp.

Depending on circumstances, S-corp status can be preferable to LLC status when the owners leave the business. The LLC is **not** taxed when appreciated property is distributed to its members, which is a standard form of business liquidation. But the members would be taxed on distributions exceeding the "basis" (broadly, the amount they invested) of their interests. S-corp owners, on the other hand, can arrange a tax-free exit, via a corporate reorganization in which they transfer their S-corp stock for stock in a corporate acquirer. (Later sale of stock in the acquirer would be taxable.)

Depending on state law, S-corps, and LLCs may be taxed at the entity level in states where they do business.

LLCs vs. Partnerships

LLCs, with their limited liability for all members, have the edge on general and limited partnerships from a **business** standpoint. While the federal tax treatment of partners and LLC members is basically the same, there are occasional special tax rules for limited partners (especially self-employment tax rules).

> It is not clear whether these special tax rules extend to **non**-manager LLC members.
>
> LLCs are more likely than partnerships to be subject to a state tax.

LLCs vs. Proprietorships

LLCs, with their limited liability, are preferable, where available, for sole proprietors from a business standpoint. Where the sole proprietor so elects, the LLC is ignored and the proprietor is taxed directly under federal tax rules as if no separate entity existed.

> Some states do-and some do not-ignore the LLC entity for state tax purposes.

Professional Practice Entities

Professional practices (such as doctors and lawyers) have a number of options as to their form of business entity.

Professional Corporations (P.C.s)

These provide limited liability for general business debts but not for the professional's own malpractice and, in some states, no limited liability for malpractice of fellow practitioners in the firm. They may be C-corps or S-corps. Unlike many other C-corps, a P.C. C-corp can use the cash method of accounting.

LLCs

Most states allow professionals to practice in LLCs, either under a general LLC law or a special Professional Limited Liability Company law (PLLC). In either case, liability is not limited for the professional's own malpractice but, depending on the state, may be limited for the malpractice of other firm members and for other firm debts. These LLCs share the comparative advantages (and minor disadvantages) of other LLCs.

Limited Liability Partnerships (LLPs)
LLPs are general partnerships whose general partners have limited liability. They are designed for professional practices. A partner is liable for his or her own malpractice but not for a partner's malpractice or, depending on state law, other acts of partners. Typically they are required by state law to maintain malpractice insurance, and are obliged to pay a per-partner fee to keep their status, but are not subject to entity-level tax.

Sole Proprietors and Partners
Many practitioners choose to practice as sole proprietors or partners, rather than in a limited liability entity. They reason that their main exposure to liability is to malpractice claims, and the entity won't protect against claims for their own malpractice (or, in some states, for a partner's malpractice). They therefore, choose to rely on malpractice insurance (which practitioners in limited liability entities may have too).

> Sole proprietorships and partnerships are less likely than limited liability entities to be subject to state entity level tax.

Other Pros and Cons of C-Corps

A C-corp can be preferable to pass through entities as to fringe benefits. As employees, owner-employees of a C-corp qualify for certain employee fringe benefits. On the other hand, self-employed persons (partners, LLC members, sole proprietors, and more than 2 percent stockholders in S-corps) **don't** qualify.

> Health insurance can be wholly tax-free to C-corp owner-employees (through full deduction by the C-corp and full tax exemption for the owner-employee). However, it is only partly tax-free to the self-employed, because of their limited tax deduction for this item.

Another modest *advantage* of the C-corp is that they are less likely to be subject to passive loss deduction limitations. These limit the opportunity to deduct losses from activities the taxpayer doesn't "materially participate" in, against income from investments or other businesses. Typically, limited partners have been the group most subject to passive loss limitations.

Another tax *disadvantage* of C-corp status is its limited ability to report for tax purposes on the cash method of accounting, which generally defers tax as compared to the accrual method.

Further Insights on S-Corps

A qualifying S-corp, generally nontaxable, can be subjected to C-corp taxation on certain items without losing S status for other items. This happens when a C-corp converts to an S-corp and carries over appreciated property later sold at a gain. The S-corp pays a corporate tax on the gain, which is then taxed to stockholders (reduced by the corporate tax). Because S-corps are intended to be operating companies rather than holding companies, this also happens when the S-corp has "excessive" passive investment-type income (interest, dividends, and the like, in excess of 25 percent of gross receipts). Here the excess is subject to corporate tax and is then taxed to stockholders (minus the corporate tax).

Some see S-corps as a way to reduce employment taxes. For example, one earning $120,000 in a sole proprietorship might convert to an S-corp and take $70,000 in pay and $50,000 in dividends. Income taxes are unchanged by this but, it's reasoned, $50,000 now received as dividends escapes employment tax (the $120,000 of self-employment earnings was subject to both retirement and Medicare tax up to $102,000 for 2008 and $97,500 for 2007 and Medicare tax above that). In abuse situations, such as where little or no wages were paid, IRS has treated the dividends as pay subject to employment taxes on the owner-employees and on the S-corp employer. But in cases where substantial wages were paid, along with substantial dividends, IRS has not objected.

Changing To Another Entity

The many advantages of LLCs, for both business and tax reasons, have encouraged many business owners to convert, or consider converting, to the LLC form. But other changes of entity may suit particular situations-for example, general partnership to LLP (for business reasons) or C-corp to S-corp (for tax reasons). For tax purposes, a change of entity via a check-the-box decision is treated for tax purposes as an actual change of the entity (whatever may happen under state business law).

Here, briefly and in broad outline, is what happens for federal tax purposes when entity status is changed (or treated as changed under-check-the-box). How these apply in your own situation must be reviewed in depth with a tax/business advisor.

- C-corp converts to S-corp or vice versa. No tax on the conversion. Pass through treatment applies while it is an S-corp.

- C- corp or S-corp converts to LLC, partnership or sole proprietorship. Generally, a tax on the liquidation of the corporation, with pass through treatment for the new entity (in modified form in the case of a liquidating S-corp).
- Partnership converts to LLC or vice versa; sole proprietorship converts to single member LLC or vice versa. No tax on conversion-pass through treatment continues.
- LLC, partnership or sole proprietorship converts to C or S-corp. Generally, no tax on conversion. Pass through treatment (in modified form) for S-corp income.

Government and Non-Profit Agencies

- The Small Business Administration (SBA) has offices located throughout the United States. Contact SBA through their website.

Retirement Plan Options For Small Businesses

According to the US Small Business Administration, small businesses employ half of all private-sector employees in the United States. However, a majority of small businesses do not offer their workers retirement savings benefits.

If you're like many other small business owners in the United States, you may be considering the various retirement plan options available for your company. Employer-sponsored retirement plans have become a key component for retirement savings. They are also an increasingly important tool for attracting and retaining the high-quality employees you need to compete in today's competitive environment.

Besides helping employees save for the future, however, instituting a retirement plan can provide you, as the employer, with benefits that enable you to make the most of your business's assets. Such benefits include:

- Tax-deferred growth on earnings within the plan
- Current tax savings on individual contributions to the plan
- Immediate tax deductions for employer contributions
- Easy to establish and maintain
- Low-cost benefit with a highly-perceived value by your employees

Types of Plans

Most private sector retirement plans are either defined benefit plans or defined contribution plans. Defined benefit plans are designed to provide a desired retirement benefit for each participant. This type of plan can allow for a rapid accumulation of assets over a short period of time. The required contribution is actuarially determined each year, based on factors such as age, years of employment, the desired retirement benefit, and the value of plan assets. Contributions are generally required each year and can vary widely.

A defined contribution plan, on the other hand, does not promise a specific amount of benefit at retirement. In these plans, employees or their employer (or both) contribute to employees' individual accounts under the plan, sometimes at a set rate (such as 5 percent of salary annually). A 401(k) plan is one type of defined contribution plan. Other types of defined contribution plans include profit-sharing plans, money purchase plans, and employee stock ownership plans.

Small businesses may choose to offer a defined benefit plan or any of these defined contribution plans. Many financial institutions and pension practitioners make available both defined benefit and defined contribution "prototype" plans that have been pre-approved by the IRS. When such a plan meets the requirements of the tax code it is said to be qualified and will receive four significant tax benefits.

1. The income generated by the plan assets is not subject to income tax because the income is earned and managed within the framework of a tax-exempt trust.
2. An employer is entitled to a current tax deduction for contributions to the plan.
3. The plan participants (the employees or their beneficiaries) do not have to pay income tax on the amounts contributed on their behalf until the year the funds are distributed to them by the employer.
4. Under the right circumstances, beneficiaries of qualified plan distributors are afforded special tax treatment.

It is necessary to note that all retirement plans have important tax, business and other implications for employers and employees. Therefore, you should discuss any retirement savings plan that you consider implementing with your accountant or financial advisor.

Here's a brief look at some plans that can help you and your employees save.

SIMPLE: Savings Incentive Match Plan

A SIMPLE IRA plan allows employees to contribute a percentage of their salary each paycheck and to have their employer match their contribution. Under SIMPLE IRA plans, employees can set aside up to $14,000 in 2022 ($13,500 in 2021) by payroll deduction. If the employee is 50 or older then they may contribute an additional $3,000 (same as 2021).

Employers can either match employee contributions dollar for dollar - up to 3 percent of an employee's wage - or make a fixed contribution of two percent of pay for all eligible employees instead of a matching contribution.

SIMPLE IRA plans are easy to set up by filling out a short form. Administrative costs are low and much of the paperwork is done by the financial institution that handles the SIMPLE IRA plan accounts. Employers may choose either to permit employees to select the IRA to which their contributions will be sent or to send contributions for all employees to one financial institution. Employees are 100 percent vested in contributions, get to decide how and where the money will be invested, and keep their IRA accounts even when they change jobs.

SEP: Simplified Employee Pension Plan

A SEP plan allows employers to set up a type of individual retirement account - known as a SEP IRA - for themselves and their employees. Employers must contribute a uniform percentage of pay for each employee. Employer contributions are limited to whichever is less: 25 percent of an employee's annual salary or $61,000 in 2022 (up from $58,000 in 2021). SEP plans can be started by most employers, including those that are self-employed.

SEP plans have low start-up and operating costs and can be established using a single quarter-page form. Businesses are not locked into making contributions every year. You can decide how much to put into a SEP IRA each year - offering you some flexibility when business conditions vary.

401(k) Plans

401(k) plans have become a widely accepted savings vehicle for small businesses and allow employees to contribute a portion of their own incomes toward their retirement. The employee contributions, not to exceed $20,500 in 2022 ($19,500 in 2021), reduce a participant's pay before income taxes, so that pretax dollars are invested. If the employee is 50 or older then they may contribute another $6,500 in 2022 (same as 2021). Employers may offer to match a certain percentage of the employee's contribution, increasing participation in the plan.

While more complex, 401(k)plans offer higher contribution limits than SIMPLE IRA plans and IRAs, allowing employees to accumulate greater savings.

Profit-Sharing Plans

Employers also may make profit-sharing contributions to plans that are unrelated to any amounts an employee chooses to contribute. Profit-sharing Plans are well suited for businesses with uncertain or fluctuating profits. In addition to the flexibility in deciding the amounts of the contributions, a Profit-Sharing Plan can include options such as service requirements, vesting schedules and plan loans that are not available under SEP plans.

Contributions may range from 0 to 25 percent of eligible employees' compensation, to a maximum of $61,000 in 2022 (up from $58,000 in 2021) per employee. The contribution in any one year cannot exceed 25 percent of the total compensation of the employees participating in the plan. Contributions need not be the same percentage for all employees. Key employees may actually get as much as 25 percent while others may get as little as three percent. A plan may combine these profit-sharing contributions with 401(k) contributions (and matching contributions).

Your Goals for a Retirement Plan

Business owners set up retirement plans for different reasons. Why are you considering one? Do you want to:

- Take advantage of the tax breaks, to save more money than you'd otherwise be able to?
- Provide competitive benefits in addition to - or in lieu of - high pay to employees?
- Primarily save for your own retirement?

You might say "all of the above." Small employers who want to set up retirement plans generally fall into one of two groups. The first group includes those who want to set up a retirement plan primarily because they want to create a tax-advantage savings vehicle for themselves and thus want to allocate the greatest possible part of the contribution to the owners. The second group includes those who just want a low-cost, simple retirement plan for employees.

If there were one plan that was most efficient in doing all these things, there wouldn't be so many choices. That's why it's so important to know what your goal is. Each type of plan has different advantages and disadvantages, and you can't really pick the best ones unless you know what your real purpose is in offering a plan. Once you have an idea of what your motives are, you're in a better position to weigh the alternatives and make the right pension choice.

If you do decide that you want to offer a retirement plan, then you are definitely going to need some professional advice and guidance. Pension rules are complex and the tax aspects of retirement plans can also be confusing. Make sure you confer with your accountant before deciding which plan is right for you and your employees.

Several different types of retirement plan - 401(k), defined benefit, and profit-sharing - can be made to suit a prosperous small business or professional practice. But if yours is a really small business such as a home-based, start-up, or sideline business, maybe you should consider adopting a SIMPLE IRA plan.

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SIMPLE IRA plans contemplate contributions in two steps: first by the employee out of salary, and then by the employer, as a "matching" contribution (which can be less than the employee contribution). Where SIMPLE IRA Plans are used by self-employed persons without employees - as IRS expressly allows - the self-employed person is contributing both as employee and employer, with both contributions made from self-employment earnings.

> One form of SIMPLE IRA plan allows employer contributions without employee contributions. The ceiling on contributions, in this case, makes this SIMPLE IRA Plan option unattractive for self-employed individuals without employees.

To establish a SIMPLE IRA Plan you:

- Must have 100 or fewer employees.
- Cannot have any other retirement plans.
- Employees must earn $5,000 a year.

And, here is a quick list of pros and cons:

- Plan is not subject to the discrimination rules that everyday 401(k) plans are.

- Employees are fully vested in all contributions.
- Straightforward benefit formula allows for easy administration.
- Optional participant loans and hardship withdrawals add flexibility for employees.
- No other retirement plans can be maintained.
- Withdrawal and loan flexibility adds administrative burden for the employer.

How Much You Can Put in and Deduct

Those with relatively modest earnings will find that a SIMPLE IRA Plan lets them contribute (invest) and deduct more than other plans. With a SIMPLE IRA Plan, you can put in and deduct some or all of your self-employed business earnings. The limit on this "elective deferral" is $14,000 in 2022 ($13,500 in 2021).

If your earnings exceed that limit, you could make a modest further deductible contribution - specifically, your matching contribution as an employer. Your employer contribution would be three percent of your self-employment earnings, up to a maximum of the elective deferral limit for the year. So employee and employer contributions for 2022 can't total more than $28,000 ($14,000 maximum employee elective deferral, plus a maximum $14,000 for the employer contribution.)

Catch up contributions. Owner-employees age 50 or over can make a further deductible "catch up" contribution as employee of $3,000 in 2022 (same as 2021).

> An owner-employee age 50 or over in 2022 with self-employment earnings of $40,000 could contribute and deduct $14,000 as employee plus an additional $3,000 employee catch up contribution, plus a $1,200 (3 percent of $40,000) employer match, for a total of $18,200.

Low-income owner-employees in SIMPLE IRA Plans may also be allowed a tax credit up to $2,000 in 2022 for single filers ($4,000 married filing jointly). This is known as the "Saver's Credit" and income in 2022 must not be more than $68,000 for married filing jointly, $34,000 for singles and $51,000 for heads of household.

SIMPLE IRA plans are an excellent choice for home-based businesses and ideal for full-time employees or homemakers who make a modest income from a sideline business.

If living expenses are covered by your day job (or your spouse's job), then you would be free to put all of your sideline earnings, up to the ceiling, into SIMPLE IRA plan retirement investments.

An individual 401(k) plan, however, could allow you to contribute more, often much more, than SIMPLE IRA Plan. For example, if you are less than 50 years old with $50,000 of self-employment earnings in 2022, you could contribute $14,000 to your SIMPLE IRA PLAN plus an additional 3 percent of $50,000 as an employer contribution, for a total of $15,000. A 401(k) plan would allow a $33,000 contribution.

With $100,000 of earnings, the total for a SIMPLE IRA Plan would be $17,000 and $45,500 for a 401(k).

Withdrawal: Easy, but Taxable

There's no legal barrier to withdrawing amounts from your SIMPLE IRA Plan, whenever you please. There can be a tax cost, though: Besides regular income tax, the 10 percent penalty tax on early withdrawal (generally, withdrawal before age 59 1/2) rises to 25 percent on withdrawals in the first two years the SIMPLE IRA Plan is in existence.

A SIMPLE IRA Plan

A SIMPLE IRA Plan really is a "simple" plan to set up and operate than most other plans. Contributions go into an IRA that you set up. Those already familiar with IRA rules investment options, spousal rights, and creditors' rights don't have a lot new to learn.

Requirements for reporting to the IRS and other agencies are negligible, at least for you, the self-employed person. Your SIMPLE IRA Plan's trustee or custodian, typically an investment institution, has reporting duties and the process for figuring the deductible contribution is a bit simpler than with other plans.

What's Not So Good about SIMPLE IRA Plans

Other types of retirement plans are often better than the SIMPLE IRA Plan once self-employment earnings become significant. Other not-so-good features include the following:

Because investments are through an IRA, you're not in direct control. You must work through a financial or other institution acting as trustee or custodian, and will in practice have fewer investment options than if you were your own trustee, as you could be in a

Keogh. For many self-employed individuals, however, this won't be an issue. In this respect, a SIMPLE IRA Plan is like the SEP-IRA.

Other plans for self-employed persons allow a deduction for one year (say 2022) if the contribution is made the following year (2023) before the prior year's (2022) return is due (April 2023 or later with extensions). This rule applies to SIMPLE IRA Plans, for the matching (3 percent of earnings) contribution you make as an employer. But there's no IRS pronouncement on when the employee's portion of the SIMPLE IRA Plan is due where the only employee is the self-employed person. Those who want to delay contribution would argue that they have as long as it takes to compute self-employment earnings for 2022 (though not beyond the 2022 return due date, with extensions).

> The sooner your money goes in the plan, the longer it's working for you tax-free. So delaying your contribution isn't the wisest financial move.

You can't set up the SIMPLE IRA Plan after the year ends and still get a deduction for that year, as is allowed with SEPs. Generally, to make a SIMPLE IRA Plan effective for the year it must be set up by October 1 of that same year. A later date is allowed where the business is started after October 1. In this instance, the SIMPLE IRA Plan must be set up as soon thereafter as administratively feasible.

Then there's a problem if the SIMPLE IRA Plan is intended for a sideline business and you're already in a 401(k) plan in another business or as an employee. In this scenario, the total amount you can put into the SIMPLE IRA Plan and the 401(k) plan combined can't be more than $20,500 in 2022 or 6,500 if catch-up contributions are made to the 401(k) by one age 50 or over.

Here's an example: If someone who is less than age 50 puts $10,500 in her 401(k), they can't put more than $10,000 in her SIMPLE IRA Plan in 2022. The same limit applies if you have a SIMPLE IRA Plan while also contributing as an employee to a "403(b) annuity" (typically for government employees and teachers in public and private schools).

How to Get Started in a SIMPLE IRA Plan

You can set up a SIMPLE IRA Plan on your own by using IRS Form 5304-SIMPLE, *Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) - Not for Use With a Designated Financial Institution,* or Form 5305-SIMPLE, *Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) - for Use With a Designated Financial Institution*, but most people turn to financial institutions to take care of the paperwork for them. SIMPLE IRA Plans are offered by the same financial institutions that offer IRAs and 401(k) plans.

You can expect the institution to give you a plan document (approved by IRS or with approval pending) and an adoption agreement. In the adoption agreement, you will choose an "effective date," which is the beginning date for payments out of salary or business earnings. Remember, that date can't be later than October 1 of the year you adopt the plan, except when a business is formed after October 1.

Another key document is the Salary Reduction Agreement, which briefly describes how money goes into your SIMPLE IRA Plan. You need such an agreement even if you pay yourself business profits rather than salary.

Printed guidance on operating the SIMPLE IRA Plan may also be provided. You will also be establishing a SIMPLE IRA Plan account for yourself as a participant.

Keoghs, SEPs and SIMPLE IRA Plans Compared For 2022

Keogh	**SEP**	**SIMPLE IRA PLAN**
Plan type: Can be defined benefit or defined contribution (profit-sharing or money purchase)	Defined contribution only	Defined contribution only
Owner may have two or more plans of different types, including a SEP, currently or in the past	Owner may have SEP and Keoghs	Generally, SIMPLE IRA PLAN is the only current plan

Plan must be in existence by the end of the year for which contributions are made	Plan can be set up later - if by the due date (with extensions) of the return for the year contributions are made	Plan generally must be in existence by October 1st of the year for which contributions are made
Dollar contribution ceiling (for 2022): $61,000 for defined contribution plan; no specific ceiling for defined benefit plan	$61,000	$27,000
Percentage limit on contributions: 50% of earnings, for defined contribution plans (100% of earnings after contribution). Elective deferrals in 401(k) not subject to this limit. No percentage limit for defined benefit plan.	50% of earnings (100% of earnings after contribution). Elective deferrals in SEPs formed before 1997 not subject to this limit.	100% of earnings, up to $14,000 for 2022 for contributions as employee; 3% of earnings, up to $14,000 for contributions as employer

Deduction ceiling: For defined contribution, lesser of $61,000 or 20% of earnings (25% of earnings after contribution). 401(k) elective deferrals not subject to this limit. For defined benefit, net earnings.	Lesser of $61,000 or 20% of earnings (25% of earnings after contribution). Elective deferrals in SEPs formed before 1997 not subject to this limit.	Maximum contribution $14,000 (in 2022)
Catch up contribution 50 or over: Up to $6,500 in 2022 for 401(k)s	Same for SEPs formed before 1997	Half the limit for Keoghs, SEPs (up to $3,000 in 2022)
Prior years' service can count in computing contribution	No	No
Investments: Wide investment opportunities. Owner may directly control investments.	Somewhat narrower range of investments. Less direct control of investments.	Same as SEP
Withdrawals: Some limits on withdrawal before retirement age	No withdrawal limits	No withdrawal limits

Permitted withdrawals before age 59 1/2 may still face 10% penalty	Same as Keogh rule	Same as Keogh rule except penalty is 25% in SIMPLE IRA PLAN Plan's first two years
Spouse's rights: Federal law grants spouse certain rights in owner's plan	No federal spousal rights	No federal spousal rights
Rollover allowed to another plan (Keogh or corporate), SEP or IRA, but not a SIMPLE IRA PLAN.	Same as Keogh rule	Rollover after 2 years to another SIMPLE IRA PLAN and to plans allowed under Keogh rule
Some reporting duties are imposed, depending on plan type and amount of plan assets	Few reporting duties	Negligible reporting duties

The "SIMPLE" Plan: A Retirement Plan for the Really Small Business

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percentage limit for defined benefit plan.		contributions as employer
Deduction ceiling: For defined contribution, lesser of $61,000 or 20% of earnings (25% of earnings after contribution). 401(k) elective deferrals not subject to this limit. For defined benefit, net earnings.	Lesser of $61,000 or 20% of earnings (25% of earnings after contribution). Elective deferrals in SEPs formed before 1997 not subject to this limit.	Maximum contribution $14,000 (in 2022)
Catch up contribution 50 or over: Up to $6,500 in 2022 for 401(k)s	Same for SEPs formed before 1997	Half the limit for Keoghs, SEPs (up to $3,000 in 2022)
Prior years' service can count in computing contribution	No	No
Investments: Wide investment opportunities. Owner may directly control investments.	Somewhat narrower range of investments. Less direct control of investments.	Same as SEP
Withdrawals: Some limits on withdrawal before retirement age	No withdrawal limits	No withdrawal limits

Permitted withdrawals before age 59 1/2 may still face 10% penalty	Same as Keogh rule	Same as Keogh rule except penalty is 25% in SIMPLE IRA PLAN Plan's first two years
Spouse's rights: Federal law grants spouse certain rights in owner's plan	No federal spousal rights	No federal spousal rights
Rollover allowed to another plan (Keogh or corporate), SEP or IRA, but not a SIMPLE IRA PLAN.	Same as Keogh rule	Rollover after 2 years to another SIMPLE IRA PLAN and to plans allowed under Keogh rule
Some reporting duties are imposed, depending on plan type and amount of plan assets	Few reporting duties	Negligible reporting duties