

2021 SMALL BUSINESS YEAR-END LETTER



Did your business get a Paycheck Protection Program (PPP) Loan?

PPP loans are not federally taxable income and are not included in the gross receipts for your business. This is true even if the loan is forgiven. However, you still need to report how much you received in PPP loans.

Deductions are allowed for business expenses paid with forgiven PPP funds. Originally this was not the case, but Congress acted to allow such deductions.

Congress made it easier to apply for PPP forgiveness (for loans under \$150,000). Ask your business banker for help if you haven't applied for PPP forgiveness.

Unfortunately, PPP funds are no longer available (as of 5/31/21).

Employee Retention Credits (ERTC)?

The ERTC is a payroll tax credit for businesses that retained employees despite revenue reductions or governmental shut-downs preventing them from doing business. The ERTC began on 3/13/20 and runs through 12/31/21.

Initially, businesses were not allowed to claim both the ERTC and PPP. However, Congress acted to allow both the ERTC and PPP if they had greater than 20% quarterly revenue reductions (vs. the prior year or prior quarter). The details regarding ERTC qualifiers are beyond the scope of this newsletter. Ask for help to see if you qualify. Don't forget to ask if you qualified in prior quarters too (payroll tax returns can be amended).

Unfortunately, the ERTC will reduce your business' deductions. Deductible wages are reduced by the amount of the credit.

Does your business lose money?

Be aware of the hobby loss rules. With the IRS hot on reducing revenue losses, be aware that your business could be reclassified as a hobby. The IRS can consider your activity to be a hobby and **not a business** if you do not have a profit in 3 out of 5 years. Hobby income is claimed in full and expense deductions are not allowed.

If a loss scenario applies to your business, *it is important to show that you are trying to make a profit.* The following strategies might be helpful.

- Keep a set of business books.
- Use a separate bank account and credit card for business.
- Keep a log of activity.
- Advertise

Is your business profitable?

Profitable business owners (excluding C-corporation owners) with taxable income under \$329,800 (married) and \$164,900 (single) may get the **Qualified Business Income Deduction (QBID)**. If you make more than that it gets complicated, so let's focus on folks below these limits first.

How big is the deduction? Taxpayers below the thresholds mentioned above will generally get to deduct 20% of Qualified Business Income (with some exceptions).

What is Qualified Business Income (QBI)? QBI is closely related to profit. If your business is profitable you likely will have QBI (with some exceptions).

Example: Paul is a single consultant with \$75,000 in QBI and no capital gains. His taxable income (after deductions) is \$57,701. His deduction is 20% of \$57,701, or \$11,540.

In this example, Paul could have gotten a bigger deduction if his taxable income was higher. However, Paul would not want his taxable income to get too high. That's because the rules are less favorable if taxable income is above \$164,900 /\$329,800 (single/married). Above these levels it matters what type of business it is. For example, service business (e.g. health, law, accounting, financial services, performers, consultants, athletes, plus others) see their deduction phase-out above those income thresholds. Those folks may want to contribute more to their retirement accounts (if possible), or buy expensive business equipment to reduce their taxable income and qualify for the QBID.

Businesses that are NOT services (e.g. manufacturing, retail, etc.) can have taxable income above these levels and still get the deduction. However, their deduction is limited by other factors such as wages paid to employees and the value of certain business assets.

Did you pay for health insurance?

A self-employed taxpayer can deduct the amount paid for medical insurance for him/herself, spouse, and dependents as an adjustment to income. Deductible payments for health insurance also include Medicare premiums. The deduction is limited to net income from self-employment. No deduction is allowed for any month that the taxpayer is eligible to participate in a subsidized health plan maintained by an employer of either the taxpayer or the taxpayer's spouse.

Have employees?

If you are planning to give your employees a holiday gift, make sure it is de minimis and not in cash, otherwise, it must be included in wages.

The IRS wants your W2 filings by Jan 31st. The same deadline applies to 1099-NEC filings for independent contractors.

If you purchased health insurance for your employees, you might qualify for a 2021 tax credit.

Small employers (less than 50 full-time equivalent employees) who do not offer a group health plan to any of their employees may alternatively offer a Health Reimbursement Arrangement. Work with a service provider to manage the rules and complexities (including but not limited to HIPAA).

Beware of misclassifying employees as independent contractors. The IRS has a form for misclassified employees to report you and they are pursuing businesses that do not comply.



Do you use your vehicle for business?

Proper documentation of business miles can make quite a difference in your bottom line profit. The following rules apply to mileage expenses:

Business Mileage Methods:

Business transportation expenses can be calculated for tax purposes in one of the following two ways. In both cases, a record must be kept of business miles, commuting miles, personal miles, and total miles.

Standard mileage rate: This method can be used if you do not use your car for hire or operate a fleet. The rate for 2021 is 56¢ for each business mile driven.

Actual expense method: This method must be used if you are unable to use the standard mileage rate. It is to your advantage to use this method if your vehicle is costly to run or is over 6000 pounds. Records of all vehicle expenses must be maintained and applied to the business mileage percentage. These expenses include gas, oil, lube, repairs, tires, batteries, insurance, supplies, washes and waxes. The business use percentage of lease payments or depreciation is also calculated.

Deductible Mileage:

You can use the following three scenarios to determine how many miles you can deduct. Keep in mind that **commuting is not deductible**.

If you have an office or regular place of business outside your home, you may not deduct commuting miles to and from work or to your first and from your last stop home, but you may deduct mileage to a temporary work place and mileage to and from different locations for work during the day.

If you have an office in your home that qualifies for a home office deduction (see below for qualifications) all of your business-related mileage is deductible.

If you work out of your home, but do not

qualify for the home office deduction, the distance between home and your first stop and the distance between your last stop and home are nondeductible commuting miles. You should plan to have your first and last stops close to home to maximize the mileage deduction. A trip to the bank, post office or nearby supplier can help increase deductible miles.

The proof is in documentation.

Meals and Entertainment:

Don't forget that recent tax law changes eliminated the deduction for certain types of client entertainment. You can still deduct business meeting food & drink. However, tickets to events and most entertainment are no longer deductible. For example, if you hosted a business meeting at a baseball game the hotdogs, peanuts, and beer would be deductible but the tickets would not.

New for 2021 & 2022: Business meals from restaurants are 100% deductible (vs. 50%). Remember that ALL business deductions must be ordinary and necessary.

Don't forget the 1099s:

If you paid any person \$600 or more to perform services for your business, you need to give them form 1099-NEC by the end of January. Failure to do so will result in loss of the deduction if you are audited and a penalty if filed late.

1099-K:

If your business does internet sales or accepts credit card payments, you may be issued a Form 1099-K. These 1099s will be issued to persons or businesses who generate \$20,000 or 200 or more sales. To avoid an audit, please include all 1099-Ks with your tax information.

Do you work at home?

You may qualify for the home office deduction if you use a portion of your home as your principal place of business, to store inventory, or to conduct substantial management or administrative activities. There can be no other fixed location where these activities could be done.

The office space still needs to be **used regularly and exclusively for business,**

however. Which means you can not have any other usage of the area whatsoever. Using your office for personal or investment reasons eliminates the deduction as far as the IRS is concerned, so be careful to keep your office space and computer usage exclusively business. Having a deductible home office means you can deduct all of your local business travel as described earlier, and you will not have to keep a log of computer usage because your computer will be used exclusively for business.

If you qualify for the deduction, you will need some additional information:

- Measure your exclusive business space and total area of your home. The resulting business percentage is then applied to the total of your household expenses.

- Gather the following information to calculate the deduction:

Mortgage interest, taxes, insurance, association fees, general repairs, maintenance, utilities, garbage pickup, security, and rent paid.

You must also depreciate your home, so you will have to bring an accounting of the total investment in your property.

- Alternatively, you can use the simplified method to calculate your home office deduction. Simply multiply the total percent of exclusive business use square feet by \$5 (maximum \$1500).

You can use the organizer on the next two pages to help you prepare for your tax appointment. Keep in mind the IRS compliance requirements and focus on documentation.



BUSINESS INCOME & EXPENSE WORKSHEET

YEAR _____

NAME _____ Federal ID # _____

NAME OF BUSINESS _____

ADDRESS OF BUSINESS _____

BUSINESS ACTIVITY (Check all that apply): sales manufacturing service

PRODUCT SOLD OR SERVICE PERFORMED _____

How many months was this business in operation during the year? 12 Months OR From _____ To _____How many hours during the year did you and/or your spouse devote to this business? FULL TIME OR # of hours _____Is any portion of your investment in this business *not* subject to payback by you? YES NO

▼ BUSINESS INCOME ▼

| | | | |
|-----------------------------|---|--|---|
| GROSS SALES/RECEIPTS | Include all 1099 income for services performed | | 1099 – FORMS Bring in ALL 1099s received. Include Non-Employee Amount in Gross Sales. Do your records agree with the amount reported? YES <input type="checkbox"/> NO <input type="checkbox"/> Did you receive \$10,000.00 in actual cash from any individual at any one time—or in accumulated amounts— during this tax year? |
| SALES TAX COLLECTED | If not included in above | | |
| RETURNS / REFUNDS | Amount included in Gross Sales that was refunded to your client | | |
| OTHER INCOME | Directly related to your business | | |

▼ Sales of Equipment, Machinery, Land, Buildings Held for Business Use ▼

| Kind of Property | Date Acquired | Date Sold | Gross Sales Price | Expenses of Sale | Original Cost |
|------------------|---------------|-----------|-------------------|------------------|---------------|
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▼ BUSINESS EXPENSES (cost of goods sold) ▼

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| PURCHASE OF PRODUCT & SUPPLIES FOR RESALE | | FREIGHT-IN | Shipping cost to receive product or materials, if not included in purchases |
| PERSONAL USE | Actual cost of items in purchases used by you or your family | OTHER COSTS | |
| ◇ COST OF LABOR | | INVENTORY AT END OF YEAR | |
| PURCHASE OF MATERIAL FOR JOBS | (construction or installation type) | How did you arrive at inventory value? Actual Cost <input type="checkbox"/> Other (explain) _____ | |

▼ CAR and TRUCK EXPENSES ▼

| | VEHICLE 1 | VEHICLE 2 |
|--|-----------|-----------|
| Year and Make of Vehicle | | |
| Date Purchased (month, date and year)◇ | | |
| Ending Odometer Reading (December 31) | | |
| Beginning Odometer Reading (January 1) | - | - |
| Total Miles Driven (End Odo – Begin Odo) | | |
| Total Business Miles (do you have another vehicle?) | | |
| Total Commuting Miles | | |
| Parking Fees and Tolls | | |
| License Plates | | |
| Interest | | |
| <i>Continue below if you take actual expense (must use actual expenses if you lease)</i> | | |
| Gas, oil, lube, repairs, tires, batteries, insurance, supplies, wash, wax, etc. | | |
| Lease Costs | | |

▼ OFFICE in HOME ▼

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|-----------------------------------|
| Date Acquired Home |
| Total Cost |
| Cost Of Land |
| Cost Of Improvements |
| Sq. Footage Of Home |
| Sq. Footage Of Office Area |
| Rent Paid (If You Rent) |
| Interest |
| Taxes |
| Utilities/Garbage |
| Insurance |
| Repairs/Maintenance |
| Hours Used Per Week |
| Hours Worked Per Week |

BUSINESS EXPENSES (continued)

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| <p>ADVERTISING/PROMOTION: Ads, business cards, greeting cards, etc.</p> <p>*COMMISSIONS & FEES PAID: Contract labor</p> <p>EMPLOYEE BENEFITS: Health insurance, company party, mileage reimbursements, etc.</p> <p>INSURANCE: Worker's comp, business liability (do not include auto/truck/health)</p> <p>INTEREST: Mortgage (on business bldg.): Paid to financial institution Paid to individual</p> <p>OTHER INTEREST: (do not include auto or truck) List life insurance loans separately Business only credit card</p> <p>*LEGAL & PROFESSIONAL: Attorney fees for business, accounting fees, bonds, permits, etc.</p> <p>OFFICE EXPENSE: Postage, stationery, office supplies, bank charges, pens, etc.</p> <p>PENSION/PROFIT SHARING: Employees only</p> <p>*RENT/LEASE: Machinery and equipment Other business property</p> <p>*REPAIRS & MAINTENANCE: Building, equipment, etc. (do not include auto or truck)</p> <p>SUPPLIES: Misc. (not included elsewhere) Small tools</p> <p>TAXES: Personal property Licenses (not auto/truck) Real estate of business building & land Sales tax (if included in gross sales) Payroll (your share Soc.Sec./Medicare)</p> <p>TRAVEL (number of nights away): City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___ City_____ Nights out ___</p> | <p>EXPENSES (AWAY FROM HOME OVERNIGHT): Lodging Meals & tips (keep total separate from other costs) Convention fees Cruise ship convention/seminar Airplane or train fares Auto rental, taxis or bus fares Other (incidentals, laundry, etc.)</p> <p>MEALS & ENTERTAINMENT*: Sales lunches Gifts (limited to \$25 per individual or couple) *Entertainment (e.g. tickets) is not deductible for tax year 2018 and beyond Tickets to qualified charitable events</p> <p>UTILITIES & TELEPHONE: Electricity (business) Natural gas/heating fuel (business) Garbage, water, sewer (business) Telephone (bus. line, second line, other options) Business long distance (from home telephone) Faxes, paging svcs, cellular svcs</p> <p>WAGES: (bring your copy of W-2s/941s if they have been filed) Wages to spouse (subject to Soc.Sec. and Medicare tax) Children under 18 (not subject to Soc.Sec. and Medicare tax) Other</p> <p>OTHER EXPENSES (not listed elsewhere): Bank charges Courier services Dues & publications Education Fuel for equipment (not auto/truck) Laundry & cleaning Printing & copying Show Fees Shipping</p> |
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EQUIPMENT PURCHASED

| Item Purchased | Date Purchased | Business Use % | Cost (including sales tax) | Item Traded | Additional Cash Paid | Traded with Related Property | Other Information |
|----------------|----------------|----------------|----------------------------|-------------|----------------------|------------------------------|-------------------|
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*1099s: Amounts of \$600.00 or more paid to individuals (not corporations) for rent, interest, or services rendered to you in your business, require information returns to be filed by payer.

Due date of return is January 31. Nonfiling penalty may apply. If recipient does not furnish you with his/her Social Security Number, you are required to withhold tax on the payment(s).

| Name | Address | Social Security # | Amount | Purpose of Payment |
|------|---------|-------------------|--------|--------------------|
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