

CONTENT

CHAPTER 5: Conclusion

References.....

INTRODUCTION
Why did we write this guide?3
Who is this guide for?4
CHAPTER 1: Tax and Fundamentals
How Taxes Work: A Quick, Painless Overview6
Deadlines and Extensions6
CHAPTER 2: Getting Started
Meet Jack8
Types of Business Taxes9
CHAPTER 3: Deducting Business Expenses
To Deduct or Not to Deduct?
Common Business Expenses
CHAPTER 4: Understanding Capital Expenses and Depreciation
The Benefit of Capital Expenses
Common Capital Expenses
Determining Depreciation Value
Choose How You Capitalize Costs Wisely19



At Molen & Associates, we know small business owners and self-employed individuals wear a lot of hats. Once you start running the show, the world expects you to be an expert in everything: marketing, management, customer service...and countless other responsibilities that keep your customers happy and your business running smoothly. So, that's why we put this guide together. Because, even if you have a tax professional who files your annual return, you still need to deliver all the records and documents needed in advance. Instead of spending hours sifting through piles of receipts and hand-scribbled notes trying to log expenses and costs—we'll show you what you need in order to organize your expenses and maximize their benefits.



This guide will equip you in any industry with information that helps them prepare your financial docs prior to filing Federal tax return. When it comes to taxes, there's no "one size fits all" solution. We recommend reviewing this guide with your tax advisor to discuss a plan tailored for your business' specific structure and circumstances.

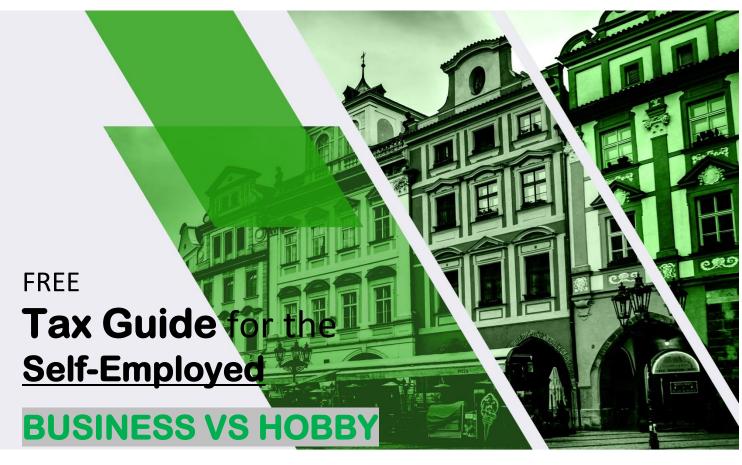
MOLEN MODEL FOR **BUSINESS MASTERY** Step 06 Traction, Accountability, Execution, Discipline Goals, Resource Mapping, Projections Step 05 Tax Return(s), Human Resources, Quarterly Reports, Payroll, IRS Correspondence Step 04 Profit and Loss Audit and Balance, Key Metrics, Budget Step 03 ANALYZE Accounting Software, Personal vs. Business Expenses, Accounts, Expense Categorizing RECORD Proper Entity, Plan or Vision, Budget, Systems and Processes, Marketing, Accountability, Customer Service, FOUNDATION Competitive Advantage

Molen Model For Business Mastery

At Molen & Associates, we have developed a proven process over the last 40 years to help people just like you be more successful and get more out of their balance. This model creates a framework to follow in order to reduce your tax liability and enjoy higher profits.

Strategic planning is the key to successfully and legally reducing tax liability. This model goes beyond just tax compliance (filing a tax return) and encourages you to proactively look for tax saving strategies to maximize your after-tax income.

If you would like the help of a trusted advisor to help you find more deductions and fully live this model, we make it a priority to enhance our mastery of the current tax law, complex tax code, and new tax regulations by attending frequent tax seminars. This guide will get you started, but we would love to help. Our Businesses and individual clients pay the lowest amount of taxes allowable by law because we continually look for ways to minimize your taxes throughout the year, not just at the end of the year.



The first thing to address as a person looking to start their own business, is knowing whether the activity in which they are carrying out is a business or hobby. Many taxpayers do not understand how to differentiate between the two, so here is some important information to help make sure you are going in the direction that you desire. The first question you should ask yourself is, am I involved in this activity to make a profit? This question is not to be confused with whether the activity is making money or not, but rather the motive of the activity. Is this activity done mostly for pleasure or is the motive mostly profit. There is a nine-question test used to distinguish between a business and a hobby, see below.

- > Is the activity being carried out in a businesslike fashion (i.e. accurate books and records)?
- > Is the individual investing enough time and effort into the business for it to be profitable?
- Does the taxpayer depend on the income from the activity as a means of support?
- Are your losses due to conditions beyond your control (i.e. startup costs)?
- Do you alter your methods of operation when necessary to improve profitability?
- > Do you have the knowledge needed to operate the business, or are you seeking professional guidance to improve performance?
- > Have you been successful with making a profit with similar activities?
- > Do you have a positive history of profits with respect to the activity? (For most businesses turning a profit at least 3 of the last 5 years is necessary)
- > Do you plan on making a profit from the appreciation of assets used in the activity?

If the answer to most of these questions is yes, then you should consider the activity a business. The income from a hobby or business must be reported regardless, but the main difference is the deductibility of expenses related to that hobby or business for tax purposes. Concerning a hobby, the ordinary and necessary expenses associated with the activity are only deductible up to the amount of hobby income. Ordinary expenses are ones commonly accepted for the activity, and necessary expenses are those that are appropriate for the activity. Just because

hobby expenses are limited to hobby income does not mean the taxpayer did not experience a loss from the activity. Unlike business losses, losses from a hobby are not deducted from other forms of income. This deduction is available to homeowners and renters who use their home as their principal place of business and a portion is used exclusively for business. Like many IRS deductions, you can choose either the actual or simplified method. The simplified method is based on the square footage of your home used for business and is beneficial for taxpayers with lower home expenses or those who itemize. When recording actual expenses, you will deduct the business use portion of mortgage interest, insurance, utilities, repairs, and depreciation that would normally fall on the Schedule A. While the tax savings from this deduction are often minimal, a home office can qualify significantly more mileage.

Self-Employment Tax

The self-employment tax applies to sole proprietors (including members of qualified joint ventures), the partners of a general partnership, and those who are members of a limited liability company that are taxed as sole proprietors or partners. The self-employment tax rate, which is FICA (social security and medicare), is 15.3% of net self-employed earnings of \$400 up to \$128,400 (adjusted annually for inflation). A taxpayer who is self-employed is paying the employee and employer portion of the FICA taxes. Those who are employed have the luxury of having their employer pay half of the FICA taxes. For this reason, self-employed individuals receive a deduction for the employer portion against their total income. Net self-employed earnings over \$128,400 are taxed at 2.9%. If you are a person that the IRS considers to be a "higher income individual", then you could also be subject to the Additional Medicare Tax of 0.9%. The Additional Medicare Tax income thresholds vary based on your income tax filing status. For more specific information regarding the additional medicare tax, consult with your tax professional.

Estimated Payments

Unlike wages, income from self-employment does not have the luxury of having automatic withholding amounts set aside each time you are paid. For this reason, it is possible for a self-employed individual to owe a significant amount in taxes if there is nothing done to take care of the tax on the self-employment income received. This makes it extremely important to be proactive regarding income tax planning. You have the option to make quarterly estimated tax payments to keep pace with what you could possibly owe once tax season comes. This can prevent or lessen the burden that could possibly be waiting for you once the smoke clears. You should consult with a tax professional when determining the amount you should pay each quarter. Payments can be made by a direct bank account debit, credit/debit card (fees apply), same day wire (bank fees apply), mailing a check or money order, and cash (at an IRS retail partner). Below are the due dates for quarterly payments.

- Quarter 1 (Jan 1 to Mar 31). Due date is April 15th
- Quarter 2 (April 1 to May 31). Due date is June 15th
- Quarter 3 (June 1 to Aug 31). Due date is September 15th
- Quarter 4 (Sept 1 to Dec 31). Due date is January 15th **of the following year**

Qualified Business Income Deduction

Section 199A is a new addition to the tax code that provides a deduction for up to 20% of your net qualified business income. While this largely affects self-employed income, there is also a 20% deduction of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. The QBI component is applicable to partnerships, S-Corporations, trusts and estates. Small business owners should be aware of the taxable income limits of \$315,000 for joint returns and \$157,500 for any other type of return. If your income isn't under this threshold than you must understand the rules regarding specified service trades or businesses (SSTBs), and QBI limitations.

Self-Employed Health Insurance Deduction

Health Insurance Premiums paid by a sole proprietor are deductible. This deduction does not reduce the amount of profit from self-employment, it is instead an AGI deduction. The deduction is limited to the net profit from business, the self-employment tax deduction, and contributions to qualified retirement plans. The self-employed individual is permitted to deduct only health insurance premiums paid with post-tax dollars for this deduction.

Depreciation

Small business owners must understand the rules of depreciation in order to correctly file their taxes. All tangible or intangible assets with a useful life of more than a year, must be deducted over the specified time period based on the IRS rules for depreciation. The De minimis safe harbor allows taxpayers to elect to fully deduct certain assets up to \$2,500 in a single year. This is useful for low cost purchases, as the full deduction can be taken immediately, rather than over time. Similarly, special depreciation allows business owners to deduct a greater percentage of qualified property in the year the asset is purchased. As of the 2018 tax year, special depreciation is 100%. The Section 179 deduction now allows businesses to deduct up to \$1,000,000 of qualified property in the tax year of purchase. Overall, there are many types of depreciation and rules that must be followed to take these deductions correctly.

Retirement plans

At some point, anyone who is working will be looking forward to being able to retire. In most cases there are tax saving opportunities available for using a retirement plan. Many self-employed individuals are uninformed about the options they have for retirement plans. Here are some plan options for those who are self-employed and the important details that you should know about each option.

1.Traditional IRA

- Contribution Limit is \$6,000 (\$7,000 for age 50+)
- Contributions are tax deductible, but are subject to phase out based on AGI
- Distributions are taxed as ordinary income
- > Any distribution before age 59.5 will carry an additional 10% penalty unless you have a qualified exception
- ➤ At age 70.5 you are required to take minimum distributions annually

2. Roth IRA

- Contribution Limit is \$6,000 (\$7,000 for age 50+)
- Contribution eligibility is subject to phase out based on AGI (6% penalty on the excess amounts contributed)
- ➤ Contributions are not tax deductible
- Contributions to the account can be withdrawn at any time tax free, but the earnings could be taxable.
- > If your IRA has been open < 5 years, then the earnings portion of withdrawals may be subject to tax and penalties.
- ➤ If you are under the age of 59.5 and your IRA has been open > 5 years, then the earnings portion of withdrawals may be subject to tax, but no penalties
- If you are over the age of 59.5 and your IRA has been open > 5 years, then you can withdraw funds with no tax or penalties

3. Solo 401(k)

- Contribution limit is the lesser of \$56,000 (\$62,000 for age 50+) or 100% of earned income (as an employee). This is a total for your employee + employer contributions.
- Contributions are made pre-tax
- > As an employee you can contribute up to \$19,000 in salary deferrals (\$25,000 for age 50+)
- As an employer you can contribute up to 20% gross earnings, not to exceed the above stated contribution limits
- Distributions are taxed as ordinary income
- Distributions before age 59.5 carry an additional 10% penalty.
- ➤ At age 70.5 you required to take minimum distributions
 - o Annual form 5500 must be filed after the plan assets exceed \$250,000

4. SEP IRA

- Contribution limit is the lesser of \$56,000 or up to 25% of net self-employed earnings/compensation (compensation factor limited to \$280,000)
- The lesser of your contributions or 25% of net self-employment earnings/compensation (compensation factor limited to \$280,000)
- If you have employees, you must contribute an equal percentage of each eligible employees' salary. So, whatever percentage you contribute to your own compensation (as an employee), then you must contribute the same percentage to each eligible employees' compensation.
- Distributions are taxed as ordinary income
- If you are under the age of 59.5 you may be subject to an additional 10% tax
- > At age 70.5 you are required to take minimum distributions

5. Simple IRA

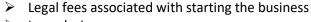
- Contribution limit is \$13,000 (\$16,000 for age 50+)
- ➤ If you also contribute to an employer plan, then the total of all your contributions cannot be over \$19,000
- Employers are required to make matching contributions or fixed contributions to every employee (fixed contributions must be paid whether employee contributes or not)
- Compensation limit for factoring contributions is \$280,000
- Distributions are taxed as ordinary income
- If you are under the age of 59.5 you may be subject to an additional 10% tax
- ➤ At age 70.5 you are required to take minimum distributions

6. Defined benefit plan

- Contribution limit is the lesser of 100% of your average highest 3 consecutive calendar years compensation, or \$225,000
- > Employer contributions are tax deductible, but must be figured by an actuary
- Contributions made by the employer on behalf of the employee and the plan earnings are tax deductible
- Distributions are taxed as ordinary income
- At age 70.5 you are required to take minimum distributions
- ➤ Annual form 5500 must be filed

Start-Up Costs

When starting a business, it is possible that you might incur non-recurring costs that are solely associated with setting up the business, those are called start-up costs. These expenses happen prior to the business operations actually start and involve the exploration, formation, and purchase of a business. Below are some examples of start-up costs.



- Logo design
- Advertising the opening of the business
- Consulting fees associated with starting the business
- > Registration related fees
- > Travel expenses associated with starting the business
- Facility costs
- Supplies
- Employee training

Taxpayers are allowed to deduct up to \$5,000 in start-up costs in their first year of business. If you have expenses related to start-up in excess of \$5,000, then you can amortize these costs over a 15-year period. The \$5,000 deduction is reduced dollar for dollar by the amount of start-up expenses in excess of \$50,000. Any amount that cannot be deducted immediately in the first year can be amortized over a 15-year period.



Ordinary and Necessary Deductible Expenses

The IRS defines an ordinary expense as one that is common and accepted in your trade or business. They define a necessary expense as one that is helpful and appropriate for your trade or business. When figuring business related expenses and whether they are deductible or not, this is how you should be thinking.



Standard Mileage Rate

For self-employed individuals deducting expenses for business use of vehicles is very important. A taxpayer who uses their personal vehicle for business is eligible to use the standard mileage rate or the actual cost method. In order to compute the vehicle expenses using the standard mileage rate, total miles driven for the year, total business miles driven for the year, and the original date the vehicle was placed in service is information that you must have. For 2019 the standard mileage rate is 58 cents per mile for business miles driven, this is up from 54.5 cents in 2018. Along with the standard mileage expense there are additional expenses that can be taken. These include parking and toll fees in the course of business, the business percentage of interest paid on a vehicle loan, and business percentage taxes paid on the vehicle (if applicable in your state). No other vehicle expenses are deductible under the standard mileage rate.

Actual Cost Method

Information such as total miles driven, total business miles driven, and date placed in service are also necessary when using the actual cost method. In addition to the aforementioned information, the actual cost method requires more detailed tracking of vehicle expenses than the standard mileage rate. The basis (original cost of the automobile, including any major improvements) is information that must be known in order to compute the depreciation expense for current tax year and each tax year that follows, until the vehicle is fully depreciated, which is a total of 5 years. Besides the depreciation expense there are a host of actual expenses that must be well documented. These expenses are gasoline, oil changes, tires, lease payments, any maintenance and repairs, insurance, registration fees, and licenses. The actual expenses must be accounted for based on the percentage of

business use vs personal use, which is derived from miles driven. For this reason, keep all receipts is very important, because only the percent of the total receipts associated with business mileage with be applicable. For self-employed individuals who operate a business such as a taxi service, truck driving, or delivery service business use of a vehicle could possibly be 100%. In these situations, the actual cost method is more likely to be used than the standard mileage rate.

Advertising

Many forms of business advertising are deductible. The key consideration when deciding what to deduct on your tax return is if the expense is ordinary and necessary for advertising in your industry. Business cards are common advertising expenses that are reasonable and ordinary in most industries. Most promotional expenses such as sponsorships, throwing events, and publicity are fully deductible. If you are advertising for a new business, these startup costs must be claimed in the year that they are paid for. Some expenses to leave off your list of deductions include entertainment with business associates, personal expenses related to your business, and research costs. Donations to non-profit organizations are deductible if they are used to secure promotional advertising for the business.





EDUCATION

For them to be deductible, your education expenses must maintain or improve skills required in your present work. Continuing education, college classes, seminars, and training courses are some examples of education that may be deducted on your Schedule C. When the education is qualified, you can write off the totals for tuition, professional development, books, supplies, and any other fees directly related to the classes. Mileage to and from should also be recorded and added to your total standard mileage deduction. Food and lodging may be applicable if you stay out of town overnight, but this is unlikely if you are enrolled in a course lasting longer than one year. Any grants or scholarship money used toward deductible education costs must be subtracted from the total.

Legal and Professional Services

Legal and professional services include short-term advice from professionals such as lawyers and accountants, regarding specific deals, transactions, or yearly taxes. Here are more examples of legal and professional services that self-employed individuals should track; professional association membership fees, organization dues, legal fees for business matters, accounting fees, short-term consulting fees, one-time management consultation fees, one-time marketing consultation fees, one-time engineering consultation fees, one-time technical consultation fees, fees paid for website analysis, one-time logo and web design fees, fees paid to talent agents, or any other fees for short-term consulting advice on specific deals. Lastly any business gift that you give in the course of trade or business can be fully or partially deductible. The maximum deductible amount is \$25 per year for the business gift given to each individual that you are engaging in a business relationship.

Meals

While you can't deduct every dollar you spend on food, there are plenty of opportunities to use the meals deduction. This deduction used to apply to entertainment expenses but has recently been eliminated. Because of this change, meal expenses must be separate from other entertainment related costs. Meals taken while traveling, at work events, and meals for the purpose of conducting business are limited to a 50% deduction. There is an 80% deduction limit for DOT (Department of Transportation) worker's meals. The IRS defines DOT workers as directly involved with moving people by plane, barge, bus, ship, train or truck who travel away from home to areas with different federal per diem rates. There are also exceptions to the 50% limit that allow for 100% of meals to be deductible. These exceptions to the 50% limit include meals treated as taxable compensation to employees, promotional activities made available to the public, employer-provided social meals to benefit employees, and meals sold to customers. If you don't have adequate records of what was spent, your best option is taking the per diem meal deduction. In order to use these rates, you must have documentation of the time, place and business

purpose of the trip.



When a business is conducted away from the taxpayer's "tax home", there are more expenses that are deductible. The tax home includes the city or general area where an individual taxpayer normally conducts business. This is not to be confused with where the taxpayer's actual home is (i.e. where they live or reside). I person can live in a different place than where their tax home is located. In order to deduct these expenses a taxpayer must be away from their tax home longer than an ordinary workday, and the trip should be such that the taxpayer is not reasonably expected to complete the trip without rest or sleep. Expenses for transportation by way of airplane, train, bus, and car between your tax home and business destinations are deductible. Also commuting fares (i.e. taxi, uber, bus, limousine, etc.) to or from an airport, train station, a hotel, work location, or business meeting location. Tips paid during commuting are also deductible. Lodging expenses are deductible if they are overnight or long enough to require sleep or rest in order to carry out work duties. Other ordinary and necessary business expenses that are incurred while traveling away from your tax home such as dry cleaning and laundry, internet access, business meals, shipping cost, business calls are also deductible.

Communication

If you're self-employed, you will rely heavily on personal communication devices such as a laptop, tablet, and cell phone. The key consideration of this deduction is business vs. personal use. The IRS is clear that personal use of these devices, even in a work setting, is not deductible. It's important that you figure your business percent usage and apply that to your total communication costs including cell phone bill, air card, and internet. A new cell phone purchase can also be included on your return through depreciation. When there are multiple people on your business-related cell phone plan, it is important not to include their portion of the costs in this deduction. Even if you only use your phone for work, it is very difficult to defend deducting 100% of the cost. On the other hand, even a personal cell phone will have some portion of personal use, so it is important to figure an accurate ratio.

Supplies/Office Expenses

No matter what kind of business you have supplies and/or office expenses will be necessary to operate. General things like paper, ink cartridges, pens, office furniture, cleaning supplies, computers, computer software, or filing cabinets are just a few examples. Obviously, this list of possible supplies and office expenses could go on forever given the many different industries that exist (i.e. dumbbells for a fitness trainer or hair products for a beautician). These costs are deductible if the items were purchased during the tax year and are used for business purposes.

Inventory

Inventories are generally goods available for sale, raw materials used to produce goods, and partially finished products. Just as any other expense, inventory must tracked but can be a little tricky as materials are moving through a process to be sold. A business must use a method to keep up with and value each item in inventory. There are 3 basic methods used to track inventory, the same method must be used from year to year.

- 1. Specific Identification Method. This method matches each inventory item with its actual cost. The value of closing inventory is its actual cost.
- 2. First-in first-out or (FIFO). This method assumes items that are purchased first produced first are the first items to be sold. The inventory items on hand at the end of the year are valued as the items most recently purchased or produced. Using the First-in-first-out Method, the value of closing inventory can be the lower of either its cost or the market cost.
- 3. Last-in first out (LIFO). This method assumes items that are purchased or produced last are the first items to be sold. In order to use this method, an application must be filed with the IRS (Form 970).



- 11555 Champion Forest Dr. Houston, TX 77066
- **(**) (281) 440-6279
- **(281) 716-6000**