7 Biggest Misconceptions Business Owners Have About Their Returns

Regardless of how life changes, one of the biggest hurdles you'll face in running your own business is to stay on top of your numerous obligations to federal, state, and local tax agencies. A tax headache is only one mistake away, be it a missed payment or filing deadline, an improperly claimed deduction, or incomplete records.

You can safely 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. The old legal saying that "ignorance of the law is no excuse" is perhaps most often applied in tax settings. On the other hand, it is surprising how many small businesses actually *overpay* their taxes. They often neglect to take deductions they're legally entitled to, or just don't know about certain breaks that can help them lower their tax bill.

Adding to the mayhem, we have tax codes that seem to be in a constant state of flux. Creating exceptions for special groups has resulted in a steady stream of new and revised tax laws, which have lengthened the *Internal Revenue Code* to over 4,500 pages and rendered it barely understandable to even the most experienced tax professionals. Often one section can run up to several hundred pages. A special tax service used by tax professionals explains the meaning and application of each part of the code. It is contained in another 12 volumes! The harder Congress tries to simplify the code, the more complex it becomes.

Preparing your taxes and strategizing 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 (God forbid) 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 and gain the advantage over the IRS.

Nevertheless, many accountants don't understand the mammoth tax code and end up being too conservative with your tax deductions. The more conservative they are, the more taxes you end up paying.

Unfortunately, the cryptic and mystifying nature of the tax code generates a lot of folklore and misinformation that also leads to costly mistakes. Here is a list of some common small business tax misperceptions:

1. <u>Start-Up Costs Are Immediately Deductible</u>

Costs incurred before you open your doors for business are deductible, but must be spread out over at least the first 60 months you are in business. There are two ways to avoid the delayed deductions. One, conduct some business during the start up phase, or two, delay paying costs until you open for business. You should talk to a tax expert before choosing either of these options because if you lose money in the first few years of operation, you may be better off having the deduction spread out.

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. Being incorporated enables you to take more deductions.

Aside from health insurance, deductions for the self-employed (sole-proprietors and S Corps) are pretty much equivalent to corporate deductions. For many small businesses, being incorporated is an unnecessary expense and burden. Start-ups can spend $1,000 in legal and accounting fees to set up a corporation, only to determine shortly after that they want to change their name or company direction. 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.

This is no longer as true as it once was. Because of the proliferation of home offices, tax officials cannot possibly audit all tax returns containing the home office deduction. A high deduction-to-income ratio tends to lead to an audit.

5. If you don't take the home office deduction, business expenses are not deductible.

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.

6. Taking an extension on your taxes is an extension to pay taxes.

Extensions enable you to extend your filing date only. If you do not pay taxes on time, penalties and interest begin accruing from the due date.

7. Part-time business owners cannot set up self-employed pensions.

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.

Besides avoiding these pitfalls, possessing basic knowledge of how the tax system works is also beneficial. After all, even if you delegate the tax preparation to someone else, you are still liable for the accuracy of your tax returns. If your accountant messes up, you pay the penalty, not him.