

Proven Tax Reduction Strategies for Sole Proprietors

If you operate your business as a sole proprietorship, there are many strategies to reduce your taxes.

Let's start with the following 10:

1. Use the Section 105 plan to make your health insurance a tax-favored business deduction on your Schedule C.
2. Employ your under-age-18 child to make taxable income disappear.
3. Employ your spouse without paying him or her a W-2 wage.
4. Rent your office, even your home office, from your spouse to save self-employment taxes.
5. Establish that an office in your home is your principal office to increase (yes, increase!) your vehicle deductions and also turn personal home expenses into business expenses.

6. Give yourself flowers, fruit, and books as tax-deductible fringe benefits.
7. Combine the home office and a heavy SUV, crossover vehicle, or pickup truck to grab big deductions this year.
8. Design a business trip that includes some personal days—days you treat as 100 percent business even though you don't work on those days.
9. Use the seven-day tax deduction travel rule to create a business trip that is 87 percent personal vacation.
10. Deduct your smartphone and provide smartphones to your employees as tax-free fringe benefits.

If one or more of these look good to you, let's talk about how to make them work.

Incorporation Is Not for Everyone

If you're not good at paperwork, the corporate form of business is probably not for you.

Let me tell you about a tax court case involving William H. Bruecher III. He learned a lesson by paying more than \$27,000 in taxes on monies his corporation supposedly loaned to him. Mr. Bruecher's corporation did not pay him a salary; rather, the corporation paid his personal expenses, classifying the payments as advances.

Advance Account on Corporate Books

Advances handled properly do not create a tax problem. The IRS in an audit, or the court in a decision, first looks to see whether the advances are loans or dividends. If repayment by the owner and collection by the corporation seem assured, or actually take place in a later year, the advance is a loan.

Intent to Repay

To decide whether there is intent to repay, the court looks at factors such as the following:

- Promissory notes or other written promises to repay the advance
- Interest charges on the advance
- Collateral to ensure repayment
- Past history of repayment

Neither Mr. Bruecher nor his corporation could produce any of these. Further, the very personal nature of some of the advances (such as divorce settlement payments, child support payments, and payments to the grocery store) got the court's attention.

In court, Mr. Bruecher delivered his self-serving testimony and presented as evidence the corporate tax return, on which the advances were classified as loans. Not good enough, ruled the court, as it made the advances taxable dividends to Mr. Bruecher.

Takeaways

When you operate as a corporation, the corporation is a separate legal entity, and you should have a corporate paper trail that clearly reflects intent and action.

- **C corporation.** Clear out the advance account and make the advances interest-bearing loans, with specific repayment dates.
- **S corporation.** Either offset the advances with the distribution account or evidence the advances as interest-bearing loans.

How to Deduct Cruise Ship Conventions, Seminars, and Meetings

If you want to attend a convention, seminar, or similar meeting onboard a cruise ship and deduct all your costs, you face some very special rules. But it can be done.

When you know the tax code rules, you will find an enlightened workaround that removes almost all the hassle and gives you what you want. The IRS considers all ships that sail cruise ships.

In 1982, your lawmakers were attempting to give the U.S. cruise ship industry a leg up by outlawing all cruise ship conventions, seminars, and similar meetings other than those

- that take place on a vessel registered in the United States, and
- for which all ports of call of such vessel are located in the United States or in possessions of the United States.

The 1982 law remains on the books. Lawmakers have not updated the limits for inflation. Here's the cruise ship convention tax code rule as it existed in 1982 and as it exists today:

With respect to cruises beginning in any calendar year, not more than \$2,000 of the expenses attributable to an individual attending one or more meetings may be taken into account under Section 162 . . . ”

Had the \$2,000 been indexed for inflation, the 2019 amount would be a reasonable \$5,431, and that would likely encourage more 2019 U.S. cruise ship convention-type travel.

The \$2,000 is pretty skimpy when you consider that the expenses include

- the cost of air or other travel to get to and from the cruise ship port;
- the cost of the cruise; and
- the cost of the convention, seminar, or similar meeting.

Bigger, Better Deductions with Less Hassle

This is a way you can avoid the \$2,000 limit, take the cruise you want, and likely deduct all your costs. And this does not have to involve a U.S. ship. Any ship from any country works.

Here's the strategy. You take the cruise ship to a convention, seminar, or meeting that's held

- on land, say at a hotel, and
- in the tax-law-defined North American area.

When you meet the two easy requirements above, you deduct

- the full cost of getting to and from the location;
- the full cost of the convention, seminar, or similar meeting; and
- likely the full cost of the cruise if your onboard ship expenses are less than the 2019 daily luxury water limits.

Using the 2019 luxury water limits, if your average daily cost of the cruise is \$692 or less, you can use this strategy to deduct all cruise ship costs to travel to and from the seminar.

Impact of Death, Retirement, and Disability on the 179 Deduction

What tax effect would death, retirement, or disability have on you or your business? Here's an easy example to illustrate.

Let's say that in 2017, you purchased for business use a pickup truck with a gross vehicle weight rating greater than 6,000 pounds. Asserting that you use the pickup 100 percent for business, you expensed the entire \$55,000 cost.

What happens to that \$55,000 expensed amount if you die, retire, or become disabled before the end of the vehicle's five-year depreciation period?

Death

If your heirs are not going to pay estate taxes, your death is about as good as it gets. Here's why: You get to keep your Section 179 deduction. (It goes to the grave with you.)

Your pickup truck gets marked up to fair market value. (Remember, you expensed it to zero, but now at your death, the fair market value is the new basis to your heir or heirs.)

Example. Using Section 179, you expensed the entire cost of your \$55,000 pickup truck. You die. Your daughter inherits the pickup at its fair market value, which is now \$31,000, and sells it immediately for \$31,000. Here are the results:

- You get to keep your Section 179 deduction—no recapture applies.
- Your daughter pays zero tax on her sale of the pickup truck.
- Your estate includes the \$31,000 fair market value of the pickup, and if your estate is less than \$11.4 million, your estate pays no estate taxes.

Disability

This is ugly. If you become disabled and you allow your business use of the pickup to fall to 50 percent or below during its five-year depreciable life, you must recapture and pay taxes on the excess deductions generated by the Section 179 deduction.

To make matters worse, you must use straight-line depreciation in making the excess-deduction calculation.

Retirement

With retirement, you have exactly the same problem as you would have if you were to become disabled. In fact, with retirement, you disable your business involvement, and that makes your pickup truck fail the more-than-50-percent-business-use test, resulting in recapture of the excess benefit over straight-line depreciation.