7 Big Tax Mistakes to Avoid Before Year End

By Kim Bey, CPA

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No one enjoys handing over tens of thousands of dollars at tax time. However, it is even worse when it's money that you wouldn't have had to pay if you had planned ahead. Yet, that's what millions of Americans do every year. Because they didn't put advance strategies in place, they overpay on their taxes—and sometimes by a lot.

There are many deductions available to business owners and sole proprietors, but you have to know what they are in order to take advantage of them. You can't just put it all off until tax time. By then, it's too late. Many of these tax reduction strategies require proactive tax planning—what steps need to be taken now in order to reduce your tax burden for the year?

Because there are only a few months left in the year, now is the time to talk about tax planning. No matter who you are, there is still an opportunity to take advantage of these strategies before the end of the year.

There are common tax mistakes that I've seen countless times in working with clients. Each of these issues can be avoided using proactive tax planning. If a business owner takes action before the end of the year, they can potentially save thousands, or tens of thousands, on their taxes.

Some of these mistakes are:

1. Failing to Plan

Maximizing your deductions means planning ahead, not trying to figure out how to create deductions after the fact. This requires having a good idea of your current financial position so that you can project your tax liability ahead of time, when something can still be done about it. This may seem like extra work. However, it will be worth it when your tax bill is several thousand dollars lower.

I've seen people spend tens of thousands of dollars in unnecessary taxes simply because no one thought it through ahead of time. Though it might seem obvious, this is the number one mistake I see.

2. Wrong Type of Business Entity

Whether your business is a sole proprietorship, a partnership, an S Corp, or a C Corp can have a profound impact on your taxes. With a sole proprietorship, you're going to report all your income on a Schedule C and pay taxes on your net income, plus a Self-Employment tax of up to 15.3 percent of your income. With an S Corp, the proceeds of your company are split into "salary" and "income." You'll pay taxes on both your salary and your income, but you'll only pay FICA on your salary.

What does that mean? On an income of $80,000, you may be able save more than $5,000 per year just by changing the way your business is set up.

3. Wrong Type of Retirement Plan

Putting money aside for retirement not only provides for your future but also defers your tax obligation until later. However, the problem is that a standard IRA has an annual limit of $5,500. The good news is that if you'd like to set aside more, you do have other options.

Other types of retirement accounts include Simplified Employee Pensions (SEPs), SIMPLE IRAs, 401(k)s, and defined benefit plans. These each have different tax ramifications and timing requirements. Your best option for a retirement plan depends on your unique circumstances.

4. Forgetting Family Employment Options

You may not realize that hiring a family member is a great way to save money on taxes. Why? Their first $6,350 of earned income is taxed at zero and up to $9,325 is taxed at just 10 percent—significantly less than your tax bracket. This means you can save money on expenses like summer camp or private school tuition by hiring a teen to do filing or social media management.

You are required to maintain the basics of employment for your child. This includes things such as having a job description, keeping a timesheet, paying by check, maintaining a record of payments, and having an account in the child's name. However, you're also allowed to pay them a reasonable wage, which can be significant.

5. Improperly Structuring Medical Expenses

It might be possible to structure your medical bills as business expenses. If you qualify, a Medical Expense Reimbursement Plan enables you to put your spouse or mature child on your payroll and reimburse medical expenses. Health Savings Accounts can also be used to combine a high-deductible insurance plan to cover unreimbursed costs.

Like retirement accounts, there is a lot to this subject. However, doing it right can save a lot of money in certain situations.

6. No Home Office Deduction

Home office deductions don't raise as many red "audit" flags as you might think. If you have no other fixed location where you conduct a significant part of your business, any room or part of room you use exclusively and regularly for your business will qualify. You just need to calculate the square footage of that area and figure out the business use percentage. You can then apply that percentage to mortgage interest, property taxes, utilities, security, repairs, insurance, and more.

Remember, if you have an S corp, you can't just take the deduction like a sole proprietor. You have to actually reimburse yourself for these expenses before the end of the year, which is then deducted from your profit.

7. Omitting Deductions for Meals and Entertainment

To utilize these deductions, you'll need some basic records. This is as simple as a little book that says who you entertained, when and where it was, what business was accomplished, and what your business relationship with that person is. Remember, entertainment can take place in the home, in a restaurant, a theater, or at a sporting event. The only requirement is that it was for legitimate business purposes.

Summary

The government has intentionally set up avenues for businesses to reduce their tax burdens, but it's up to us to take advantage of them. Meet with a trusted advisor to see if any of these strategies apply to your situation. Just remember that it's best to approach these issues before December 31, not afterwards.

Kim Bey, CPA, recently spoke at the D.C. Bar Practice Management Advisory Service's *Small Firm Lunch and Learn Series* *on September 14. She is the owner of Bey & Associates, CPA, PC, and co-author of Amazon bestseller* Secrets of a Tax-Free Life: Surprising Write-off Strategies Most Business Owners Miss. *Currently serving on the D.C. Bar Association's Practice Management Service Committee, Kim's focus is helping business owners and attorneys maximize their deductions so they can keep more of their hard-earned money.*