AICPA NATIONAL TAX CONFERENCE

SELF-EMPLOYMENT ISSUES

SESSION 202

TUESDAY, OCTOBER 28, 2008

7 AM (much too early!)

AICPA NATIONAL TAX CONFERENCE

- DISCUSSION LEADER:

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Entity Selection for Small Businesses

– **Sole proprietorship**

- Simple
- No liability protection
- All profits exposed to S/E tax

Partnerships

- Form 1065 is a nuisance (or does it reduce audit probability?)
  - No liability protection unless LLP
  - All profits for active partners subject to S/E tax
    - Limited partners are not subject to S/E tax but they can't be involved with management, hiring, check signing, etc.
    - Narrow opportunity to allocate some profit to return on capital to avoid S/E tax

LLC (not a corporation)

- Disregarded for Income Tax purposes

- Single Member LLC – Files a Schedule C
- Multiple Member LLC – Files a 1065

Corporations

- C Corp can establish "reasonable compensation" to reduce S/E Tax exposure

Ugly DOUBLE TAX exposure

- Allows all benefits such as HRA and disability insurance for owners
- **S Corp** avoids double tax AND reduces S/E tax based on salary

Retirement Plan Considerations

- Low salary limits retirement plan contributions
  - SIMPLE or Defined Benefit Plans may solve problem

Medical Insurance

Profitable Schedule C or positive 1065 K-1 can generate S/E medical insurance deduction

- S corporation can pay or reimburse for medical insurance, report amount on W-2 and generate S/E medical insurance deduction
- C corporation can pay and deduct insurance cost

Health Savings Accounts are Sure Winners

Insurance companies **don't** recommend HSA's

- High deductibles are rewarded with large savings in premiums
- Employees will avoid unnecessary medical procedures
- Money in HSA carries over from year to year
- HSA belongs to employee and can be left to spouse
- HSA provides additional tax deferred income – like a supplemental IRA

HSA EXAMPLE OF SAVINGS

ANNUAL COST FOR FAMILY COVERAGE

DEDUCTIBLE	$1000	$3000	$5000
2002	$10,000	$8,200	$ -
2003	12,000	7,800	-
2004	13,000	8,000	-
2005	14,532	10,296	6,432
2006	15,480	11,028	7,116
2007	15,708	11,376	7,428

HSA EXAMPLE

LET'S TAKE A FEW MINUTES AND GO THROUGH AN EXAMPLE OF HOW A HEALTH SAVINGS ACCOUNT CAN SAVE SERIOUS MONEY

YOU GET BETTER HEALTH CARE FOR LESS MONEY !

EXAMPLE of Cost Saved with HDHP/HSA

Firm pays 40% of Health Insurance
Employee Cost (60%) for Family Coverage –
$1000 Deductible - 60% of $15,708 = $9,425
$5000 Deductible - 60% of $7,428 = 4,457
Savings to employee with HSA = $4,968

Employer also saves $3,312 (40% of $8,280)
Employer contributes $3,312 to HSA for employee

HSA EXAMPLE

- Net cost to employee to maintain quality HDHP with Company contribution to HSA

• Employee's cost for insurance	$4,457
• Employer Contribution to HSA	3,312
• Net Cost to Employee	$1,145

- Employee said: "I work for a wonderful firm"

HSA EXAMPLE

Non-Monetary Benefits of HDHP/HSA

>Less contact with Insurance Companies

> Fewer ridiculous rules

> Less delay getting providers paid

>"It's my money"

>Fewer unnecessary medical procedures and drugs

HSA EXAMPLE

TAX DRIVEN BENEFITS:

- Smart employees never touch HSA
- Additional contributions are deductible even for taxpayers who don't itemize deductions
- HSA can be set aside for catastrophic medical events
- HSA can supplement IRA's

HSA EXAMPLE

- NOW BACK TO OUR REGULAR PRESENTATION………

OTHER INSURANCE

Long Term Care – Deductible as S/E medical insurance within limits

Disability & Life – Not deductible for owners except for C corporation owner / employees

Employee Benefits

Health Reimbursement Arrangements (HRA's) Medical Reimbursement Plans (owners of unincorporated businesses not eligible)

- **Cars** – Lease, Own or reimburse
- **Continuing Education**
- **Undergraduate / Graduate Education** - $5250 per year limit (owners and their relatives under age 21 not eligible)
- **Travel, meals and entertainment**

Deductions allowed

Many expenses would be personal and not deductible if business didn't exist

- Cell phones
- Cars
- Computers
- T, M & E

Employment of Family Members

* Qualifying family members cannot be owners of business

Children under age 18 working for parents in UNINCORPORATED business

- Exemption for FICA and Medicare taxes
- Retirement Plan opportunities – consider ROTH IRA

Employment of Family Members

– **Parents** and other older relatives

- Utilize **lower tax brackets**
- Contribute to **retirement plans**

Employment of Family Members

- Spouses – SOME GREAT OPPORTUNITIES
  - Retirement plans
  - More deductions for T, M & E, cell phones, etc.
  - Medical insurance deduction moves to Schedule C to reduce S/E tax

continued……

Employment of Family Members

- **Health Reimbursement Arrangement** – IRC 105(b) – Medical Reimbursement Plan (Written plan document required)
  - Employed spouse qualifies and can **cover owner spouse** and other dependents
  - HRA can reimburse for deductibles, co-payments and uninsured items such as dental, eye care, and laser surgery

Spouses – SOME GREAT OPPORTUNITIES

- **Need good records**
  - Employment contract
  - Payroll records and tax returns (941's, 940, W-2 and State filings)
  - Workers Compensation Insurance in some states
  - Specific duties compensated at market rates
  - Social Security and Medicare cost may kill the deal
  - Compensation package does not need to include salary

Best of All Worlds

– Work as **W-2 employee** to get FICA coverage, 401(K) and insurance

AND

– Generate outside income for a **Schedule C**

Have a W-2 and Sch C

DEDUCT ON SCHEDULE C:

- car
- phone
- computer
- T, M & E
- CPE
- Office in the Home???

Have a W-2 and Sch C

Establish a retirement plan

SIMPLE plan for small profits (not allowed if covered by another retirement plan

Keogh Plan – requires 5500 filing

SEP IRA – easy and shelters 20% of profit

Defined Benefit Plan – requires actuary but may provide huge deductions

- Hire spouse (see above)

Other Considerations

High profits will generate high S/E tax

- 2.9% of $1million = $29,000
- Elect to be taxed as an S Corp (only Form 2553 required) and pay **reasonable salary**
  - $102,000
  - $7000
  - $161,000
  - $230,000

Other Considerations

- Avoid Gross receipts tax, as in California, by using S corporation
- Keep salary below $13,650 for early Social Security retirees

ENJOY THE CONFERENCE

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