

Fact Sheet for Small Business Owners

As you embark on your new small business venture (sole-proprietorship), it is important that you are aware of the applicable income tax rules and regulations. Failure to comply could result in significant tax adjustments along with penalties and interest. It is also important to dispel some common misunderstandings regarding income and deductible expenses pertaining to a small business owner.

Fiction:

- Now that I have my own business I will be entitled to “**all kinds of deductions**”.
- I won't have to report **all** of my income. Who would ever know?
- My business “*deductions*” will reduce my current tax liability.

Facts:

A business owner is entitled to deduct any **ordinary** (common/expected) and **necessary** (essentially required) expenses incurred to **produce, pursue, or secure** income in their trade or business. That is, there must be a direct correlation to the expense incurred and the operation of the business. **All** expenses must be substantiated in the manner prescribed by law. No substantiation, no records (or poor records), no deduction.

In order for a taxpayer to deduct *business* expenses there must in fact be a “trade or business”. The IRS describes a “business” as a venture undertaken by the taxpayer with the intent and expectation of generating a profit (taxable income). Certain part-time ventures and/or “*hobbies*” are **not** considered businesses and deductions are either prohibited or severely limited. **All** gross income earned by the business/venture must be recorded and reported. Legitimate business deductions will simply reduce this new income (from business venture) and generally have no impact on other non-business income reported on your tax returns.

A successful business owner will generate profits and those profits are subject to at least 3 separate taxes. Prepayment of taxes (estimated quarterly taxes) may be required.

Home-based businesses present additional complications regarding deductible expenses. A careful review of these rules is strongly suggested **prior** to the opening of the business. In order to maximize your legitimate deductions you must be aware of what qualifies for deduction and what the substantiation (record keeping) rules are.

If you have any questions regarding this material or would like to set up a consultation to discuss your business, please contact our office at your earliest convenience.

Sincerely,

Berman and Sons, LTD