BMC
Accounting LLC

The Entrepreneur's Handbook

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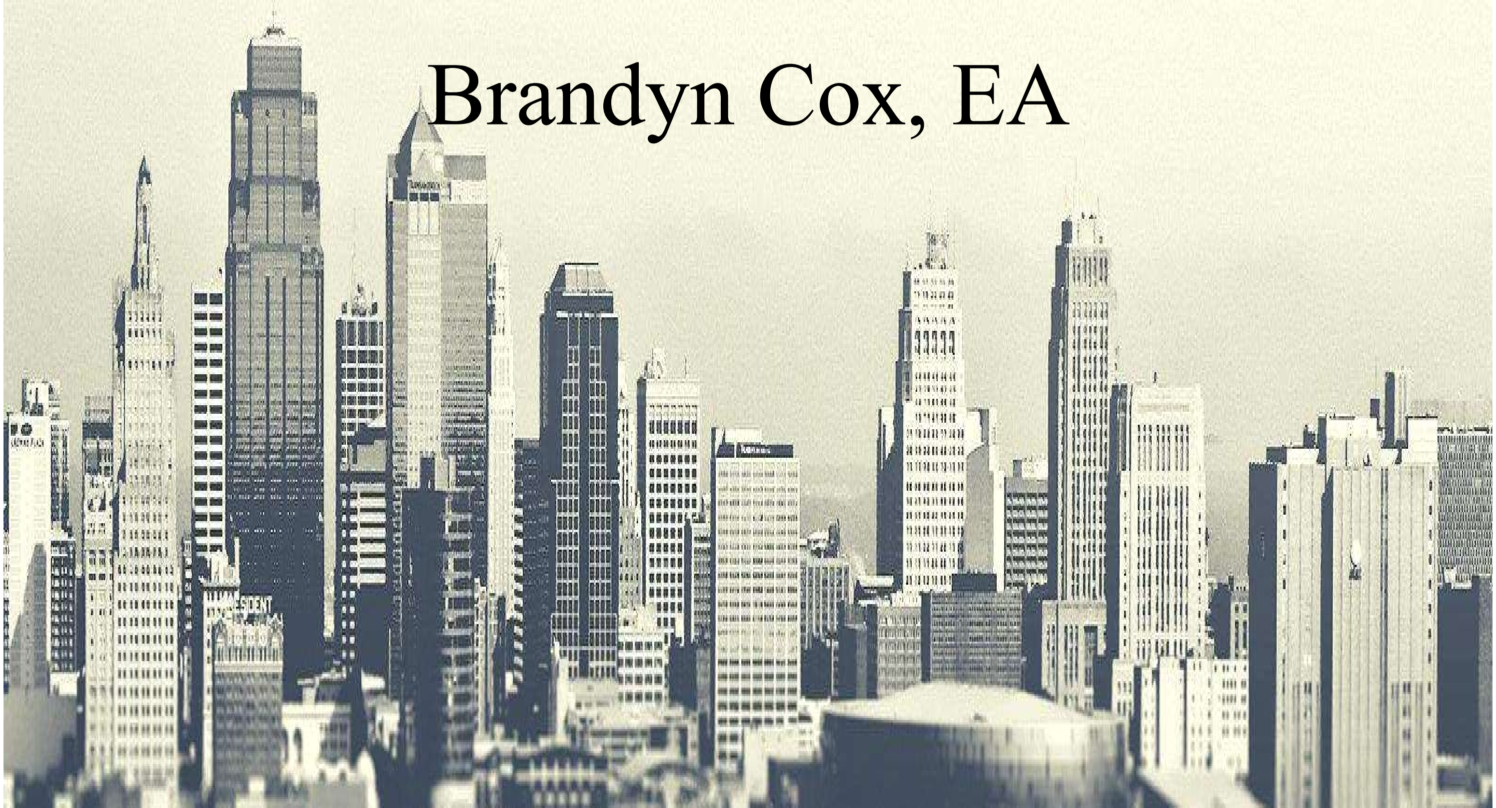

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INTRODUCTION

Starting your business is difficult. Understanding how everything fits in and how to keep the most money in your pocket is really the main goal of a for profit business. Most entrepreneurs fail in the first three years because of any combination of three things:

- Lack of Revenue
- Underestimating Expenses and
- TAXES.

Notice I have TAXES in all caps. This is because this is the most common reason for failures.

Startups typically run very lean. Expenses are only made if they immediately create revenue and any revenue is good revenue. Although this is how a business can be profitable early, you shouldn't be as focused on the now as you are the coming weeks and months that lie ahead. Ignorance is bliss when you're a child, but ignorance as an entrepreneur means early failure.

This book isn't meant to cover all the grounds of taxes and accounting for small businesses, nor make you a tax expert. This isn't a collegiate level book. This book was designed for YOU, the self-starter making a name for yourself who wants to make educated business financial decisions. I can only imagine you sit at your desk, frustrated and wondering how do the rich get rich. The rich get rich many ways, but one of their tools is a basic understanding of taxes.

I understand taxes and accounting can be boring, and I'll do my best to avoid the dryness associated with it. There will be examples on everything, so it makes sense to even the least experience entrepreneur. The math for these examples will be done with easy round numbers to illustrate the principal behind it all. However, for those of you savvy enough to read further into taxes and accounting, there will be footnotes indicating where you can find substantial authority on each topic discussed. Do yourself a favor and take the time to read this no risk literature to better your business and yourself, you'll be glad you did. Don’t forget the call to action at the end to help keep you held accountable for your business. What good is a book if there is no follow through right?

WHAT ARE TAXES?

I can already see your face now... Taxes, ugh. Well, unless you enjoy donating to Uncle Sam, then a basic understanding of taxes can save you thousands of dollars each year. In that case, then what are **Taxes**? Simply put, it is corporations and individuals paying the government for basic needs and services. That is the definition you would likely find in the dictionary or something like it. To you, taxes should be a mindset which will be one of many tools that guide your business to profit. This mindset does take some practice and it does take some effort. However, throughout this book, you will see how making simple tax conscious decisions can save you thousands each year.

To get you into the mindset, think of Amazon and their $0 tax bill in 2018. Impressive right? Think they did that with zero tax strategy? I highly doubt it. To illustrate further, consider two businesses that are exactly the same and make exactly the same income. One of those businesses will pay much, much less in taxes if that business makes decisions based on how that will affect their tax liability throughout the whole year. Let's take a closer look and understand the different types of taxes most small businesses will come across.

WHO PAYS TAXES? – There are two main categories of businesses

- Corporations[1]
- Flow Through Entities[2]

Flow through entities are the most common and most numerous. These are your sole proprietorships, LLC's, partnerships, and S-Corporations. We will discuss in more depth in Chapter 3 about these types of business entities. The most important thing to understand right now is that the owners of flow through entities will pay taxes on the income they make each year. The business itself does not pay taxes, except for payroll taxes and excise taxes.

[1] 26 USC Subchapter C

[2] 26 CFR § 1.67-2T

Now, let's discuss the most common types of taxes an entrepreneur will face:

- Income Tax
- Self-Employment Tax
- Capital Gains Tax
- Depreciation Recapture Tax

INCOME TAX

This is the tax everyone is familiar with. You have income taxes withheld from your wages as an employee and may even get an income tax refund at the end of the year. The 2019 tax rates for this tax are[3]:

- 10%
- 12%
- 22%
- 24%
- 32%
- 35%
- 37%

Depending on your taxable income and filing status, this will determine your income tax rate. Below is the pecking order of how a return is typically filed:

	Wages, Interest, and Dividends
+	Business and Rental Income
+	Retirement Distributions
+	Other Income
	Gross Income
+/-	Adjustments to Income
	Adjusted Gross Income
-	Standard/Itemized Deductions
-	QBI Deduction
	Taxable Income

The biggest myth of income taxes is that once you reach a bracket, say 24%, then all your income is taxed at 24%. This is not true.

[3] 26 U.S. Code § 1

Below is a chart for single taxpayers for tax brackets between 10% and 24%. Consider a single taxpayer who has $45,000 of taxable income in 2019. If all income were taxed at his tax rate of 22%, that would mean that this taxpayer would pay $9,900 in income taxes. As we'll see, this is much more than is due.

Tax Rate	Taxable Income Bracket	Amount of Tax Owed
10%	$0 - $9,700	10% of taxable income
12%	$9,701 - $39,475	$970 plus 12% of the amount over $9,700
22%	$39,476 - $84,200	$4,543 plus 22% of the amount over $39,475
24%	$84,201 - $160,725	$14,382.50 plus 24% of the amount over $84,200

According to the tax bracket for 22%, only income that is over $39,475 gets taxed at 22%. Amounts below that are taxed at 10% and 12% first. So how much does this taxpayer owe for the year?

$45,000 - $39,475 = $5,525

$5,525 x 22% = $1,215.50

$4,543 + $1,215.50 = $5,758.50

See how big of a difference this makes? What if you thought that income taxes were calculated in the first situation where you pay $9,900? You might consider spending money to reduce your tax rate. This would obviously be a very bad decision and not get the desired result of profit.

What we see here is the difference between **Effective Tax Rate** and **Marginal Income Tax Rate**. The effective tax rate is the amount of tax owed for every single dollar earned. The marginal income tax rate is the rate for which each subsequent dollar in taxable income, what tax rate that dollar will incur.

To show the difference, below is an illustration of this example's effective tax rate and marginal income tax rate:

Effective Tax Rate = Total Tax ÷ Taxable Income
Effective Tax Rate = $5,758.50 ÷ $45,000
Effective Tax Rate = 12.79%
Marginal Tax Rate = 22%

What a difference right? Using marginal tax rates to estimate how much tax you owe will only work when you already know where you sit for taxable income before the next business decision. Effective tax rates slowly increase as you make each new dollar. Income Tax is also called Ordinary Tax, so you may hear that throughout this book.

SELF-EMPLOYMENT TAX[4]

This is the tax entrepreneurs pay if they are a Sole Proprietor, Single Member LLC, General Partner in a Partnership, or an Independent Contractor. This is the most often forgotten tax, only to be discovered during tax season, and it is expensive! This tax is also in addition to income tax. To understand Self-employment tax, let's consider when you were once an employee.

Employees get a paycheck every week or two and pay Social Security and Medicare taxes. They are automatically withheld from your paycheck. Social Security is 6.2%[5] and Medicare is 1.45%[6], for a total of 7.65%. What most people fail to realize is that your employer must pay the exact same amount you do, and it is all based on your gross income. Consider an employee that makes $1,000 per paycheck:

Employee		Employer	
Social Security		Social Security	
$1,000 x 6.2% =	$62.00	$1,000 x 6.2% =	$62.00
	+		+
Medicare		Medicare	
$1,000 x 1.45% =	$14.50	$1,000 x 1.45% =	$14.50
	$76.50		$76.50

[4] 26 U.S. Code § 6017
[5] 26 U.S. Code § 86
[6] 26 U.S. Code § 3101

Want to take a guess what the rate of Self-Employment tax is? That is right, 15.3%[7], the same as the employee plus the employer rate. Of course, the IRS does offer a tax break with this by only taxing 92.35% (Which is 100% - 7.65%). Further, the IRS allows for 1/2 of your Self-employment Tax to be deductible for income tax. Only S-Corporation and C-Corporation shareholders can be employees of their business, thus receive a paycheck. All other entrepreneurs do not receive a paycheck from their company. Since this is the case, we will calculate Self-Employment tax on an entrepreneur that makes $10,000 of taxable income for the year:

$10,000 x 92.35% = $9,235.00

$923.50 x 15.3 % = ***$1,413.00***

So, on top of income tax, this entrepreneur must also pay $1,413 in self-employment tax as well. This makes the effective tax rate of self-employment tax equal to 14.13%. We will use this rate to discuss self-employment tax for the rest of the book for the sake of simplicity. Furthermore, $706.50 of this self-employment tax is deductible against taxable income, as we state above. $706.50 is one half of the total self-employment tax.

CAPITAL GAINS TAX[8]

Capital gains tax arises from when **Capital Assets**[9] are sold. Capital assets are assets that have a life of longer than one year. Equipment, machinery, computers, vehicles, buildings, etc., are all capital assets. Capital gains taxes are also assessed on stocks, mutual funds, and money markets.

[7] 26 U.S. Code § 1401
[8] 26 U.S. Code Subchapter P
[9] 26 U.S. Code § 1221

There are two types of capital gains taxes[10]:

- Short-Term
- Long-Term

Short-term capital assets are assets that were placed into service and sold in exactly one year or less. Long-term capital assets are assets that were placed into service and sold after one year.

Short-term Capital Tax rates are:

- 10%
- 22%
- 32%
- 37%
- 12%
- 24%
- 35%

Look familiar? These gains are taxed at ordinary rates. Told you that you'd see that term again.

Long-term capital tax rates are:

- 0%
- 15%
- 20%.

The percentage you must pay is determined by your filing status and taxable income. Consider the example below:

Adam and John both sell a rental home. Both originally paid $400,000 for their properties and both sold it for $500,000. Adam is single and has taxable Income of $78,000 and John is married filing a joint return with taxable income of $78,000. Adam will pay $7,500 in Long-term Capital Gains Taxes and John will pay $0. How is this possible? The next page has the 2019 Long-term Capital Gains brackets.

[10] 26 U.S. Code § 1223

Because John had less than $78,750 in Adjusted Gross Income and was married filing a joint return, he just earned tax free income. For you truly savvy readers, yes we did ignore depreciation recapture. That will be discussed next.

Here is a great point to stop and think about that mindset again. The only difference between Adam and John above, was their filing status. Everything else in the scenario was the same. Now, I am not telling you to go out and get married just to save on taxes, although that status does help, but this illustrates how you must consider taxes as an entrepreneur. In this case, Adam would have to reduce his taxable income by $38,626, almost half in order to receive a 0% long term capital gains rate. John, on the other hand, only can increase his taxable income by $751 until he no longer has a 0% long term capital gains tax rate. John would want to know this so he doesn't incidentally sell another asset or create more taxable income for the year.

Adam ↓ **John** ↓

Tax Rate	Single	Married Filing Joint	Head of Household
0%	$0 - $39,375	$0 - $78,750	$0 - $52,750
15%	$39,376 -$434,550	$78,751 - $488,850	$0 - $461,700
20%	Over $434,550	Over $488,850	Over $461,700

Digging even further, assume John does make $751 more in that tax year. That $751 of taxable income just cost him $7,500. Was that mere $751 worth it? I certainly don't think so.

DEPRECIATION RECAPTURE TAX[11]

Of course, Uncle Sam isn't going to let you walk away selling that rental property we just discussed tax free. **Depreciation Recapture Tax** is exactly what it sounds like, it forces you to recapture the **Depreciation**

[11] 26 U.S. Code § 1250 and §1245

you took on capital assets and pay ordinary income tax on that. There aren't many ways out of this, and for those strategies, you should really seek out guidance from a qualified tax professional. Depreciation is the deduction allowed for regular wear and tear on an asset.

So how do you figure out what the amount to recapture is. First, you need to understand Depreciation Recapture Tax is a tax on the GREATER of:

- Depreciation Taken
- Depreciation Allowable.

So, if you forgot to take depreciation on capital assets, you're about to pay tax on it twice, once when you didn't take the deduction and again when the allowable depreciation is recaptured. The real bite of the depreciation recapture is that this amount is added to your gross income for the year and may place you into the next higher tax bracket.

Consider the situation above where John sold his property for $500,000 when he purchased it for $400,000. Assume he places that property into service 1 Jan 2015 and sells it in 2019. This is $57,464[12] in depreciation allowable. This amount is going to put almost all this amount in the 22% tax bracket as seen below.

Tax Rate	Taxable Income Bracket	Amount of Tax Owed
12%	$19,401 - $78,950	$1,940 plus 12% of the amount over $19,400
22%	$78,951- $168,400	$9,086 plus 22% of the amount over $78,950

So, for simplicity sake, let's say that all $57,464 will be taxed at the 22% rate. That is $12,642 in unrecaptured depreciation tax to pay. Imagine John selling this property in the beginning of the year and using the funds to buy a new property or take his family on vacation. Think he will have almost $13,000 in April to pay Uncle Sam? Not likely. You should start to see how important this is. What John would want to do, immediately upon selling this capital asset, is make an estimated tax payment to the IRS for the $12,642. This way, when tax time comes, John isn't left holding a large tax debt and no way to pay it.

[12] 26 U.S. Code § 168

BUSINESS ENTITY TYPES

The way you form your business will determine how you are taxed. The two main categories of entities are **Corporations** and **Flow Through Entities**. Corporations are C-Corporations while flow through entities are made up of sole proprietors, partnerships, and S-Corporations. C-Corporations pay taxes on their income, not their owners. A C-Corporation could make $100,000,000 in a year, and the single owner of that business will pay $0 in income taxes. Flow through entities are the exact opposite. Instead of the business paying taxes on its income, the individual owners themselves will pay taxes on their allocated income each year.

Sole Proprietors

These are businesses that operate as a DBA (Doing Business As) or an LLC (Limited Liability Company) where there is only one owner. This is often referred to as a single member LLC. These entrepreneurs file Form Schedule C with their personal tax return. They are subject at a minimum to Self-employment Tax and Income Tax. Their tax return is due on 15 April each year. You cannot separate out the "Business Taxes" and your personal taxes. Also, the business itself does not pay any taxes. Lastly, the IRS doesn’t quite recognize LLC’s as its own entity when there is only one owner. If you are the sole member of an LLC, you are personally responsible for all the taxes that result of that LLC income each year. By default, if the LLC has only one member, it is a sole proprietorship and if there are more owners it is a partnership

Partnerships[13]

Partnerships exist when two or more people own a business. It can be a:

- General Partnership
- Limited Liability Partnership
- Limited Liability Company

[13] 26 U.S. Code § 761

To understand the difference of the entities above, it matters what type of owners there are in the partnership. Within partnerships there are two types of owners[14]:

- General
- Limited

General Partners have material participation in the company, meaning they are active within the business more than merely their financial investment. Limited Partners do not have material participation in the company and generally only provide an investment via capital into the business. General Partners are subject at a minimum to Self-employment Tax and Income Tax. Limited Partners are generally only subject to Income Tax since they do not materially participate.

You cannot really have a partnership where both partners are limited partners. At least one partner needs to be a general partner.

At the end of the year, when taxes are filed for the Partnership, each partner will receive a **Schedule K-1[15]** which indicates how much income is allocated to the respective Partner. Partnerships tax returns are due 15 March each year, unlike Sole Proprietors. Partnerships do not pay taxes either[16], the partners each pay taxes on their allocated income. Here is an example of what this looks like:

Consider Jackie & John Holdings LLC where both are general partners and Jackie owns 75% of the LLC while John owns 25%. If the company earns $150,000 in net income for the year, Jackie will have to pay taxes on $112,500 and John will have to pay taxes on $37,500. This is regardless if they took any type of owner draw from the company or not. This is because the entity is a flow through, meaning all income is allocated to their owners at the end of the year based on net income and percentage owned.

[14] 26 U.S. Code § 761(b)
[15] 26 U.S. Code § 704
[16] 26 U.S. Code § 701

S-Corporations[17]

No, the "S" does not mean small. It simply refers to the sub chapter of the Internal Revenue Code for which it discusses this entity type. S-Corporations are a hybrid of C-Corporations, partnerships, and sole proprietorships. Although an S-Corporation can be wholly owned by one shareholder. A business does not start as an S-Corporation. A business either starts as a Sole Proprietor, Partnership, or Corporation. It must subsequently elect to be taxed as an S-Corporation. For the election to start from 1 January, it generally must be filed by 15 March of the same year[18]. S-Corporation owners are called shareholders and pay less taxes for their business income than they would as a partner or member in an LLC or sole proprietorship. The reason is that S-Corporation shareholders only pay income tax on their allocated income they earn each year, but do not pay self-employment tax.

S-Corporations do not distribute dividends and do not pay a corporate tax, so the S-Corporation election stands to be abused easily. Therefore, the IRS has required S-Corporation shareholders who provide personal services to the corporation to take a reasonable compensation salary[19]. This means that the shareholders will receive wages as an employee of the company. This money will of course be subject to payroll taxes:

- Social Security
- Medicare
- FUTA
- State UI
- State and/or Federal Wage Withholding

This is very similar to Self-employment tax. The reasonable compensation amount is not defined by the IRS in any statute[20], however, there have been many tax court cases surrounding this issue and you should seek professional guidance on what amount would likely qualify as reasonable compensation.

[17] 26 U.S. Code § 1361
[18] 26 U.S. Code § 1362(a)
[19] 26 CFR § 1.162-7
[20] 26 CFR § 1.162-7(b)(3)

The magic here for S-Corporations is the excess earnings that are allocated to the owners. To illustrate this, consider an S-Corporation that has one shareholder (wholly owned) and it makes $120,000 in net income for the year, before considering the reasonable compensation the shareholder must take. If this shareholder's personal services are what drives the income of the business, then a reasonable compensation may be $90,000. In this case, there is $30,000 which would get allocated to this shareholder at the end of the year:

$120,000	Net income
- $90,000	Reasonable Compensation
= $30,000	Allocated Income

This $30,000 will be placed on a Schedule K-1 and given to the shareholder after the S-Corporation files its tax return. This $30,000 will only be taxed with income tax, not self-employment tax. In this case, that is over $4,000 of savings in tax due. Of course, you wouldn't likely take your $90,000 salary right at the end of the year or when you file the S-Corporation taxes. This should be done in line with company cash flow needs and throughout the entire year.

There are also some restrictions as to S-Corporation ownership. If the S-Corporation does not maintain its qualified status at any time of the year, the S-Corporation involuntarily is terminated and defaults to a C-Corporation. It is highly recommended that you work with a tax professional if you elect to become an S-Corporation. To qualify to be an S-Corporation, at a minimum your company must[21]:

- Have no more than 100 shareholders
- Have only one type of stock (common stock)
- Have only US citizens and certain trusts or estates to own stock

Most small businesses do not need to worry about the first two elements that much, as they would be uncommon to come up as a potential issue. However, if an S-Corporation sells even one share of stock to another S-Corporation, C-Corporation, partnership, or non-US citizen, it immediately becomes a C-Corporation[22]. So, if you and a business partner each own share in an S-Corporation, and your business partner

[21] 26 U.S. Code § 1361(b)(1)
[22] 26 U.S. Code § 1361(3)(c)

sells even one share to another partnership, non-US citizen or non-qualified shareholder, the entire business could become a nightmare.

C-Corporations

When a company is incorporated in any state, this is the default status for that company. C-Corporations are living, breathing taxpayers in the eyes of the IRS. C-Corporations currently pay an income tax rate of 21%[23], they distribute dividends to its shareholders, and anyone can own part or all of a C-Corporation.

There are also many more tax strategies that can be done with C-Corporations that otherwise are not beneficial for other business entity types. These extra tax strategies will not really be covered in this text. There are entire collegiate courses dedicated to simply C-Corporations. In most cases, you would not want to start your business as a C-Corporation unless there are circumstances that make it beneficial:

- Your personal effective income tax rate is higher than 21%
- Managing the amount of income that is shown on your personal tax return
- Stronger asset protection
- Need of large equity investments that would otherwise disqualify you from S-Corporation status
- You wish to make this company publicly traded

Generally small business owners will not want to be a C-Corporation because the corporate tax rate will be higher than their personal effective income tax rate. To illustrate this, let's look at a comparison example of an LLC and C-Corporation below:

Assume Mike and Tim both own a business where they are the sole owners. Mike owns an LLC and Tim owns a C-Corporation. Both Mike and Tim's companies will make $200,000 in net income for the year. To compare apples to apples here, let's further assume that Tim does not take a salary from the company, but does distribute all remaining earnings as dividends to himself at the end of the year. Below is the math to show who pays more in taxes:

[23] 26 U.S. Code § 11(b)

	LLC	C-CORPORATION
Net Income ---	$200,000	$200,000
SE Tax/Corporate Rate---	x 14.13%	x 21%
SE Tax/Corporate Tax	$28,260	$42,000
Income Tax	$29,694	$29,214
TOTAL TAXES	**$57,954**	**$71,214**
Effective Tax Rate	28.97%	35.61%

What happened here? The effective tax rate tells the story on why the LLC member paid less in taxes overall compared to a C-Corporation shareholder. The effective tax rate for the LLC was quite low overall, only 28.97% compared to 35.61% of the C-Corporation. Since both owners had the same marginal tax rate (which wasn't shown for simplicity sake), the self-employment tax was less than the corporate tax rate of 21%. Typically once the owners have net income over about $400,000, that is when the C-Corporation shareholder overall will have less taxes to pay.

Below is a quick chart to break it down:

Entity Type	**Sole Proprietor**	**Partnerships**	**S-Corporations**	**C-Corporations**
Taxes the entity pays	N/A	N/A	N/A	Corporate 21%
Taxes the owner pays	Income Tax Self-employment	Income Tax Self-employment	Income Tax Payroll Taxes	Income Tax
Flow Through?	Yes	Yes	Yes	No
Owner take paychecks?	No	No	Yes	Yes
Formation Document	Articles of Organization	Articles of Organization	Articles of Organization Articles of Incorporation	Articles of Incorporation

HOW TO KEEP RECORDS[24]

This is the part that gets most entrepreneurs in trouble with the IRS and other taxing authorities. You are required to maintain records for at least three years from when the return was filed or due, whichever was earlier. This is because this is the same statute of limitations that the IRS has to assess additional taxes. Generally, the only way for the IRS to assess taxes beyond the three-year limit is in criminal or negligent returns. This chapter will discuss the types of documents you may have and how to best maintain them.

The most common types of documentation an entrepreneur would need are:

- Invoices
- Sales Receipts
- Refund slips
- Purchase orders
- Purchase receipts
- Loan documentation
- Bills of sale
- Pay stubs
- Bank statements

You should be familiar with these types of documents, so we will only briefly discuss them. The most important of all are **Source Documents**. Source documents are the original copies that cause any type of transaction. Really, the only one in the list above that isn't a source document is bank statements. These are replicated transactions and are not as reliable as source documents. Consider a purchase at a hardware store. If you're a landlord and you purchase a stove, an HVAC, some cleaning supplies, and some flowers, you have several different types of transactions built into one purchase receipt. The stove and HVAC are assets and must be capitalized, whereas the rest are immediately expensed. What that means is the stove and HVAC aren't necessarily written off entirely on the tax return, but the cleaning supplies and flowers would be. If you were to only rely on transactional history, like a bank statement, you may misclassify all these costs as repairs and

[24] 26 U.S. Code § 6001

maintenance. In the event of an audit or examination, you would find yourself likely being assessed additional taxes and penalties.

Sales receipts are the best source of revenue for any business. It isn't recommended that you simply write a sales receipt for "Services" and apply one charge. If you charge a client for more than one good or service, be sure to itemize the receipt. There are a couple reasons for this.

First, if you are selling a combination of services and goods, you could be unnecessarily collecting sales tax from the customer. Services are generally not sales taxable in most states, whereas the sale of tangible property (goods) are.

Also, if a customer returns one or more items on the sales receipt, you can see whether you sold them that item. Just because you are a good citizen and provide valuable goods and services to others, doesn't mean that your clients will reciprocate this behavior. Fraudulent refunds and returns cost businesses millions of dollars each year.

Lastly, this makes your Cost of Goods Sold easier to track. When you purchase an inventoriable item, it is carried on the Balance Sheet as Inventory. You don't write that off as an expense until it is sold, hence the name Cost of Goods Sold. If you are too lax on keeping your own books and you go back to record the sale of inventory from months ago, you may find it impossible to determine your true gross profit. Aside from improper tax reporting, this is a major issue and will cause nothing but stress and money.

Invoices, like sales receipts, should be itemized. Invoices are sent to clients either before or after a good or service is sold. You can even add terms to the invoice. For example, 2/10 n,30 is a common term for companies. This means that the client receives a 2% discount if the invoice is paid in full within 10 days, otherwise the net amount is due within 30 days. Pay attention to these terms when you receive invoices from vendors, called purchase orders or bills. If a vendor is willing to reduce your bill because of timely payment or payment in cash, you could be missing out on hundreds or thousands of dollars saved each year. Furthermore, accounting for invoices is called **Accounts Receivable**. Accounts receivable means someone owes you money, and that is an asset. It is very important to keep an eye on the status of these invoices with an **Aging Receivables** report. The aging receivables report typically breaks down invoices by due date into time frames. On the next page would be an example of an Aging Receivables report summary:

	98%	88%	35%	10%	4%	
Client	**Current**	**31-60**	**61-90**	**90-180**	**180+**	**Total**
John	$1,500					$1,500
Jake		$2,000		$4,000		$6,000
Brian	$1,000				$10,000	$11,000
Ashley			$1,500		$30,000	$31,500
Total	*$2,500*	*$2,000*	*$1,500*	*$4,000*	*$40,000*	***$50,000***

If you simply looked at a current balance sheet and saw $50,000 in accounts receivable, that wouldn't tell you the whole story. Statistically speaking, the further down the line you allow a client to be late, the less likely you are to collect that invoice. The percentages above indicate the average I have seen clients receive the money they are supposed to collect. Notice how dramatic of a drop it becomes once you allow an invoice to be later than 60 days past due. That is huge!

Also, the chance you are going to collect almost 88% of the funds sitting in accounts receivable is slim to none. $40,000 of your goods and/or services are likely not to be collected and that is a problem. There is a way to stop this from happening.

First, ensure that all invoices clearly state the terms of the invoice. If there are no terms, then technically the invoice has an infinite amount of days to pay it. Also, make sure there is a section which indicates that interest will be added for any invoices which are overdue. Lastly, state on each invoice that accepting an invoice automatically forces the client to agree to being sent to collections if they are 60 days or more late and that the collections agency will assess additional fees to recoup your lost funds.

Purchase orders are essentially the mirror image of an invoice. What is an invoice to you is a purchase order to the client and vice versa. Just like sales receipts and invoices, ensure you are receiving itemized purchase orders. This makes tracking inventory and cost of goods sold so much easier. You can also see if you are being overcharged for any item. You might be surprised to learn how much of a markup is on certain items. If you can find approved vendors that sell similar or identical items, then an itemized purchase order is going to ensure you are paying the lowest possible. If one of your vendors charges $50 for cable but a different vendor may charge $40 for cable, it should be an easy decision on who to buy from, especially in bulk.

Loan documentation is often an oversight with entrepreneurs. It shouldn't be though because there are two parts to every debt:

- Principal
- Interest

No matter the type of debt, whether it is a line of credit, credit cards, or a mortgage, the principal portions of payments are not deductible and shouldn't be recorded as an expense on the profit and loss statement either. However, interest is an expense and is deductible generally. Too often I come across entrepreneurs that failed to recognize this and would try to write off an entire year's worth of car payments or mortgages. It is a hard lesson to learn come tax time. Get an amortization table to show how much each payment is interest and how much is principal. This will be a tremendous help in determining whether you are taking on good debt or bad debt. Take the below situation for example:

Which debt is better? 5 year debt with 10% interest or 10 year debt with 5% interest when both loans are for $15,000? Believe it or not, the first option is cheaper. Without an amortization schedule, you may not be able to figure it out. This is because interest on debt like this compounds monthly. The interest rate in this situation is called the **Nominal** or **Stated** rate. It is the interest rate for which is applied evenly over each monthly payment. Effective interest rate is more important. The effective interest rate for each loan above is 27.3% and 27.51%, respectively. Who would have thought that a 10% interest loan was more expensive than a 5% interest loan huh?

So what can you do when you have a high effective interest rate loan? There are a few options:

- Refinance
- Sell the equipment after its main use
- Don't take the loan

Refinancing is generally going to be the best option, but you'll want to consider any refinancing fees. Selling the equipment after its main use is a great option as well but understanding the depreciation recapture on that property is an important element as well. Lastly, you may not even want to take the loan. It may not be the greatest news to hear, but unless a piece of equipment or property is absolutely necessary, you could just forgo the loan until you have enough capital and credit to make it more economically feasible. If this is the case, determine if renting or leasing is a better economical option.

Bank statements are useful as well, but since they are not a source document they do not hold the same weight under an audit or examination. Bank statements are generally much easier to obtain, even when you don't use that bank anymore. So, if you have no documentation at all, which is not ideal, relying on bank statements to prepare tax returns and financials may be all you can do.

AVOIDING FIRST YEAR FAILS

This chapter is called avoiding first year fails, but these types of fails can happen really in any year of a business's life. However, a smart business owner will take their company tax returns to a professional rather than self-prepare, because self-preparing will not tell you what you just did wrong. Tax and accounting software are only as good as the operator. Consider this, Wix is a website software that is wildly affordable and relatively easy to use. However, we have all seen a website someone put together on their own without understanding basic marketing techniques or design experience. It looks terrible! Yeah, you can make a website with that software, but it doesn't mean it will be any good. You can even think of a time you tried a simple repair on your vehicle. Do those always go as planned and is the outcome as good as a professional?

Mistaking personal expenses as business expenses are often something I deal with year after year. For business to take a deduction for an expense, it must be ordinary and necessary[25]. With that being said, there are some expenses that are inherently personal, but can be used for business as well. Expenses such as cell phone, internet, mileage on your vehicle etc. These are all expenses that you regularly incur regardless if you own a business or not. However, these types of expenses either have a flat rate you can use for business or you make a reasonable estimation. For example, the standard mileage rate for business miles is $0.58 per mile[26]. With cell phones and internet, there isn't a standard rate. Instead, you make a reasonable estimation as to the business use percentage. There isn't exactly an easy way to back this claim up if audited. Call logs would be a good way to substantiate the claim, but so would internet browser history on your phone as well. Most business owners use their phone anywhere between 45% - 95% for business. So, for someone who pays $150 per month for their cell phone, it would translate into $810 - $1,710 tax deduction per year without really incurring any additional expenses.

Business expenses don't necessarily have to come from company funds either. Capital contributions are when you purchase something for the company with personal funds. Since the company doesn't recognize this contribution as revenue, it should also be understood that taking money

[25] 26 U.S. Code § 162

[26] IRS Notice 2019-02

from the company isn't a deduction either, regardless how little or how much you take. This means that there is no such thing as your company reimbursing you for expenses. You can call it that, but it is still just an owner draw. Unless you are a shareholder in an S-Corporation or C-Corporation, you will not take a paycheck. Owners draws are simply taking money from the company and placing it into your personal account. When you do become an S-Corporation or C-Corporation, then you will take a paycheck, and those payments are deductible on the corporate tax return.

Also, many entrepreneurs will attempt to misclassify a worker to save on payroll taxes. There are two main types of workers for an employer:

- Employees
- Independent Contractors

For the most part, I always tell people if it looks like a duck, walks like a duck, and quacks like a duck, it's probably a duck. The same is true for workers. There is no one element of workers that definitively makes an employee or independent contractor. The IRS does provide some guidance though, which should be accounted for as a totality of circumstances. To help classify a worker correctly, use the following three categories of elements:

- Behavioral Control
- Financial Control
- Relationship of the Parties

Behavioral control focuses on how the employer controls the work environment for the worker. Employees typically have a set schedule, request time off, and punch out for lunch. Independent contractors set their own hours and work schedule. Furthermore, employees generally need to receive onboarding training and education. Independent contractors are typically specialized and already have training and education. Employees will also receive evaluations on a periodical basis, this does not usually happen with independent contractors.

Financial control focuses on how the worker is paid and their investment. Employees are not usually asked to provide their own equipment and tools, whereas an independent contractor already has purchased their equipment. Think of a secretary for a business. This secretary likely isn't asked to bring a desk, laptop, scheduling software, a chair, and supplies. This is all given to him or her by the employer, making the secretary an employee. Also, employees are either paid a salary or an hourly wage. Employees also don't get much wiggle room in what that rate is, aside from initial negotiations during hiring or pay raises. Independent contractors have their own set rates and they are generally paid upon completion of work or a contracted method. Also, the concept of profit and loss is important for independent contractors. Employees don't have this concern because it is always a profit, regardless the size.

The relationship between the employer and worker needs to be considered as well. Often, employees are awarded benefits such as health and dental, retirement plans, sick and vacation days, etc., whereas independent contractors will simply receive money. The permanency of the work is also a great guide. Employees are pretty much retained indefinitely aside from layoffs, sequesters, termination, or company bankruptcy. Independent contractors are set by contractual boundaries and there is no guarantee the contract will be renewed. Further, if this worker provides the same services to other employers, this is indicative of an independent contractor. Employees only really work for one employer, at most two if they have two jobs. Independent contractors may work for hundreds or even thousands of different employers.

Of course, it is often cheaper to hire an independent contractor rather than an employer. There are no benefits to pay for and most importantly, there are no payroll taxes to pay. The last part of that sentence is what gets most entrepreneurs in trouble, and this can easily sink a business within a year. The federal trust fund recovery penalty[27] is the penalty the IRS will assess on employers who incorrectly classify a worker as an independent contractor instead of an employee. This is a major penalty and claiming bankruptcy will not absolve you of this either. The federal trust fund recovery penalty is equal to the amount of Social Security, Medicare, and federal income tax that should have been withheld and paid in total. For even one employee who was paid $50,000 per year that penalty is upwards of $10,000. That is a significant penalty to have to pay on just one worker. What if that payroll had multiple employees? You can see how quickly that will accumulate. The payroll taxes on this employee would only have cost the employer just under $4,000. Misclassifying workers is much more expensive when caught.

Even though the federal trust fund recovery penalty is severe enough, the state also has penalties for this as well for state unemployment insurance

[27] 26 U.S. Code § 6672

tax and state income tax withholdings. So, on top of that $10,000 federal penalty, you could incur another few thousand dollars from the state.

Another common first year mistake, is not filing taxes on their business income. I generally see this from two types of entrepreneurs, those who didn't make much and those who have failed to file since they started the business. Obviously, the entrepreneur who doesn't file their taxes for long periods of time will face major consequences with the IRS and their state. The filing requirement for business owners is $400. If you earned at least $400 in net income for the year, you are required to report that. How do these entrepreneurs eventually get caught? Usually one of two forms will end up busting the owner:

- 1099-MISC
- 1099-K

The 1099-MISC form is filed with the IRS when an independent contractor is paid at least $600 in wages for a year. The 1099-K form is filed with the IRS when someone receives at least 200 transactions and $20,000 in revenue from third party merchant services. Merchant services are companies like Square, Stripe, Shopify, etc. Often, the IRS will wait a few years to see if the recipient of those forms will file their return. The IRS has the later of 3 years from when the return was filed or due to assess additional taxes[28]. If the return was never filed, there really isn't a statute of limitations for the IRS to come back and audit or examine. Even further, the IRS has a statute of limitations of 10 years to collect those taxes from the date they were assessed[29]. Some states are even longer, such as California whose statute of limitations for collections is 20 years.

So, what happens when income isn't reported, and the IRS catches it? First, a lien[30] is placed on the owner's assets, both personal and business. This is for all assets currently owned and any future assets until the lien is removed. If the tax debt still isn't paid within a certain time period, the IRS will place a levy[31] against you. First assets levied are usually checking and saving accounts, retirement accounts, disability checks and Social Security, and money market funds. If this happens and the debt is still not settled, the IRS will go after assets such as vehicles, real estate,

[28] 26 U.S. Code § 6501(a)
[29] 26 U.S. Code § 6502(a)(1)
[30] 26 U.S. Code § 6321
[31] 26 U.S. Code § 6331

and other business assets[32]. You can see how quickly this can escalate into a very, very major problem.

Of course, the easiest way to solve this problem is prevention. Avoiding this issue altogether is the best tax strategy. But there are ways to handle large tax debts and uncertainties. The most common tax resolution strategy is an Installment Agreement[33]. This allows you to request up to 72 months to pay this debt with monthly payments. If the debt is still too high, you can request a partial payment installment agreement[34]. This is where you intend on paying off as much as possible of the debt, but it is unlikely you will ever pay it all off. Lastly, and the most invasive of options, is an offer in compromise.

The offer in compromise is often referred to as the second chance program and tax forgiveness plan. Those terms are not entirely accurate. Often you'll hear these companies that claim, "We fight the IRS for you, and you'll pay pennies on the dollar" or "If you have at least $10,000 in tax debt you can now pay only a fraction of the cost". These companies are sharks and will charge you outrageous fees for minimal results. I consider many of these types of companies as the payday loan companies of the tax industry. Working with an Enrolled Agent, Tax Attorney, or CPA who has experience in handling these cases are your best bet. What those commercials don't tell you is that you must be current on all tax filings, estimated taxes, and generally pay 20% down of your tax debt to be considered for the application. Even then, it isn't a guarantee and is a lengthy process.

Aside from complicated tax resolution issues, often young entrepreneurs get told about Bonus Depreciation and Section 179 expensing. Bonus Depreciation and Section 179 expensing allows for you to elect to deduct in full the amount of certain assets in the first year. This sounds attractive and is often marketed as follows:

Your new truck MSRP's for $80,000. If you assume a tax rate of 37%, this is an instant tax savings of $29,600 which makes your $80,000 truck now only cost you $50,400.

Sounds great right? The big issue with this is that the marketing agency is likely assuming you have the highest tax rate. This is often not the case.

[32] IRM 5.11.1
[33] 26 U.S. Code § 6159
[34] 26 CFR § 301.6159-1

Most entrepreneurs fall into much lower tax rates and the depreciation recapture tax that we talked about earlier will just add that amount back at the end when you sell it or trade it in. Of course, that information isn't in the marketing. There are times when electing bonus depreciation or section 179 expensing is in your favor. If you have had an unusually high net income year and don't expect it to repeat for the next few years, then now would be the time to do it. Generally speaking, entrepreneurs are better off with taking the normal depreciation each year over the life of that asset. Typically, young entrepreneurs don't have extraordinary net income the first few years. It takes some time to build that income. Over the course of the first five years of a new business, the net income should in theory be going upwards, meaning higher tax rates each year. Why take all the depreciation in the first year when your tax rate is lower? Below is an illustration of this $80,000 truck in an example:

		Bonus/§179	**Normal**
Year	Tax Rate	Tax Benefit	Tax Benefit
1	12%	$9,600	$1,920
2	22%	$0	$5,632
3	22%	$0	$3,379
4	24%	$0	$2,112
5	32%	$0	$2,112
6	32%	$0	$1,475
		$9,600	$16,630

Pretty stark difference there right? If a business whose tax rate will increase each year because they are gaining more net income each year, then depreciation is better taken over the entire life of the asset rather than all up front. You would almost get twice the tax benefit with the same exact purchase. Timing is key in tax planning and strategy. So, this situation begs the question: Did that $80,000 truck cost you only $50,400 (ignoring interest)? No, of course not. The best-case scenario above the truck still cost $63,370.

REAL ESTATE

Real estate has a special place in the Internal Revenue Code. There could be, and potentially will be, an entire book dedicated solely to real estate investments for taxes. This chapter is to give you more than just the basics to work with so you can make wise investment decisions. The parts of this chapter we will cover is:

- Depreciation
- Cash Flow versus Tax Income
- Active Participation
- Section 1031 Exchanges
- Cost Segregation Studies
- Real Estate Professionals
- §199A Deduction

Depreciation is the bread and butter to real estate. That is why this is getting discussed first. Without understanding how depreciation works for you, you'll never be able to understand how real estate can be such an amazing investment. Depreciation in the first and last year the property depends on what month it is placed into service. In the first year, January receives the most depreciation, whereas December receives the least amount of depreciation. For the most part, all years between year 2 and year 26 are the same for depreciation. When real property is purchased, there are two elements to the deal. (1) Building & (2) Land. The building can be depreciated, but the land cannot. You must subtract from the purchased price of the property the tax value of the land. Generally speaking, land makes up between 15%-30% of the cost of the property. We will use 25% to illustrate the example below:

Consider you purchase a property and place it into service in June 2019 for $300,000. Assuming our estimate of 25% land value, then that means the amount you can depreciate is $225,000. The amounts for depreciation on the first three years are as follows:

- Year 1 $4,433 (Average $370/mo)
- Year 2 $8,181 (Average $682/mo)
- Year 3 $8,181 (Average $682/mo)

This element is important to understanding the concept of positive cash flow versus taxable income from the business. Continuing with our example above, a $300,000 mortgage on a single-family home with a 4%

interest rate will be about $2,000 per month. The breakdown on average for PITI (Principal, Interest, Taxes, and Insurance) are as follows:

Principal	$440
Interest	$990
Taxes	$500
+ Insurance	$100
	$2,030

If you have invested in real estate before, you should already see what is coming. The only part of the PITI that is inherently not deductible for taxes is principal. Interest, Taxes, and Insurance are deductible for taxes. Let's assume that on this investment, you can rent it for $2,500 per month. Let's have a look at the comparison of cash flow versus taxable income:

Rental Income……$2,500	Rental Income…….$2,500
- Principal…………$440	- Depreciation……...$682
- Interest…………....$990	- Interest…………....$990
- Taxes……………...$500	- Taxes……………...$500
- Insurance………….$100	- Insurance………….$100
= Cash Flow/mo…....$470	= Taxable Income…..$228

See the difference here? Depreciation for the first half of the loan will always be higher than the principal. So, for at least 15 years, you will have this phenomenon where you are bringing in a positive cash flow of about $5,640 per year, but only pay taxes on $2,736. You are literally only paying taxes on no more than 48% of your income each year. You don't get that kind of tax break with any other business activity. Of course, other expenses such as repairs and maintenance, cleaning, etc., were ignored. This is because none of those other costs are affected by your monthly mortgage payment. Although having a higher mortgage payment each month may correlate to more cleaning expenses, it certainly does not cause the higher cleaning expenses.

Rental income is considered a passive activity, no matter how much you participate in the activity[35]. This has its pros and cons. Passive activities

[35] 26 U.S. Code § 469(c)(2)

do not incur self-employment tax as we discussed in a prior chapter. However, passive activities with a tax loss for the year generally must be carried forward to the next year there is passive gains. This means any loss you incur in a tax year from passive activities don't reduce your taxable income, they have no effect. However, with rental real estate, **Active Participation** may allow you to deduct up to $25,000 in passive rental losses against your other income, thus reducing your taxes[36]. Active participation in rental activities is making significant and bone fide business decisions about that property. There is no hour requirement to be met each year. However, you must have at least 10% ownership in the rental to be able to claim it. So, what does this look like? Well, if you had $50,000 from wage income as an employee and you had a tax loss of $10,000 with active participation from a rental activity, you would overall only be taxed on $40,000.

Again, real estate is the only activity in the internal revenue code that gets this special treatment. To compare this to other businesses, think of owning a vending machine operation. Generally, you won't exceed 750 hours per year in owning a few vending machines, but much like rental properties, you will have a tax loss for the year. In this case, $0 of the tax loss you incurred that year is deducted against your other income, thus you receive no benefit from it.

If you wanted an avenue of deferring taxes indefinitely, Section 1031 exchanges are the way to go. Section 1031 exchanges essentially are two taxpayers swapping properties that are like kind with no recognition of taxes. To illustrate this, take the scenario below:

John and Breanna both have single family homes as investment rental properties. Brian's rental property was purchased for $500,000 and Breanna's rental property was purchased for $350,000. John and Breanna decide to swap properties. Typically, what would happen, is that John would have to recognize $150,000 in long-term capital loss and Breanna would have to recognize $150,000 in long-term capital gains. However, under a qualified Section 1031 transaction, this swapping of properties would result in $0 taxable gain or loss for John and Breanna. The taxes are deferred[37].

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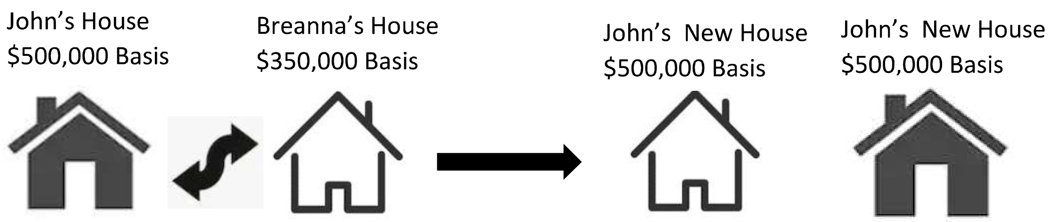
[36] 26 U.S. Code § 469(i)(6)
[37] 26 U.S. Code § 1031(d)

What happens here is that Breanna retains her basis in her transferred property ($350,000) under the new property. The diagram on the next page helps clarify this.



As we can see, John initially had a $500,000 basis in the black property and he now has $500,000 in the white property. You may ask yourself, "Why would John want to do that? Isn't he switching the property out for one that is worth less?" Yes, he is. This could be part of a larger tax strategy which it outside the scope of this text. Since John had an initial basis of $500,000, he will continue to take depreciation deductions on the white house as though he still owned the black house. Obviously this will be much more than if he received Breanna's basis of only $350,000. On the other side of the coin, the additional $150,000 that Breanna assumed as a result of swapping up will go on a new depreciation schedule. Breanna will continue to depreciation the black property as though she still owns the white property and she will have $150,000 to depreciate over the next 27.5 years as well.

Of course, the situation above doesn't typically happen where two people meet up and swap properties. There is a lot more that goes into it, such as closing costs, finalizing the loan, etc. What tends to happen is real estate investors will use a **Qualified Intermediary**. The qualified intermediary is a third party who will transfer the title from one person and their property to another person and their property. They essentially help facilitate the transaction and ensures that it follows proper tax protocol. If you were to use a qualified intermediary, once you transfer the title to the qualified intermediary, you have 45 days to identify which property the section 1031 exchange will involve[38]. Furthermore, you must have received that property from the earlier of 180 days of your original property being transferred to the qualified intermediary or the due date of the tax return[39]. Obviously, if you are enacting a section 1031 exchange in the last quarter of the tax year, you could run into issues of getting this

[38] 26 U.S. Code § 1031(a)(3)(A)
[39] 26 U.S. Code § 1031(a)(3)(B)

transaction settled in time for reporting it on your tax return. Filing a timely extension of the tax return will ensure you do not have to rush this process.

So, you may have noticed earlier the term “Like Kind” when referring to a section 1031 exchange. This is because Section 1031 exchanges are also called like kind exchanges. Under the new Tax Cuts and Jobs Act of 2017, only real property qualifies for this transaction. Prior to 2018, you could have qualified tangible property and initiate a section 1031 exchange. When we discuss cost segregation studies shortly, you will see why cost segregation studies could end up being a big mistake now. When you exchange not like kind property in connection with like king property in a section 1031 exchange, any property that isn’t like kind is called **Boot**, and it is taxable[40]. Take the example below to understand boot:

John and Breanna, the couple in the last example initiate their section 1031 exchange. In connection with the exchange of the black and white properties, John will also receive $100,000 from Breanna to make up for the difference in the market value between the properties. This $100,000 is not real property, thus it is boot and is entirely taxable. The same would be true if Breanna transferred partnership interest, vehicles, stock, etc., in exchange for this property.

Cost segregation studies are a strategy to accelerate depreciation on real property. To properly understand cost segregation studies, you’ll need to understand the three types of property you acquire when purchasing a property:

- Land §1231
- Building §1250
- Tangible Personal §1245

When you invest in a real estate property, the purchase price only gets allocated to the land and the building, which we discussed in a previous chapter. However, with a cost segregation study, this property gets broken down even further into land, building, and tangible personal property. This is the whole point of the cost segregation study. Tangible personal property typically has a depreciation life of either 5, 10, 15, or

[40] 26 U.S. Code § 1031(c)

20 years. This is much shorter than the 27.5 the building depreciation life. So, let's look at an example of a cost segregation study:

Baxter purchases a multifamily complex for $2,500,000. The land has a basis of $500,000 and the building has a depreciable basis of $2,000,000. Below is a chart which indicates how much depreciation is taken in the first three years, assuming the property is placed into service in June.

1. $39,400
2. $72,720
3. $72,720

Now, let's assume that after a cost segregation study, the study indicated the following basis for each class life:

Class Life	Value
5 Year	$1,000,000
7 Year	$750,000
10 Year	$100,000
Building	$150,000
Land	$500,000
TOTAL	$2,500,000

Have a look at the chart one the next page to see what happens if we have three different scenarios:

Class Life/Property	No Cost Seg Study	Cost Seg Study	Cost Seg Study + Bonus Deprecation
5 Year	N/A	$150,000	$1,000,000
7 year	N/A	$107,715	$750,000
10 Year	N/A	$10,000	$10,000
Building	$39,400	$39,400	$39,400
Land	N/A	$0	$0
TOTAL	$39,400	$307,115	$1,799,400

Clearly this cost segregation study makes a significant difference in the amount of depreciation to take during the first year. If you notice, there is one major fallacy though with cost segregation studies. The fact that the real property is broken down into real property and tangible personal property. Now the issue with this is when Baxter decides he wants to do a section 1031 exchange or even sell the property. If Baxter either attempts a section 1031 exchange or sells the property in the second year after a cost segregation study he will have at a minimum of $307,115 to recognize in depreciation recapture. Even if this is taxed at the 24% bracket, that is over $73,000 in taxes to pay back. Imagine if Baxter sold the property or attempted a section 1031 exchange with bonus depreciation. That is almost $1,800,000 in taxable income now.

Now, what are the likelihoods that with a cost segregation study that Baxter won't have more than $25,000 in tax loss for the year? Probably slim, likely Baxter is going to have significant losses in the year. Remember the active participation we discussed earlier. Active participation only allows you to deduct up to $25,000 in the year of passive losses. How does Baxter get around the $25,000 active participation limit? Baxter gets around it by claiming real estate professional.

Real estate professional is probably how you may introduce yourself to others when you invest in real estate. The only issue with this is that you aren't, at least not in tax terms. Real estate professional is a status within the Internal Revenue Code which allows for taxpayers to claim losses in excess of $25,000 on their tax return from rental activities[41]. The reasoning behind this is because as a real estate professional, you no longer are engaged in passive activities. As a real estate professional, you are limited to the at-risk amount for deducting losses. The at-risk amount is the amount for which you have contributed to the company essentially. The at-risk amount goes up with net income, contributions of property and cash. The at-risk amount goes down when you incur a net loss or take money from the company as draws.

The other question this situation begs to ask is “Why do this?”. Below is a list of a couple reasons you may want to attain this status:

- Sale of stock or mutual funds which created a large taxable gain
- Large depreciation recapture to help offset from the sale of other capital assets
- Unusually high adjusted gross income
- Large withdrawals from a traditional IRA, SEP-IRA, or 401(k), etc.

Of course, this list isn’t comprehensive, but you can see how this may help. It isn’t recommended to attain real estate professional status just to do it, since once you make the election you should regularly retain that status.

The last topic of discussion for real estate and taxes is the §199A deduction. §199A is new as of 2018, because of the Tax Cuts and Jobs Act of 2017. This deduction can become quite complicated, but we aren’t going to get into all the intricacies of this deduction, just the part that deals with rental real estate activities. The §199A allows for a taxpayer to take 20% deduction of rental real estate activities for income taxes. So, what this means is you own a rental property for which you made $20,000 in 2019 of net income, you’ll only pay taxes on $16,000. Depending on your marginal tax rate, this can be quite a bit of savings.

The §199A was meant for active trades and business, which we said that rental real estate activities were passive. However, the IRS does allow for

[41] 26 U.S. Code § 469(c)(7)(A-B)

passive rental activities to receive this deduction too[42]. There are a few qualifications for it:

1. Each property must have its own set of books to record income and expenses separately
2. You must provide more than 250 hours of **personal rental services** for any three of the last five tax years
3. A constantly updated record of personal rental services that detail:
    a. Hours of all services
    b. Dates of services
    c. Description of services
    d. Who performed the services
4. Must not be a **NNN Lease**

What these tests are doing essentially is allowing for your rental real estate activities to rise to a level similar to an active trade or business, without the self-employment tax associated with it. The above list isn't terribly difficult to overcome either, but we will want to talk about a few key aspects of it.

Personal rental services include:

- Advertising to rent or lease the property
- Negotiating and executing leases
- Verifying information in tenant applications
- Collection of rent
- Daily operation, maintenance, and repair of property
- Supervision of employees and contractors
- Purchasing supplies
- Management of real estate

Personal rental services DO NOT include:

- Financial or investment management activities
- Planning, managing, or constructing long-term capital improvements
- Time spent traveling to the property

As we mentioned, the rental property may not be a NNN lease. A NNN lease is where the lessee (person who rents the property from you) pays for insurance, taxes, and general repairs and maintenance of the property.

[42] IRS Notice 2019-07

COMMON TAX MYTHS

This chapter will be discussing the many "strategies" out there on social media and google to reduce taxes, that don't reduce taxes. These strategies may even increase taxes. One to get out of the way now is the myth that income tax is a voluntary system because the 16th amendment to the constitution was never properly ratified. This is what is called a frivolous position[43]. Regardless how you interpret the 16th amendment's ratification or whether there is no specific line in the tax code which says you must pay taxes (which it does by the way), you do have to file and pay income taxes. The only thing that can be manipulated in that last sentence is the amount. Proper tax strategies with at least a reasonable basis to stand on will provide you with reduced or eliminated tax burdens each year.

The other tax myth is renting your vehicle to the business or other property so it can be a deduction on the business return. Unless you are a C-Corporation, this simply doesn't work. The reason being is that only rental of real property is not subject to self-employment tax. Renting tangible personal property like vehicles, equipment, machinery, etc., is subject to self-employment tax. So, in an LLC or partnership where you already pay self-employment tax on the entire amount of net income each year, you only move income from the business to another self-employment income source on your personal return. Self-employment tax is taxed against the total of self-employment income each taxpayer earns per year, not just one source

Another common myth is that by having your spouse on the tax return, or even hiring her, is beneficial for tax purposes. If you file a joint return, then again, this doesn't work. We will even look at the math to prove the fallacy of this approach on the next page:

[43] 26 U.S. Code § 6702

	One Owner LLC	Husband 50%	Spouse 50%
Net Income	$50,000	$25,000	$25,000
SE Tax	$7,065	$3,532	$3,532
Income Tax	$6,000	$3,000	$3,000
TOTAL TAX	$13,065	$13,065	$13,065

The only reason the option where both spouses own a percentage of the business was $1 less is due to rounding. Even if you did 99% husband and 1% wife, the math at the end would equal the same. Now, what this would be beneficial for is receiving credit for Social Security. Self-employment tax gives you credit towards Social Security.

Now, what if you were to hire your spouse? Would this reduce the amount of taxes you would pay overall? Actually, you pay more:

	One Owner LLC	Husband 100%	Spouse W-2
Net Income	$50,000	$28,470	$20,000
SE Tax	$7,065	$4,239	$0
Payroll Tax	$0	$1,530	$1,530
Income Tax	$6,000	$3,416	$2,400
TOTAL TAX	$13,065	$13,115	

You may be wondering why this is the case? Although this isn't the exact to the penny math, what this demonstrates is a very common issue everyone forgets; payroll taxes. As we discussed in the self-employment tax section of the introduction, when it comes to employees, Social Security and Medicare is equally divided between the employee and employer. If you only considered self-employment tax and income tax, since those would be the only two really shown on the tax return, you would miss out on the single reason this doesn't work to reduce taxes. In the first situation where the husband and spouse owned equal percentages of the business or where only one person owned the business, the overall cash kept from the married couple was $36,935. In the second scenario where the husband hired his wife, overall they only kept $36,885. Clearly this isn't a major change, but if you were to attempt this with much higher net income for the year, you really lose out.

Another common tax myth I come across every year is that business owners tend to believe that whatever your bank balance difference is from 1 January to 31 December each year means that is how much taxable income you have. Although it can certainly be true, it rarely ever is. This is because of many things, such as depreciation, vehicle mileage, non-taxable benefits, etc. However, what most commonly happens is entrepreneurs will spend their money from the business for personal expenses that aren't business related or don't receive full deductions on the tax return. The classic example is when entrepreneurs account for their home's utilities, property taxes, and interest. Of course, these items can be deductible, but they aren't deductible in full and may not even be deductible if you have a tax loss anyhow. The way home office expenses are deducted is based on the square footage of the office compared to the total square footage of the home. If your office is 200 square feet and the entire home is 2,500, then you only get to deduct 8% of actual expenses. Not a whole lot, although certainly helpful. It is highly recommended that if a cost is going to be related to personal expenses whatsoever, to run it either through payroll if you are a corporation or take an owner draw.

Another tax myth that takes people by surprise every year is the self-employed health insurance deduction[44]. When you are self-employed, you may only take a deduction for the months you pay health insurance premiums and you are not able to be covered by your spouse's health care plan. So, if your spouse can cover you on their health plan and you choose not to, you won't receive that deduction. The real surprise is where the deduction is taken on the tax return. Self-employment tax is not affected by this deduction. Meaning if you had $50,000 in net income from self-employment and paid $10,000 in health insurance premiums paid for the year, you still pay self-employment tax on $50,000. It does, however, reduce income taxes.

This next myth is likely the most destructive and it goes something like this "The IRS has bigger fish to fry than my small company. I may have lied about $10,000 worth of income or deductions, but other large companies may be fraudulent of $1,000,000 or more, the IRS is focused on those guys". This couldn't be farther from the truth. The IRS has separate departments to handle large corporations and small businesses.

[44] 26 CFR § 1.162(l)-1

Although your Uncle Jim who hasn't filed taxes in 10 years and hasn't been caught doesn't mean he won't be. I have had quite a few cases just like Uncle Jim come to my office. What typically happens is due the current market demands for the ability to pay via credit card, Uncle Jim starts accepting credit cards. What happens is once that person receives over 200 transactions and $20,000 in gross sales, they will receive a 1099-K from that merchant service, which gets reported to the IRS. Years later the IRS decides it's time to audit and then the whole can of worms is busted open. However, that may not even be the way Uncle Jim gets busted. There are many, many elements to determining who gets audited. The IRS even has systems in place to check whether or not their algorithms and software are working correctly, and they will essentially randomly choose taxpayers to audit, sort of like an unlucky lottery.

Last tax myth to talk about gets confused a lot. Filing an extension means you have another 6 months to pay the taxes you owe. Unfortunately, this isn't the case. A timely filed extension allows for you to file your taxes by a later day[45]. The taxes are still due on 15 April each year regardless if an extension is filed or not. I will caveat this though, if you are due a refund when you file the return late, you will still receive your refund. The worst you may get is a late filing penalty, which for individual tax returns isn't all that much.

[45] 26 U.S. Code § 6081

DO YOU NEED AN ACCOUNTANT?

For this chapter, by accountants, we mean Enrolled Agents, CPA's, and staff accountants. Of course, you may think this chapter is a little bias since, well, a tax professional is the author. However, having some variant of an accounting professional on your side isn't always necessary. Didn't think I would say that did you? There are sometimes where you may just not need one yet, and much of it is a cost-benefit analysis you will have to do. Below are some circumstances where you may not need an accountant on board:

- Just started a business and have incurred no expenses or revenue yet
- Owning one or two single family home rentals
- You are unable to afford hiring an accountant
- Unable to find a well vetted accountant with knowledge in your industry

Although those instances mentioned may have you thinking you don't need an accountant, you could be digging yourself a larger hole. When you are thinking of an accountant, or whether you need one, you should ask yourself a series of questions below:

- Do I have the time to keep the books?
- Do the books even balance when I do them?
- Do I really know how much money my business is making?
- Have I researched all areas of my business model for tax concerns?
- If I self-prepare a tax return and got audited, how likely would I be able to fight the IRS and win?
- Do I truly understand all the tax implications involved with my business entity type?
- Do I know how to run a payroll and what payroll forms to file?
- Do I know how to register for all the payroll tax accounts I will need?

In all reality, if you can't answer most of those with a very confident "Yes", then you truly should outsource this work. Tax professionals really should pay for their own work. Consider this situation below, which is a true occurrence (Names changes):

Gary owns Gary's Siding and Roofing LLC. Gary is the sole owner of this business He has been in business for over a decade and has seen little growth. He is constantly having money issues because every year he owes several thousand dollars in taxes and he spends all next year paying for last year's taxes and penalties. Furthermore, Gary doesn't believe he can afford new equipment which would expand his service line and become more efficient. Gary also prepares his own books and tax returns with software because he doesn't believe he can afford an accountant.

In this scenario Gary is likely paying more in taxes than he needs to because he doesn't know of all the deductions and credits he can take. Also, he keeps getting penalties for filing his returns each year because he is using software. Software is only as good as the person using it. Tax and accounting software aren't going to ask you the questions an accountant would ask. Also, Gary doesn't have proper financial statements, like a balance sheet and profit and loss statement, to base his business decisions on. In this case, the accountant noticed he was paying almost $6,000 per year in vehicle repairs and maintenance. With this being the case, Gary was instructed to go buy a new vehicle, which will be cheaper than the $500 per month in repairs he is spending. Not to mention, a $300 per month truck on a 5-year note is about $25,000 or so. That is a $25,000 tax break begging to be exploited.

This case may sound like you, maybe it doesn't. The important lesson to see here is that someone with an expertise in an area that you don't have will be able to provide the guidance you need to become successful and maintain that success. What if you didn't know that forming an S-Corporation required you take a reasonable compensation and you never do? You may find yourself on the wrong end of an audit where the IRS reclassifies all your income as wages, and you get hit with the federal trust fund recovery penalty we discussed earlier. However, not every accountant is created equal. Just being an Enrolled Agent, CPA, or Tax Attorney doesn't inherently make you a credible source or reliable. Consider it like this: how often have you taken your car to a mechanic shop, only to be told the alternator is going out. Then you take it to another shop, and they tell you it is just low on coolant and actually show you how the solution has solved the car problem? Both were mechanics and both were certified ASE. No matter what industry you look for an expert in, this mindset rings true for them all.

So how do you pick an accountant? Here is a good series of questions you can ask to do your due diligence on vetting an expert:

1. Do you have professional licensure?
2. Do you have insurance? If so, can you provide documentation
3. Do you stay current on tax laws? If so, how much continuing education do you do each year?
4. Do you have other clients that are like me?
5. What is the cost of your services and what all do they entail?
6. Is your license in good standing? If so, where can I fact check that?
7. What is your process for keeping books, running payroll, or filing taxes?
8. How easily or often will I be able to get ahold of you?

Although this is certainly not all the questions you can ask an accountant, these would be some pretty important aspects to touch on. On top of this, you could search online to find any negative reviews or positive reviews of any accountant. If there are negative reviews, try to determine whether they really hold any weight or if they just seem mad about something they did themselves. Also, the accountant that works exclusively with high net worth individuals is likely not going to be a good fit for a budding business and vice versa. Lastly, an accountant that is stellar for your friend may not work out for you. Accountants are people after all with personalities just like you. Sometimes personalities just don’t align. If that is the case or you don’t entirely feel comfortable with that accountant, just move on. It will save you and the accountant many headaches later in the relationship.

Of course, the accountant can only do so much. Sometimes the work we do seems impressive, but that only comes with correct and accurate data. Accountants are a lot like computers. If you put garbage data in, you are going to get garbage data back. Be honest with your accountant and be sure to ask plenty of questions. We genuinely enjoy helping others out, and I love watching as small businesses grow and become successful.

BONUS CHAPTER

So far this book has covered so many aspects that will guide all levels of experienced entrepreneurs. The bonus chapter will show you some basic research skills and tactics to fight the IRS when they send you letters that aren't in your favor. This section should be done in coordination with a qualified tax representative, but this content should allow you to better understand what is happening when the IRS has concerns with your tax returns. Most people want nothing to do with the IRS and for good reason. They have trained employees and staff to handle cases and ensure the IRS collects all the money they are due. However, arming yourself with basic IRS letters and notices will give you a good defense to prevent unnecessary penalties and taxes.

CP 2000 letters are among the most common letters the IRS will send to you. This is called a Notice of Proposed Adjustment for Underpayment or Overpayment. Inherently, this letter isn't bad. Receiving one of these notices could indicate the IRS noticed a mistake on the return which involves you receive a refund. However, it is much more common that the IRS believes that you owe more in taxes. The first step in deciphering this letter is to read it. There are usually several pages in this letter, and they instruct you on how to protest the letter and what to do if you need to arrange payments. Just because the letter says they believe you owe the IRS money; doesn't mean you do. This notice isn't a bill or a tax assessment. If you notice, the letter is called a Notice of *Proposed* Adjustment.

CP 501 notices are when the IRS has assessed a tax due on your account. This letter is often called the 90-day letter, because you have 90 days to respond to it. This letter is the first official written warning from the IRS that you need to take one of five actions:

1. Pay the Amount in Full
2. Arrange for a tax resolution
3. Amend the return
4. Protest the notice
5. Do nothing

Paying the amount in full or arranging for a tax resolution, such as an installment agreement, means that you agree with their determination and you are going to make payments. Amending the return, on the other hand, will inform the IRS that you do not agree with the return and wish to make corrections. Also, protesting the notice will inform the IRS you do not agree with the IRS and that you stand by your original return. There is one very important aspect with these letters, the CSED, or Collections Statute Expiration Date. Earlier we mentioned that the IRS has 10 years from the date of taxes assessed to collect the amount. By taking options one through four, you will put a hold on the IRS collections process. Clearly, by taking option five, this will only make things worse. Doing nothing means that the IRS assumes you agree with the tax assessment and the amount will therefore be assessed against you. Failure to respond to this notice and possible subsequent notices of tax due will get you the next letter we discuss. Also, not receiving the letter isn't a defense against the 90-day limit.

CP 504B is usually the first step taken by the IRS when you don't respond to the CP501 and subsequent letters that you owe taxes. What is important to know about this letter is that once the 90-day window of the CP 501 notice passes, the IRS automatically places a statutory lien against you. The IRS isn't even required to send you this notice, so it is possible to have a federal lien against you without you ever knowing. The letter that typically follows the CP 504B is the CP 504. This is when things are very serious. The IRS is telling you with a CP 504 notice that they intend to levy your assets.

What can be levied you may ask? The following list are possible assets liable for seizure (not comprehensive):

- Bank Accounts
- Stocks and Bonds
- Retirement Accounts
- Real Estate
- Equipment and Machinery
- Vehicles and other modes of transportation
- State Tax Refunds
- Wages and Social Security

As you can see, not paying attention to what the IRS is sending you can landslide into a major issue for which you will most certainly want representation for. These notices are definitely not all the IRS notices and letters that can be sent but are the most common when issues arise. Now that you have a basic understanding of what these mean, how can you attempt on your own to protest the IRS and know your rights?

Most importantly, let's discuss where you do not want to base your information from. What you are about to read seems very counterintuitive and make you wonder why bother fighting the IRS on tax issues. Literature that you will not want to base your defense on because they lack substantial authority are:

- IRS Publications
- IRS Form Instructions
- Internal Revenue Manuals

Most everyone knows what the first two are. IRS Publications are sources of literature to help explain to taxpayers about taxes on certain taxes. For example, IRS Publication 925 is titled Passive Losses and At-Risk Amounts. This publication talks about the real estate professional discussed in the Intro to Real Estate chapter. However, there isn't nearly enough information in here to properly understand the entirety of real estate professionals and how the IRS intends to execute that law. Also, Schedule E instructions will talk about real estate professionals, but fail to provide enough information to be called substantial authority. Internal Revenue Manuals are the IRS's literature to its' employees on interpreting the IRS policy on enforcing laws. This is helpful information, but again, lacks substantial authority.

So why does the IRS provide this guidance and information if you can't even reference it to protest IRS issues? It is simply informative in nature and is meant to educate the basics of taxes for taxpayers. Also, sometimes there are mistakes in these publications and instructions. Where would you want to look for substantial authority then? Using the following sources would give you great legal footing to protest the IRS:

- Tax Court Cases
- Internal Revenue Code
- Treasury Regulations
- Code of Federal Regulations
- IRS Notices

Those references are not easy reading material. However, doing your due diligence on this material before speaking to a qualified tax professional will assert that you will not be taken advantage of and help you gauge whether that tax professional is really going to provide any real help. That last sentence is the key to this chapter so far. I don't expect, nor agree that individuals and entrepreneurs should fight the IRS on their own. Doing this reduces your chances of success. How you choose and determine who is a qualified tax professional is not an easy task either. There is one great place you can reference to make sure you aren't being taken advantage of and ensure your tax professional is acting in your best interest and is ethical.

IRS Circular 230 is essentially the IRS's power to govern tax professionals and sets ethical standards for all EA's, CPA's, and Tax Attorneys to abide by. Of course, just because there are ethical standards doesn't mean everyone abides by that. For example, tax professionals cannot charge you a percentage of your refund or a contingency fee on certain cases. Also, a tax professional may not hold hostage your records for which you need to file a tax return because of a payment issue. Even if you fire the tax professional right before they file the return, you have the right to receive all documentation you provided to the tax professional.

CONCLUSION AND CALL TO ACTION

None of this book would be any use to an entrepreneur without some sort of call to action and accountability. Now that you have read this book, sign up for a free consultation by visiting https://www.BMCaccountingLLC.com. As we mentioned, this book was not intended to make you a tax and accounting professional, nor was it entirely inclusive of all facts. Quite frankly, that would just bore everyone before the end of the first page. Also, this book shouldn't be a read it once and done task. This is something you should use to reference often. Of course, tax laws change each year, but that shouldn't discourage you from referencing this book years later. If there is one take away from this book it should be this: having taxes and accounting as an important aspect in your business decision making will help you become successful.

ABOUT THE AUTHOR

Brandyn Cox is the founder and owner of BMC Accounting LLC. Brandyn is an Enrolled Agent and in good standing with the IRS for this status. The Enrolled Agent credential is the highest award the IRS provides to tax professionals. Enrolled Agents are the only tax professionals that are tested and checked by the IRS to practice before the IRS. Enrolled Agents also have unlimited practice rights for any client and any tax matter before the IRS. Brandyn also studied accounting at the University of Toledo and opened the business while working full time at the Department of Veterans Affairs and attending college full time. Brandyn lives in Toledo, Ohio with his wife Jaimie and daughter Addison. He enjoys working with business owners and helping the little guys get on the path of major success. Tax and accounting are as much a fun activity for Brandyn as it is a business.

BMC

Accounting LLC

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GLOSSARY

§1031 Exchange - An exchange between two taxpayers for real estate property which is like kind. §1031 exchanges allow to defer taxes indefinitely

§1231 Property - Land

§1245 Property - Personal tangible property

§1250 Property - Real property

Accounts Receivable - A ledger account which indicates how much money you are currently owed for services and goods.

Active Participation - Participation in rental real estate activities which do not rise to the level of material participation but allow for potential to deduct up to $25,000 in losses against other income for the tax year.

Aging Receivables Report - A report which breaks down the accounts receivables report. This report indicates whether an account is current or overdue, and if it is overdue how overdue the account is.

Boot - Any property that is given up or received during a §1031 exchange that is not like kind. Any property that is not real property.

Capital Asset - An asset which must be capitalized because the asset lasts longer than one year and is subject to depreciation, amortization, or depletion.

Capital Gains Tax - This tax is assessed on the sale of capital assets. They can either be short term or long term.

C-Corporations - Corporations are living, breathing taxpayers in the eyes of the IRS. These companies pay corporate tax of 21% on their income.

Depreciation - Deductions allowed for capital assets for normal wear and tear. Every capital asset has a class life. The most common are 5 year, 7 year, 10 year, and 27.5 year.

Depreciation Recapture - This tax is generally on the greater of deductions for depreciation taken or allowable.

Effective Tax Rate - This is the tax which equals total tax divided by taxable income. This translates to what percentage every single dollar made in taxable income is due as tax.

Flow Through Entities - Business structures in which there is not "Business Tax", but all income from the business is allocated to all owners based on the percentage of ownership. Each owner is individually responsible for paying those taxes.

General Partner - A partner which materially participates in the business. This partner must pay self-employment tax and income tax on their allocated income.

Income Taxes - Taxes which are due from income. The rates are 10%, 12%, 22%, 32% 35%, and 37%. The tax rates depend on taxable income and filing status.

Limited Liability Company - Business structure which provides limited liability protection to the owner. This structure can be taxed as a sole proprietor, partnership, S-Corporation, or C-Corporation upon election.

Limited Partner - A partner which does not materially participate in the business. This partner is only required to pay income tax on their allocated income.

Long Term Capital Gains Tax - Sales on capital assets which were held for more than one year. The tax rates are 0%, 15%, and 20% generally. The tax rate which applies depends on filing status and taxable income.

Marginal Income Tax Rate - This tax is the rate for which the next dollar in taxable income is taxed at.

Member - Owner of an LLC

NNN Lease - A lease of real estate property which the lessee pays the insurance, real estate taxes, property taxes, and repairs or maintenance.

Nominal Interest Rate - The interest rate which is stated on loan and other liability accounts. Also known as an annual percentage rate.

Parent Company - A company which owns the majority of the interest or shares in another business.

Partner -Owner of a partnership

Partnerships - Business structure in which two or more persons own the business. Can be an LLC or Partnership.

Schedule K-1 - The form which the partnership provides each partner, member, or S-Corporation shareholder, upon filing the partnership taxes. The partnership reports all forms of income, deductions, and credits on this form.

S-Corporation - Business structure in which the owner can be an employee of their business. The shareholder-employee must take a reasonable compensation. This status must be elected and cannot be a default entity type upon formation.

Self-Employment Tax - Taxes which are due from self-employment income. The effective tax rate is 14.13%. Sole proprietors, members in an LLC, and partners in a partnership pay this tax.

Shareholder - Owner of a corporation.

Short Term Capital Gains - Sales on capital assets which were held for exactly one year or less. The tax rate is the same at income taxes.

Sole Proprietors - Business structure in which only one person owns the business.

Source Documents - Documents which are original copies of transactional history for a business.

State Interest Rate - See nominal interest rate.

Subsidiary - A company which has a parent company.

APPENDICIES

Income Tax Brackets

SINGLE

10%	$0 to $9,700	10% of taxable income
12%	$9,701 to $39,475	$970 plus 12% of the amount over $9,700
22%	$39,476 to $84,200	$4,543 plus 22% of the amount over $39,475
24%	$84,201 to $160,725	$14,382.50 plus 24% of the amount over $84,200
32%	$160,726 to $204,100	$32,748.50 plus 32% of the amount over $160,725
35%	$204,101 to $510,300	$46,628.50 plus 35% of the amount over $204,100
37%	$510,301 or more	$153,798.50 plus 37% of the amount over $510,300

MARRIED FILING JOINT

10%	$0 to $19,400	10% of taxable income
12%	$19,401 to $78,950	$1,940 plus 12% of the amount over $19,400
22%	$78,951 to $168,400	$9,086 plus 22% of the amount over $78,950
24%	$168,401 to $321,450	$28,765 plus 24% of the amount over $168,400
32%	$321,451 to $408,200	$65,497 plus 32% of the amount over $321,450
35%	$408,201 to $612,350	$93,257 plus 35% of the amount over $408,200
37%	$612,351 or more	$164,709.50 plus 37% of the amount over $612,350

HEAD OF HOUSEHOLD

10%	$0 to $13,850	10% of taxable income
12%	$13,851 to $52,850	$1,385 plus 12% of the amount over $13,850
22%	$52,851 to $84,200	$6,065 plus 22% of the amount over $52,850
24%	$84,201 to $160,700	$12,962 plus 24% of the amount over $84,200

32%	$160,701 to $204,100	$31,322 plus 32% of the amount over $160,700
35%	$204,101 to $510,300	$45,210 plus 35% of the amount over $204,100
37%	$510,301 or more	$152,380 plus 37% of the amount over $510,300

MARRIED FILING SEPARATELY

10%	$0 to $9,700	10% of taxable income
12%	$9,701 to $39,475	$970 plus 12% of the amount over $9,700
22%	$39,476 to $84,200	$4,543 plus 22% of the amount over $39,475
24%	$84,201 to $160,725	$14,382.50 plus 24% of the amount over $84,200
32%	$160,726 to $204,100	$32,748.50 plus 32% of the amount over $160,725
35%	$204,101 to $306,175	$46,628.50 plus 35% of the amount over $204,100
37%	$306,176 or more	$82,354.75 plus 37% of the amount over $306,175

Long-Term Capital Gains Rates

SINGLE

0%	$0 to $39,375
15%	$39,376 to $434,550
20%	$434,551 or more

MARRIED FILING JOINT

0%	$0 to $78,750
15%	$78,751 to $488,850
20%	$488,851 or more

HEAD OF HOUSEHOLD

0%	$0 to $52,750
15%	$52,751 to $461,700
20%	$461,701 or more

MARRIED FILING SEPARATELY

0%	$0 to $39,375
15%	$39,376 to $244,425
20%	$244,426 or more