

Tax tips for the self-employed and small-business owners

Editor's note: This is Part 5 in a special series of columns on year-end tax planning.

By GARY KLOTT

Between now and New Year's Eve, self-employed individuals have plenty of opportunity to make a sizable dent in their 1998 income tax bills.

People who run their own businesses, including freelancers and employees with sideline businesses, tend to have far more flexibility than other individuals to maneuver at year-end to reduce their taxes.

Many business owners can defer tax on much of their year-end income for an extra year just by delaying billing long enough to ensure that customer payments won't arrive until after Dec. 31.

And thousands of dollars in extra deductions can be picked up by paying outstanding bills, stocking up on office supplies and embarking on a year-end shopping spree for business equipment.

This flexibility to control when deductible expenses are paid and income is received will be especially valuable to business owners who are trying to hold down their adjusted gross income in order to qualify for some of the valuable new tax breaks that made their debut this year. Most of the new breaks — including the tax credits for families and college tuition, and the new Roth IRAs — are phased out for taxpayers with incomes above certain levels.

Paying business expenses before year's end may help many business owners meet the income-eligibility requirements. Business expenses reported on Schedule C (the form used by sole proprietors to report business profits or losses) will reduce your adjusted gross income — the figure that will largely determine your eligibility for the new law breaks.

Self-employed workers who use the "cash method" of accounting have the most flexibility to maneuver at year-end. Under the cash method — which is used by most individuals and small businesses — expenses are deductible in the year they're paid, and income is reported in the year it's received.

If you use the "accrual method" of accounting, you're stuck reporting income in the year it's earned and deducting expenses in the year they're incurred.

Office equipment

If you expect to soon be in need of a new comput-

er system, a photocopier, fax machine or other equipment or machinery for your business, consider making the purchase before the end of the year.

Self-employed individuals can often trim their tax bill by thousands of dollars by accelerating equipment purchases. Small businesses are eligible to write off up to \$18,500 in business equipment purchases this year without having to depreciate the costs over a period of years.

The immediate write-offs available under this "expensing" method provide a big incentive for business owners to assess their equipment needs and buy before the end of the year.

But be sure that whatever you buy is something you really need because the write-offs will subsidize only part of the cost.

"We tell clients to accelerate into December purchases they're going to make in early '99," said Thomas Bonevetti, a Chicago area tax partner at the accounting firm of McGladrey & Pullen. "But we don't tell them to buy if they're not sure they're going to need it."

You'll be eligible to fully write off the equipment using the expensing method no matter how late in the year you make the purchase. (By contrast, if you're claiming regular depreciation deductions, making a lot of year-end equipment purchases can often prove counterproductive. Under conventional depreciation rules, if more than 40 percent of your 1998 equipment purchases are made during the final three months of the year, you could wind up with fewer depreciation deductions this year.)

Before you head to the office supply store for a new Pentium 450 computer, calculate how much of a tax benefit you'll actually get. The expensing method carries a number of restrictions.

The main restriction limits your write-offs to the amount of taxable income you have from your business. So if your business isn't generating much income, you probably won't generate many expensing write-offs for your tax return, either.

There is an exception if you have income from another job. The IRS allows employees with sideline businesses to count salary they earn from their regular job as business income when figuring their limit on expensing deductions for the sideline.

Buying a new car for Christmas won't steer you to a fat write-off under the expensing method or any other depreciation method. No more than \$3,160 of a new car's cost can be deducted in 1998.

When placing an order for business equipment,

be aware that ordering and paying for the equipment by Dec. 31 isn't sufficient to make the purchase deductible on your 1998 return. The equipment also must be "placed in service" by year's end. That essentially means the equipment must be physically in your office and ready for use by Dec. 31.

So if you're buying a computer from a mail-order manufacturer, be certain the company will be able to have it delivered to your office before the end of the year.

Office supplies

Another common route to last-minute deductions is a year-end trip to the office supply store to stock up on supplies you'll be needing in the near future, like laser-printer cartridges, photocopier toner, fax paper, stationery and computer disks.

Pay outstanding bills

One of the simplest ways to earn extra deductions is to pay your outstanding bills for deductible business expenses, including utilities, subscription renewals to trade publications, insurance and cellular service.

Chances are, you'll be paying the bills only a few days or few weeks before they're actually due. But by paying them by Dec. 31, you'll be getting the tax write-offs a year sooner.

Health insurance premiums

Paying outstanding bills for health insurance premiums by year's end may also bring some extra deductions for your 1998 return. Self-employed workers who aren't eligible to participate in an employer-subsidized medical plan can deduct 45 percent of their health insurance premiums on the front of Form 1040, regardless of whether they qualify for the itemized medical deduction.

If you have a health insurance payment due in January, you'll have to decide whether it's worth paying the bill by Dec. 31 in order to reap some tax savings now or wait until next year to pay the bill and qualify for a bigger deduction on your 1999 tax-year return.

The deductible portion will rise to 60 percent next year as a result of the tax bill passed by Congress in October.

Sideline businesses

If you have a sideline business, project whether you'll turn a profit or loss for the year.

If you anticipate a loss, see if there is anything you might be able to do before year's end to eke out a profit for the year. Figuring a way to turn the business around will be especially important if your business has been producing more losses than profits in the last several years.

Making the business profitable will prevent the IRS from trying to classify your sideline business as a hobby rather than a real business.

The distinction is important. If your sideline is deemed a hobby, you'll only be able to deduct expenses to the extent of income generated by the venture.

To be eligible to deduct expenses in excess of income, your sideline needs to be considered a for-profit business in the eyes of the IRS. The IRS will automatically presume your sideline is a profit-motivated business if it's profitable in at least three of the last five years (two of seven years for breeding, training, showing or racing horses).

If your sideline doesn't turn a profit that often, you won't automatically lose the right to deduct expenses in excess of income.

But that's not always an easy case to make. "It's an uphill battle, particularly if it's the type of thing that people have as a hobby, like growing flowers," said David Rhine, a tax partner at the accounting firm of BDO Seidman in New York.

As a consequence, he advises trying hard to meet the three-of-five-year-profit test. If your sideline is currently operating in the red, assess whether it might be possible to show a profit for the year by holding down expenses the rest of the year and making an extra effort to sell off existing inventory during the holiday season.

Keogh deadline

Self-employed individuals have until their 1999 return is due next year to make a deductible contribution to a Keogh retirement plan or Simplified Employee Pension (SEP) plan.

But if you hope to contribute to a Keogh in the upcoming tax season, you'll need to have a Keogh established at a financial institution by the close of this tax year, which for most self-employed individuals is Dec. 31.

The year-end deadline applies only to Keogh's, not SEPs. A SEP plan can be set up and funded as late as the due date of your return.

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Guidebook to Meadow Brook available through Oakland University Press

A new publisher, the Oakland University Press, announces the release of its inaugural work, a guidebook to Meadow Brook Hall, one of the nation's largest and most significant historic homes.

A Place in the Country: Matilda Wilson's Personal Guidebook to Meadow Brook Hall, is a color, 64-page work (8.5 by 6.5 inches) that features a tour of the mansion and its collection of fine and decorative arts in the words of the woman who was the motivating force behind its design, construction and decoration — Matilda Dodge Wilson.

Matilda, widow of auto pioneer John Dodge, set out to build a suitable monument for her children, heirs to the Dodge fortune. She spent a year with second husband, Alfred G. Wilson,

developing plans for the home that she would care for and live in for 38 years.

The book features Matilda's words from her *Guidebook to Meadow Brook Hall*, published in 1966, an interview with filmmaker Shelby Newhouse filmed

two days before her death on Sept. 19, 1967, and photographs of the hall's rooms and treasures.

Proceeds from the sale of the book help support Meadow Brook Hall.

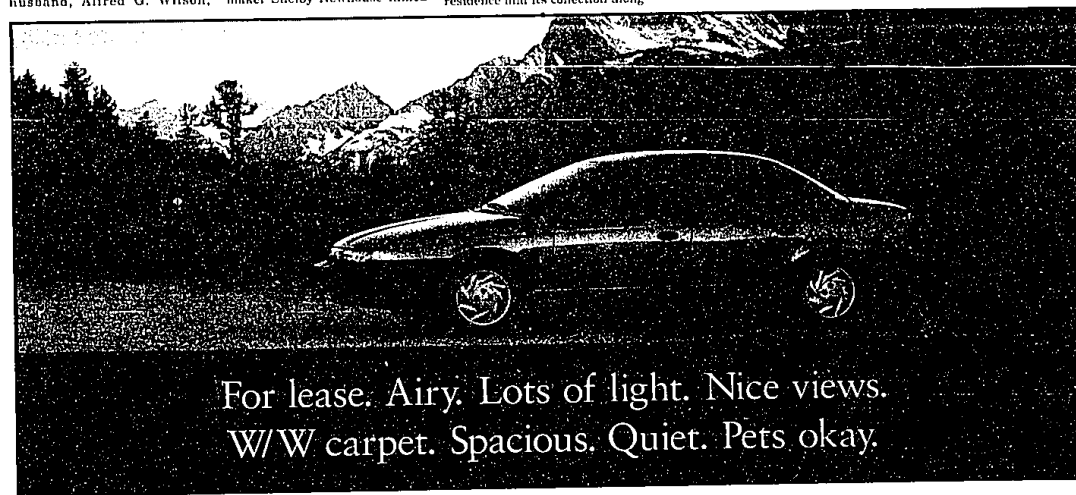
In 1957, the Wilsons left their residence and its collection along

with the estate's 1,500 acres and \$2 million to found Oakland University. Matilda lived in the hall until her death.

Meadow Brook Hall welcomes more than 100,000 visitors each year to participate in tours, educational programs and a variety

of special events.

A Place in the Country is available at Oakland University's Meadow Brook Hall Gift Shop and the university's Bookcenter at a cost of \$8.95. Call (248) 370-3140 for more information or to place mail orders.



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