

SMALL BUSINESSES

Information You Need to Know — Now and in the Future

According to the Small Business Administration statistics, small businesses (defined as having less than 500 employees) account for 99.7% of all employers in this country. They employ one half of the entire private workforce. They have generated 60 to 80% of the net new jobs over the past 10 years. 53% of these are home-based, 3% are franchises*. All in all, they are an extremely important part of the US economy. There are numerous considerations that are important in starting and maintaining a small business successfully. In this special issue of SUCCESS we have provided information on two: tax deductions and business insurance. Whether you are just about to embark in a new business, or have been doing it for a while, we hope you find these tips to be helpful.

* Source: U.S. Small Business Administration: Frequently Asked Questions / Advocacy Small Business Statistics and Research (www.sba.gov/advo/stats/sbfaq.pdf)

TAX DEDUCTIONS

What You Can Do and What You Can't

There are a number of deductions that one can take running a small business. Here are a few to think about.

Home Offices

To qualify as a deduction, a home office is an area in your home used exclusively and regularly for business. So, if you have a computer in the TV room that you use for business but the room is also used personally, then you probably cannot deduct the TV room as your home office. However, if you have a room, or a portion of it, that you use only for your business then that may qualify. How much is deductible? Measure the work area and divide it by the square footage of your home. That percentage is the part of your home business expense (mortgage, rent, insurance, electricity, etc.) that you can claim.

Other tests qualifying your home office as your principal place of business are:

1. If it is used for administrative and management activities even though your work is actually done in the field (i.e., contractors, plumbers, consultants, independent sales reps) as long as there is not another fixed location used for this.
2. Client meetings are held at the office.

3. The office is set up in a building separate from your house (i.e. in the garage).

The home office deduction is generally limited to gross income less business expenses. Expenses that are not deducted in the current year can be carried over to the next year.

Furniture, Equipment & Software

When you are setting up an office, or even if you already have one, and are purchasing business furniture (desk, chair, filing cabinets), equipment and software, you may be able to deduct 100% of the cost in the year you buy it, under Internal Revenue Code Section 179. Otherwise, the cost will be depreciated over a seven-year period. For 2004, up to \$102,000 can be expensed, \$105,000 for 2005. The expense limitation is scheduled to decrease to \$25,000 after 2007.

You must elect to take the Section 179 deduction with the original return filed for the tax year the property was placed in service. Any amount over the maximum deduction can be depreciated. It is important to note that the deduction cannot exceed your taxable income,

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TAX DEDUCTIONS (cont'd)

therefore you cannot create a loss with Section 179—the deduction is limited to your “aggregate taxable income that comes from the active conduct of any trade or business”.

Exclusive of the above, there is also an additional first-year depreciation deduction, commonly called the “bonus depreciation,” that can be taken. For 2004 purchases, 50% of the cost of the property can be used.

Purchases of computers, copiers and fax machines are also deductible and can qualify for the same Section 179 allowance. However, if you opt to depreciate, it can be over a five-year period, not seven. Up until 2003, the cost of computer software had to be depreciated over 3 years. Under the Section 179 changes, off-the-shelf business software purchases can be fully expensed in the year it was purchased. This is in effect through 2007.

Car and Truck Expenses

When calculating your car or truck business expenses you can use the standard mileage rate or actual expenses.

Mileage: The mileage rate for 2004 was 37.5 cents a mile, for 2005 it is 40.5 cents per mile. If your business is based in your home, then business-related mileage is calculated from when you pull out of your driveway until you arrive back home. If your office is not in your home, then your mileage calculations start from your first business destination, ending at your last. Mileage to and from home cannot be included. If you choose to use the standard mileage rate for a year, then you cannot deduct actual car expenses for that year except for business related parking fees and tolls.

Actual Expenses: If you don't use the standard mileage rate, you may be able to deduct your actual car expenses. Those expenses include the following: depreciation, garage rent, gas, insurance, lease payments, licenses, oil, registration, repairs, tires. If your car or truck is used for business and personal purposes then you must divide your expenses between the two, based upon the miles driven for each purpose. (i.e., you've driven your car 20,000 miles during the year, 16,000 were for business, 4,000 were for personal use. By dividing the business mileage by the total miles driven you will arrive at the percentage that you can claim as a business expense, in this case 80%).

Travel, meals, and entertainment

If you travel for your business, you can deduct the cost of the hotel and the cost of the travel (air, train, car). You can also deduct expenses for being out on the road like dry cleaning, rental cars, etc. However, only 50% can be deducted for meals, unless the meals are reimbursed by a customer. This also applies if you take a client out to dinner, at home or on the road.

Office Supplies

Whether you take a deduction for a home office or not, you can still deduct business supplies. Keep all receipts as the purchases must be documented.

Insurance

Generally, you can deduct premiums you pay for the following kinds of insurance related to your business: fire, theft, flood or similar insurance; group hospitalization and medical insurance of employees; liability insurance; malpractice insurance covering your personal liability; overhead insurance that pays for business overhead should you be disabled for long periods of time; business interruption insurance; car and other vehicle insurance (for liability, damages & other losses) that covers vehicles used in your business. If the vehicle is also for personal use, you can deduct only the part that applies to your business.

PLEASE SEE THE NEXT SECTION OF THIS ISSUE TO READ ABOUT THE DIFFERENT TYPES OF INSURANCE THAT ARE AVAILABLE FOR BUSINESSES.

For more information, check out IRS Publication #334, “Tax Guide for Small Business” which can be accessed through the IRS web site: www.irs.gov/formspubs/

BUSINESS INSURANCE

Getting the Right Coverage for Your Business

When venturing into a new business, one of the many tasks that must be done is obtaining business insurance. More than likely, you have some kind of insurance but, is it enough? If you are running a business out of your home, do you have the right type of policy? Is it structured to suit your needs? Are you getting a fair and reasonable price?

Finding the Right Agent

If you already have an agent for your personal insurance, ask them for advice on the kind of insurance you might need. If that is not possible, check with others who are in a similar type of business and find out what agent they use. Contact trade associations too, as they may sponsor insurance programs for your specific business. If not, they can provide a list of insurers who specialize in your business. Above all, make certain that your insurance agent is knowledgeable about your business insurance needs.

Home Businesses

It is more than likely that your homeowner's policy won't have enough coverage to protect your business equipment. Most standard homeowner's policies cover only \$2,500 for business equipment/business property. If you are a professional (i.e., accountant, architect) you will also need to purchase professional liability insurance, separately. And, if you sell food or health care products, it may be required that you have a special policy for that, too.

THE ALTERNATIVES

There are basically three choices when it comes to insurance for home-based business—depending upon its size and purpose.

Home Owner Policy Endorsement

Adding a simple endorsement to your home owner's policy may take care of your insurance needs. This could increase your policy limits from the standard \$2,500 to \$5,000 (possibly even as high as \$10,000) and would cover any equipment you may have. You can also add a liability endorsement to the policy. This will provide protection should someone get hurt on your premises. In most cases, insurance companies will offer this type of endorsement to a business owner who has only a few business-related visitors. It is limited to special classes of business. Check with your agent.

In-Home Business Policy

An in-home business policy provides more comprehensive coverage than a standard home owner's policy endorsement. Coverage can vary considerably depending upon the insurer. In addition to coverage for business equipment, this policy also will cover loss of important papers and records, accounts receivable and off-site business property. Business interruption coverage may also be an option (more information on that later). These types of policies will offer more extensive liability insurance in the package and contain higher coverage amounts. Some will also allow for a certain amount of employees.

In-home business policies can be purchased from either a home insurance company or you could go to a specialty insurance company and purchase a stand-alone policy.

Business Owners Policy (BOP)

This type of policy was created specifically for small to mid-size businesses, making it a good option for those businesses with a number of employees and for businesses that may have more than one location. While offering the same types of coverage as the in-home business policies (business property & equipment, loss of income, extra expenses and liability) it is on a much broader scale.

Business owner's policies do not include worker's compensation, health or disability insurance or professional liability insurance. These are covered under separate policies. It also does not cover automobiles used for business activities, so you should check to make sure your car insurance will protect you should you have an auto accident when out on business.

Business interruption coverage

Business interruption insurance is just as important as fire and disaster insurance. Most people know that it is necessary to have fire and disaster insurance but don't go the step beyond to think about what they would do if, as

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BUSINESS INSURANCE (cont'd)

a result of that disaster, the business could not function for a long period of time. This is where business interruption insurance applies. It provides income to the insured should their business be shut down for any length of time and is usually purchased as additional coverage.

Any profits that you would have earned would be covered, based upon your financials. Your CPA should be able to help you determine the type of insurance that would be appropriate and how much coverage is needed. If you have to file a claim, they can also assist you as there are some basic factors to determine the loss-of-income i.e., operating expenses.

Disaster prevention is also a good idea. Walk through your property to determine measures you can take to prevent a disaster (i.e., sprinkler system, train employees in fire safety, etc.). Records, both computerized and written should be kept up-to-date. Copies should be kept off premises. You should have a disaster plan in place.

Professional Liability Insurance

Any professional who operates their own business must have professional liability insurance. Clients come to professionals expecting a high level of knowledge and expertise in their field, and they expect these professionals to do what they are hired for. Having professional liability insurance protects you in the event

that a lawsuit is brought against you. This is special coverage and can only be purchased separately from other business policies.

Money-Saving Ideas

It makes sense to shop around, as prices will vary from company to company. Find ones that specialize in your type of business. Contact several companies and compare prices and the types of services that would be provided.

Choose a financially stable firm. You can check their finance health through A.M. Best (www.ambest.com) and Standard & Poors (www.standardandpoors.com/ratings), both ratings companies.

Develop a good working relationship with your agent or broker. Their advice will be invaluable to protect your business. Keep them informed on any major changes in your business, as this could affect your coverage.

Other areas of business insurance to think about: general partners/limited partnership liability insurance, buy/sell agreements, employment practices liability insurance, worker's compensation policies and corporate auto policies.

For more information, go to www.iii.org
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Additional resources for small business owners:

Internal Revenue Service: Small Business and Self-Employed One-Stop Resource: www.irs.gov/smallbiz

Small Business Administration: www.sba.gov offers extensive information for small business owners.

Within the SBA website:

- You can also access information regarding their **Small Business Development Centers** (SBDCs) www.sba.gov/sbdc. If you are a current or prospective business owner SBDCs can provide counseling, training and technical services to those who cannot afford a private consultant.
- You can find a local **Business Information Center** (BIC). These centers have small business reference libraries, management videos and computer technology. They also provide one-on-one help.

There is no charge to use these centers.

- You can locate the local chapter of **SCORE** (Service Corps of Retired Executives) or you can go directly to their website www.score.org. Counseling and training is provided by current and former business people there to offer their expertise and knowledge. Small business workshops are also available

All the above services are provided for anyone who is beginning, improving or expanding a small business.

The information we have provided in this issue is general in nature and should not be taken as professional advice. Please call us with any questions you may have. We will be happy to assist you.

