15 Must see tax breaks for small business owners in 2020

We all know small business owners are super busy running the operation, planning strategy and making sure they earn a healthy profit at year-end. Thus, understanding and staying up to date on the latest tax rules is not always top of mind. However, we don't want to totally neglect this area because there can be good tax savings involved and this adds to the bottom line. Even though these tax breaks are ultimately claimed on the tax return, year-round tax planning is important to fully maximize any tax benefits.

The following article discusses some of the higher impact and more generous tax deductions and credits available to small businesses. In general, these tax breaks are not specific to 2020 but are available in any year. Under the tax code, self-employed individuals are treated like small business owners so the rules apply uniformly.

#1: Consider the general rules

Businesses are generally allowed to deduct the costs of carrying on the trade or business. To be deductible, the Internal Revenue Code requires that the business expenses be **ordinary and necessary**. By ordinary, it means that the expense is common and accepted in an industry; and by necessary, it means that the expense is helpful and appropriate for the trade or business. Examples of allowable expenses are salaries paid to employees, rent expense for office space and interest paid on a company loan.

The personal portion of an expense is not deductible, such as personal use of a company automobile. The rules apply to small businesses regardless of entity type (sole proprietorship, partnership, corporation or S corporation).

#2: Take the 20% Business Income Deduction

Under tax reform, there is a **20% deduction** on business income for small business owners who report their operations on Form 1040, such as sole proprietors who use Schedule C (as well as income from partnerships, S corporations and limited liability companies).

This is a big windfall for small business owners as $20,000 of $100,000 of business income would go untaxed! This deduction allows small business owners to keep more earnings tax-free and helps curb high tax rates and the 15.3% self-employment tax. Small businesses qualifying for the 20% tax deduction could see their effective marginal tax rate reduced to 29.6%.

There are some calculations and limitations surrounding this deduction, including a phase-out of the deduction for high-income earners (over $160,700 for single filers, $321,400 for joint filers, $160,725 for married filing separate filers).

#3: Deduct your home office

If you use part of your home **regularly and exclusively** to perform administrative or managerial activities for your business, you can claim a home office deduction for utilities, rent, mortgage interest, depreciation, and cleaning fees based on the square footage of your home used for your business. Any allowable home related itemized deductions, such as mortgage interest and real estate taxes, can still be claimed.

The IRS also provides a **simplified calculation** for figuring the deduction for using your home for business. It simplifies the calculation and recordkeeping requirements, but does not change criteria for who may claim the deduction. A portion of the home must still be used exclusively and on a regular basis for business purposes. In general, you will figure the deduction by multiplying the area of your home used for business by $5, up to a maximum deduction of $1,500.

#4: Deduct start-up costs

The government encourages people to open a new business by allowing a $5,000 write-off for start-up expenses. This $5,000 deduction is reduced by the amount that your total start-up expenses exceed $50,000. Any start-up costs that are not allowed to be expensed can be amortized over a 15-year period, beginning in the month you start operations.

Start-up costs include amounts paid either **to create a trade or business or to investigate the creation or acquisition of a trade or business**. Examples include: advertisements for the opening of the business; and travel and other necessary costs for securing prospective distributors, suppliers or customers. Once the enterprise actually begins operations all business expenses are deductible.

#5: Retirement plan deductions

It's always a good idea to plan for retirement especially with nice government incentives. There are a variety of retirement plans available to small businesses that allow the employer and employee a tax favored way to save for retirement. Contributions made by the owner for himself or herself and for employees can be deducted.

There are lots of choices in retirement plans.

- Set up a **401(k) or SIMPLE plan** if you want to cover employees.
- **IRAs, SEP IRAs and SIMPLE IRAs** are retirement plans that avoid the complex rules, red tape and expensive administration costs that apply to qualified retirement plans

The small business owner is also allowed a tax credit equal to 50% of the first $1,000 incurred in **starting up a plan**. It's smart to consult with a financial planner before deciding on a plan that best suits the business needs.

#6: Consider depreciation write-off

Business owners are allowed to fully write-off the entire cost of new purchases (**100% bonus depreciation**), such as computers, furniture and equipment, in lieu of depreciating the cost of the asset over a number of years. Another huge bonus is that used property now qualifies.

Under a companion measure, the government has increased the popular **section 179 tax** break to $1,020,000, which represents the amount of assets you can deduct in the first year. Sports utility vehicles carry a $25,500 section 179 limit.

These generous depreciation deductions allow the small business owner to increase their deductions and thereby reduce their taxable income, self-employment income and tax liability. The depreciation deduction for vehicles is limited.

#7:How do deduct transportation costs

When you're deducting transportation costs, you can't deduct the commute between your home and place of business. You can deduct business-related trips throughout the day, such as traveling to get supplies or attending meetings offsite.

You also have to choose between two methods: **actual expense method or standard mileage method**. The standard mileage rate for 2019 is 58 cents per mile. This figure is meant to reflect each of the following expenses: gasoline, lease payments, insurance, maintenance and repairs, vehicle registration, and depreciation. On the other hand, the actual cost method entails deducting each business-related car expense by itself. This includes gasoline, insurance, maintenance, depreciation and lease payments.

#8: Deducting health insurance

You can deduct the costs of your personal **health insurance premiums** as a self-employed person, as long as you meet certain criteria:

- Your business is claiming a profit. If your business claims a loss for the tax year, you can't claim this deduction.
- You were not eligible to enroll in an employer's health plan. This also includes your spouse's plan. If you were eligible to enroll in one and chose not to, you cannot claim this deduction. You can only claim premiums paid for the months when you were not eligible for an employer's health plan.

#9:File your meal expenses

Meal deductions can be taken either within the context of business travel or if provided to a current or potential business customer. You can deduct up to **50 percent** of the meal expense as long as the food or beverages are not considered lavish or extravagant. For business meals, the meeting must include business either directly before, during or after the meal is consumed.

#10: Business travel

If you need to travel out of town for business, the cost of getting to and from your destination and any business related expenses when you're at your destination can be deductible. To be allowable by the IRS, the travel expenses must be considered reasonable and not lavish or extravagant.

Meals are deductible when you're away from your **tax home** in pursuit of your trade, and your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Meal expenses must be reduced by 50% before being deducted, but lodging expenses are not reduced.

#11: Self-employment tax deduction

Where traditional employees have their FICA taxes split between themselves and their employers, self-employed individuals are responsible for paying their own share of those Social Security and Medicare contributions, which are known as SECA. Self-employed individuals can claim a portion of the self-employment tax as a deduction (roughly one-half).

#12: Giving business gifts

Holiday gifts for clients, customers and other business associates qualify as deductible business expenses. However, there's a catch: A taxpayer can **deduct only $25 annually** for business gifts given directly or indirectly to any one person. Promotional items, such as calendars or pens, don't count toward the $25 limit if each item costs $4 or less, has the taxpayer's name clearly and permanently imprinted on the gift, and is one of a number of identical items widely distributed.

#13. Take credit for paid family and medical leave

The Tax Cuts and Jobs Act (TCJA) implemented a new credit for employer-paid family and medical leave. It allows business owners to claim a credit for wages paid to employees on family and medical leave. It starts at 12.5% for payments of 50% salary, and goes up to 25% if the leave payment rate is 100% of the normal rate. The maximum leave allowed for any employee is 12 weeks per year.

#14: Claiming research and development expenses

To qualify for this credit, the business must incur expenses for the purpose of discovering information that is technological in nature and for the development of a new or improved business component. For example, a bakery that invests in developing machinery that automates the icing process may qualify. Ordinary testing and inspection; consumer, management and efficiency studies; and promotions do not count as research.

#15: Claiming the work opportunity credit

This credit is available to businesses that pay first and second year wages to **certain targeted employees**, such as veterans, long-term family assistance recipients and summer youth. The credit is figured as a percentage of the employee's wages and can range from $2,400 to $9,600 per employee depending on the type of targeted employee. To qualify, you must first request and be issued a certification for each employee from the state employment security agency (SESA) to prove that the employee is a member of a targeted group.

Wrapping up

As discussed, there are a multitude of tax breaks available to small business owners. These tax breaks will help to **reduce your tax liability and put more money in your pocket**, which can be rolled back into the business, saved for retirement or spent on personal items. Remember to plan ahead, document your expenses and retain any receipts. Please consult with a tax professional if you need help understanding these tax breaks.

Resources

- Intuit TurboTax
- Intuit QuickBooks
- IRS: Deducting Business Expenses
- · IRS Publication 535: Business Expenses