

BUSINESS BILLS AND DEDUCTION DILEMMAS

Before you decide to list such expenses on your company's tax return, they need to pass strict IRS tests first. Then, other rules apply.

Q A year ago, I founded a cell phone recycling company with three partners. We set up as an limited-liability company (LLC) and have no employees. I have personally paid for travel, meal, and entertainment expenses this year because the company cannot afford to pay them. How do I claim these expenses? Do I list them on my personal tax return or on the company's return?

-- K.C., Fremont, Calif.

A Before we get into tax-return specifics, experts advise that all small-business owners make absolutely certain that the expenses they deduct are legitimate and properly documented. Business expenses need to pass strict IRS tests, no matter what kind of business entity you're operating.

Things like meals and entertainment must be substantiated with receipts and notations that explain how the expense is directly related to or associated with an active business. In order to be deducted, entertainment expenditures must directly precede or follow a bona fide business discussion, says Bradford Hall, managing director of Hall & Company, an Irvine (Calif.) accounting firm (www.hallcpas.com).

"These requirements are rarely met, from our experience," Hall says. "Most of the time, we see businesses fail to maintain entertainment documentation to substantiate the expense or what was discussed."

HIRE AN ACCOUNTANT. What if your LLC agreement specifies that members are supposed to be reimbursed for business expenses they pay themselves? You should submit an expense report directly to the LLC for reimbursement, Hall says.

If your company cannot reimburse you in the same tax year and your LLC is operating on either a cash or accrual basis for tax purposes, the outfit cannot claim the expenses until the year reimbursed, he says.

If your company plans to file taxes as a corporation (either S or C), you should submit the expense reimbursements to the enterprise and wait for reimbursement. If you were to deduct corporate expenses on your personal return, you'd have to use Schedule A, and the expenses would be subject to a 2% itemized deduction threshold — meaning that you'd probably lose much of the benefit of the deduction, according to Hall.

Confused yet? Well, this is just one small situation that business owners have to puzzle out when it comes to finances. You and your partners would do well to hire an accountant who has experience dealing with small businesses — not only to do your taxes but also to advise you on company financial matters.

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