Tax Reduction Strategies

For the Progressive Attorney

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Introduction:

At Polaris Tax & Accounting we take a forward-thinking approach to our clients' Accounting and Tax by implementing proactive year-round tax-saving strategies.

> "Taxpayers overpay taxes by almost a billion dollars each year to mistakes and missed opportunities"

2002 Study by US General Accounting Office

This e-book briefly discusses some of the major tax reduction strategies that most attorneys of solo or small legal firms often overlook. Implementing these and other tax reduction strategies is part of our comprehensive Tax Planning solution to help Attorneys minimize their tax liability and take a proactive approach to their tax situation.

The Annual Meeting:

If your legal firm is incorporated, or you have a Limited Liability Company (LLC) you are required by law to hold an annual meeting, yet attorneys very rarely do actually hold this very important annual meeting. This is not only a requirement but also a great tax planning opportunity that is often missed.

Large publically traded corporations spend tens of thousands of dollars in hosting their corporate annual meeting by bringing shareholders together, entertaining them, and conducting the meeting. Most of these expenses are bona fide deductions that can be expended through the business.

Just like large corporations, your law firm can benefit from the annual meeting strategy by deducting this as a business expense. There are no set requirements that oblige you to hold your annual meeting where your firm office is physically located, therefore, consider hosting your Annual Meeting offsite, perhaps at your favorite vacation spot to deduct a large portion of expenses. Do not forget to maintain detail records of the event and work with your trusted Tax Advisor for additional guidance to help audit-proof your annual meeting.

Choosing the Right Business Entity:

Choosing the right Business entity is critical and often a very big missed tax opportunity for most Attorneys. Your legal firm might often start as a Sole Proprietorship, while this makes for fewer regulations and requirements, you soon realize that your business income is now subject to self-employment tax equal to 15.3% of Net Profits, this is On TOP of your Ordinary Income Tax we all pay.

Fortunately, there are other tax-advantageous legal firms can choose from, S Corporation, for example, are more cumbersome to manage, they require good accounting records, and payroll, but they do eliminate the dreaded self-employment tax of 15.3%. This alone can save thousands of dollars each year.

Not everyone is a good candidate for an S Corporation, so careful evaluation must be made to identify if an S Corporation is best for your individual situation. Look at the Business Entity Matrix on the next page for a side by side view of how different entities and potential tax savings.

Business Entity Comparison Matrix

	Sole Prop.	LLC	Partnership	C Corp.	S Corp.
Approximate Tax on $ 100,000 Net Profit	**$ 29,023**	**$ 29,023** * * **Assuming no S Corp. Election Made**	**$ 29,023** * ***Assuming no S Corp. Election Made**	**$ 31,755** * ***Assuming a $ 60,000 Wage and $ 40,000 Dividend**	**$ 24,667** * ***Assuming a $ 60,000 Reasonable Salary Wage and $ 40,000 Distribution**
Are my Personal Assets at risk?	Unlimited exposure.	Limited to investment, except for personal services.	Unlimited if general partner; limited to investment if limited partner.	Limited to investment, except for personal services.	Limited to investment, except for personal services.
How easy is to Form this Entity?	Very easy.	Articles of organization generally required.	Partnership agreement is helpful.	Articles of incorporation generally required, attorney help highly encouraged.	Articles of incorporation generally required, attorney help highly encouraged.
Do I need to outsource my business accounting to a professional?	No for initial startups and micro businesses. Yes, for more mature businesses.	Depends on tax status as sole proprietorship, partnership, or corporation.	No for initial startups and micro businesses. Yes, for more mature businesses.	Yes, highly encouraged to outsource accounting functions to a professional.	Yes, highly encouraged to outsource accounting functions to a professional.
What is the best Accounting Software to use?	Xero Tax Touch for initial startups and micro businesses. Business Xero managed by Accountant for more mature businesses.	Depends on tax status as sole proprietorship, partnership, or corporation.	Business Xero managed by Accountant.	Business Xero managed by Accountant.	Business Xero managed by Accountant.
How many individuals can be involved in the Business Entity?	One	Depends on tax status as sole proprietorship, partnership, or corporation.	Unlimited	Unlimited	100

Note: This chart is intended for informational purposes only and does not include all aspects of Accounting and Tax regulations. When choosing a business entity, extreme care must be taken to ensure maximum tax benefit as well as making sure all federal and state laws are being followed. As a result, consult with your Accountant regarding the benefits and risks of each business entity. Please reach out to our firm should you have any additional questions regarding the best entity type for your Business.

Maximizing your Home Office Deduction:

Most Attorneys often find themselves working from home on a regular basis, in fact, a recent survey identified that almost five percent of Americans are working exclusively or most of the time from home. Over time, the IRS has realized that most Attorneys need the flexibility of working from home therefore, optimizing your Home Office Deduction is a very powerful tax reduction strategy.

The biggest roadblock to qualifying for the Home Office Deduction is that you must use a portion of your home exclusively and regularly for your business. This can be established when:

- The office is generally in a separate room or group of rooms.
- The office can also be a section of a room if the division is clear, thanks to a partition for example, and you can show that personal activities are excluded from the business section.

In addition to passing the exclusive test, your home office must be either:

- The principal location of that business, or
- a place where you regularly meet with customers or clients.

Regularly meeting with clients at your home office does not imply that you must meet with clients in person, advances in technology allow most of our Attorney clients to easily pass this test by regularly meeting clients via video or conference call.

The Home Office allows you to deduct expenses paid for utilities, homeowners' insurance, homeowners association fees, security, and general repairs and maintenance based on the percentage of the square footage of your office divided by the total square footage of your entire home, this is often referred to as the "actual method". Alternatively, the IRS allows you to use a "simplified method" where you can deduct $ 5 for every square foot of your home office.

There are benefits and drawbacks of using either method, therefore, make sure you discuss these options with your Trusted Tax Strategist in order to compare and evaluate the best method for your individual situation.

Traveling Expenses:

Attorney often must travel for business reasons, whether they are attending a seminar for continuing education or traveling to a client that is unable to meet in person, these travel expenses are fully deductible.

However, most attorneys don't realize that they can deduct Traveling Expenses associated to Board Meetings and Firm Retreats to a remote business location, like a resort, when the meeting cannot be held at the business primary location. For example, if your firm has a board of advisors (if you don't, you should consider establishing one) and you want to entice your board of advisors to attend your meeting.

Travel costs for spouses and children are typically non-deductible, however, if they are involved in the day to day operation of your firm and have a business purpose for attending, the travel may be deductible. For example, you hire your child as your Administrative Assistant to take extensive notes and facilitate your board meetings. In this case, travel expenses for that purpose would usually be deductible.

Hiring your child:

If you have children above age 7 here's an idea for your law firm, consider hiring your child as a bona fide employee, this can be either on a part-time or full-time basis. This powerful strategy allows law firms to write-off as a legitimate business expense their child wages. Not only by hiring your child will you be teaching them valuable life skills, but you will also help reduce your business Income subject to Federal and State tax.

Your child can earn up to $ 12,000 in wages without being taxed. Your law firm is not required to pay Social Security tax for your child's wages until he or she is 18 years old, your firm can also avoid paying unemployment tax until your child turns age 21.

To audit-proof this strategy:

- Your child's activity needs to be directly related to your firm.
- The child's wages must be reasonable for the work performed.
- Maintain a detailed timesheet for your child's work including when and where the work was completed and what task was completed.

Is there work for which you cannot hire someone under 18? Yes! In fact, the Fair Labor Standards Act, a federal law, outlines what types of jobs kids cannot do. Therefore, be sure to check with our firm regarding potential limitations associated with hiring your child in your firm.

Use section 179 to your advantage:

Section 179 of the IRS tax code allows firm owners to deduct the full purchase price of qualifying equipment and/or software purchased or financed during the tax year allowing you to reduce your overall taxable income. As of 2019 tax year section 179 increases to $1,000,000, the item must meet three qualifications:

- The property must be tangible.
- The property must have been acquired for business use.
- The property must have been purchased by you, not gifted.

The Section 179 election is made on an item-by-item basis for eligible property meaning that you do not have to elect the full depreciation on all eligible property purchased during the fiscal year. The election must be made in the tax year the property is first placed in service and reported on Form 4562, our firm can properly advise you if Section 179 is a good option for your firm.

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Failing to work with a proactive accountant:

We know that as a law firm owner you are often engaged in various roles, from firm visionary to chief compliance officer. Accounting and Tax are convoluted, complicated, and changes regularly. As a result, managing your own accounting records and not working with a proactive accountant can be costing you more than you think you are saving in fees.

> "72 percent of small-business owners change their CPA or Accounting Firm because they received reactive service instead of proactive advice"

2014 Study by The Sleeter Group

What can be even more frustrating is working with a reactive Accounting Firm that only manages your accounting records and prepares your tax returns without providing any guidance. As a proactive accounting firm, we get that frustration and, we help you identify tax saving opportunities throughout the year that are individualized to your own situation. By outsourcing your accounting, you can spend more time doing what you love, and spend less time worrying about your accounting and how to minimize your taxes.

Working closely with an accounting firm like Polaris Tax & Accounting can help you avoid overpaying taxes while identifying the best tax saving strategies tailored for your individual needs. What's more, the accounting and tax fees also count as a business deduction. Bonus!

Conclusion:

One of the ways we help our clients is by working hard to provide tax-smart strategies to minimize the impact the IRS can have on your bottom line. If you have any questions about your taxes or how tax-efficient planning can help reduce your tax burden, please give us a call.

All the best,

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Managing Partner

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