

TAX AND ACCOUNTING DIGEST

BAMBO SONAIKE, CPA, LLC

770.956.6455

1640 POWERS FERRY RD, BUILDING 8 STE 220, MARIETTA, GA 30067

WWW.CPA-SERVICE.COM

HOME OFFICE DEDUCTION

If you use a portion of your home for business purposes, you may be able to take a home office deduction whether you are self-employed or an employee.

Expenses that you may be able to deduct for the use of your home for business may include the portion of real estate taxes, mortgage interest, rent, utilities, insurance, depreciation, painting and repairs.

You can claim this deduction only if you use that part of your home regularly and exclusively: (a) as your principal place of business (b) as a place to meet or deal with your patients, clients or customers in the normal course of your trade or business.

Generally, the amount you can deduct depends on the percentage of your home that you used for business. Your

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deduction will be limited if your gross income from your business is less than your total business expenses.

If you use a separate structure not attached to your home for an exclusive and regular part of your business, you can deduct expenses related to the structure.

If you are self-employed, report those deductions on Schedule C of Form 1040. There are special rules for qualified daycare providers and for persons storing business inventory or product samples.

If you are an employee, you have additional requirements to meet. The regular and exclusive business use must be for the convenience of your employer.

S. CORPORATIONS VS. LLC: WHAT IS THE RIGHT STRUCTURE FOR YOUR BUSINESS?

Determining the type of legal structure for a new business can be daunting for small business owners. Corporations and limited liability companies (“LLCs”) are preferred business structures because, unlike sole proprietorships and partnerships, both offer liability protection. This means that the owner of a company cannot be held responsible for the company’s debts. The assets of an owner are shielded from company liabilities.

S corporation and LLCs are similar in that they are both “pass-through” entities for tax purposes; the income of these companies are passed through to their owners and reported on the owners’ personal income tax returns, thereby eliminating the double taxation incurred by owners of C corporations.

So what is the difference between an S corporation and an LLC? And which structure is right for you?

The answer depends on your own unique situation. If operational ease and flexibility are important to you, an LLC is a good choice. If you are looking to save on employment tax and your situation warrants it, an S corporation could work for you.

There are restrictions on who can be owners of an S corporation. An S corporation cannot have more than 100 shareholders, shareholders cannot be nonresident aliens or other corporations or LLCs. S corporations must follow certain formalities and record keeping procedures and an S corporation has no flexibility in how profits are split up amongst its owners. The profits must be distributed according to the ratio of stock ownership, even if the owners may otherwise feel it is more equitable to distribute the profits differently.

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“A major factor that differentiates an S corporation from an LLC is the employment tax that is paid on earnings. The owner of an LLC is considered to be self-employed and, as such, must pay a “self-employment tax” which goes toward Social Security and Medicare. The entire net income of the business is subject to this tax at a rate of 15.3%.

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LLCs offer greater flexibility in ownership and ease of operation. There are no restrictions on the ownership and it is simpler to operate because it is not subject to the formalities by which S corp. must abide. An LLC can be member-managed, meaning that the owners run the company; or it can be manager-managed, with responsibility delegated to managers who may or may not be owners in the LLC and the owners of an LLC can distribute profits in the manner they see fit.

A major factor that differentiates an S corporation from an LLC is the employment tax that is paid on earnings. The owner of an LLC is considered to be self-employed and, as such, must pay a “self-employment tax” which goes toward Social Security and Medicare. The entire net income of the business is subject to this tax at a rate of 15.3%.

In an S corp., only the salary paid to the employee-owner is subject to employment tax. The remaining income that is paid as a distribution is not subject to employment tax under IRS rules. Therefore, there is the potential for tax savings.

Still, while the potential employment tax savings may make the S corporation an attractive structure for your business, bear in mind that you would then have to deal with all the paperwork associated with payroll tax. There is no one magical entity that works for everyone. Our office can assist you in choosing the right structure for your business. The important thing is to consider the operational, legal and tax aspects of each structure as they apply to your unique situation.

**Bambo Sonaiké, CPA, LLC
1640 Powers Ferry Rd
Building 8 Suite 220
Marietta GA 30067**