INCOME TAX AND OTHER TAXES

GOOD PLANNING AND RECORDKEEPING HELP KEEP THOSE PAYMENTS AT A MINIMUM

Among the biggest challenges in operating your business is understanding how you are taxed.

This is an area where many new owner-operators run into problems. You can avoid any big surprises on April 15 by using good planning and record-keeping throughout the year.

As an owner-operator, you now are responsible for paying your taxes yourself and calculating the net profit for your business. For anyone who was a company employee, this is a major change. It was your employer's responsibility to deduct all required taxes from your paycheck, which then were reported on the W-2 you received in January of the following year.

Now you will receive a Form 1099 MISC, which shows the gross earnings your carrier reported to the Internal Revenue Service.

Your weekly settlement statements and receipts provide the explanations for the deductions that will help you arrive at your net pay. If you examine the weekly net pay of a typical company driver, you might conclude that owner-operators make more than twice the money.

But no taxes are deducted from owner-operators' settlement sheets or payments from brokers and shippers, to say nothing of expenses.

Furthermore, owner-operators do have to pay the same taxes as the company employee, plus the employer's share of the Social Security and Medicare taxes. As an employee, only 50% of these taxes were deducted from your pay, but as an owner-operator, 100% of these, known as self-employment taxes, must be paid on the net profit of your business.

Both are paid on Form 1040at the end of the year, but estimated tax payments must be made each quarter. They're often 20% to 30% of the net income received over the quarter. Complying with this regulation not only avoids a penalty, it also eliminates any surprise of a huge tax bill as April 15 approaches.

TYPES OF TAXES

SELF-EMPLOYMENT TAXES.
These equate to the Social Security and Medicare withholdings paid through a company for employees. For 2019, rates are unchanged from 2018 at 15.3%. This is made up of 12.4% Social Security tax and 2.9% Medicare tax.

FEDERAL AND STATE INCOME TAX.
This is calculated on your tax return. As a company employee, this amount was estimated and withheld from your check. As an owner-operator, you are responsible for its estimation and payment.

ESTIMATED TAX PAYMENTS.
Those who expect to owe at least $1,000 in tax after subtracting withholding and credits are required to make quarterly payments of self-employment taxes and federal and state income taxes. Though

WHAT'S IT WORTH?

In this example, keeping records of business expenses saves $515 in income tax for someone in the 15% tax bracket, or more if a state income tax applies.

EXPENSES
Personal vehicle use $200
Contract labor $700
Work clothing $300
Credit card charges $500
TOTAL $1,700

TAX SAVINGS
Self-employment tax (15.3% of $1,700) $260
Income tax (15% of $1,700) $255
TOTAL $515

the IRS allows estimates based on the prior year's data, owner-operator financial services provider ATBS uses current data to compute estimated taxes due.

For payment vouchers and addresses for IRS estimated payments, as well as other federal tax information, visit www.irs.gov. Each state that imposes income taxes has a website to obtain their payment vouchers and addresses.

If you make a late payment to the IRS, or no payment, it is authorized to apply penalties and interest based on the amount of tax due.

DEDUCTIONS AND RECORD-KEEPING
Owner-operators' estimation of expected profit is used not only for estimated tax payments, but also is used to calculate the taxes due at the end of the year when the Form 1040 is filed. The profit equation you should use is:
Gross Pay (as reported on 1099-MISC) – Allowable Business Expenses = Net Profit

If you fail to show deductions or file a tax return, the IRS will determine the taxes that are due based on their estimate of your income from 1099s provided by your business partners and not consider your deductions/ expenses. This amount certainly will be much higher than you otherwise would have been required to pay.

As an owner-operator, you have many deductible expenses. The main criteria in determining deductibility are whether you have a record of the expense and whether it is an ordinary and necessary business expense. Other than honesty, the best protection from audits and penalties is good record-keeping. Keep all records that support every deduction you claim on your tax return, beginning with your logbook for those per diem deductions.

With electronic logs, make sure you download your records every month or so for tax purposes. A leasing carrier is not likely to keep them beyond the time required for compliance.

Save and label expense receipts, maintain an expense log or spreadsheet, and sort it all at the end of every run.

YOUR ROLE IN TAX PREP

If you want to avoid the most common mistakes seen in owner-operator tax returns, you need to get involved in checking the major numbers your tax preparer uses. Doing this can save you thousands of dollars in taxes. Or it could save you from thousands of dollars in penalties and interest if your preparer makes a mistake in your favor.

An example: A husband-wife owner-operator team had a feeling something wasn't right on their return, though it had been prepared by a trucking specialist. The couple had shown a net operating loss on their Schedule C for seven years; an operating loss is often the result of high depreciation. Their most recent tax return, however, showed less than $1,500 in depreciation.

The preparer, following settlement sheets that separated mileage pay from fuel surcharge pay, was including only mileage revenues in the gross numbers. Fuel surcharge payments were listed under "reimbursements," which is not standard accounting practice. So gross revenue was less than $100,000 each year, even though the per diem showed more than 250 days on the road each year. This is an absolute giveaway that the gross revenue is incorrect.

This mistake resulted in underreporting income by $20,000 to $40,000 per year for seven years. Tax was underpaid by $3,500 to $7,000 per year. With interest and penalties, the liability could be as high as $75,000.

Here's what you can do to avoid such situations:

SPOT-CHECK YOUR 1099 TOTAL.
Most leased owner-operators make about $1.20 or more per mile with the fuel surcharge included. The number of dollars on your 1099 should be higher than the number of miles you ran during the year. If they're similar, it's close to $1 a mile, possibly indicating missing surcharge revenue.

VERIFY THE ACCURACY OF THE 1099 AMOUNT.
Having established that the amount is reasonable, go further. A relatively small mistake, like an extra $5,000, wouldn't jump out, yet you would pay $1,000 in tax you didn't owe. Verify the amount by adding each settlement to determine your 1099 revenue.

CHECK AT LEAST THESE THREE EXPENSES.

- ***Fuel.*** *You know the rough amount of your weekly fuel spending. Multiply that by 50 (assuming you took off a few weeks) to get a year's estimated total.*
- ***Maintenance.*** *See how your big expenses add up. If you know you had one $8,000 repair and total maintenance is just over $10,000, there's probably a mistake.*
- ***Per diem.*** *Look at your Schedule C for meals and entertainment. Take the total number of nights away from home, and multiply it by $63. Then multiply that number by 0.8. That should be your total deductible per diem.*

If you find mistakes or red flags for one of these categories, continue checking entries, from largest dollar amount to smallest. If amounts in these are correct, odds are the tax return has been prepared correctly.

A receipt is the most obvious evidence of a deductible purchase, but you also can use canceled checks, bills, credit card statements, invoices, an expense notebook – anything showing when, where and what you bought and how much you paid.

Don't be too quick to label expenses "miscellaneous," either; the more specific you are, the better.

Don't forget to collect receipts for lumper fees or any expenses automatically charged to your credit card such as tolls, scales and credit card fees. Many owner-operators maintain separate credit cards for business and personal use just to simplify keeping track of such expenses.

Don't overspend on supplies, equipment and services in your zeal to accumulate deductions. Only a portion of those expenses will be recouped through your tax filing. IRS Publication 552 goes into aspects of keeping records you might not have considered, such as the kinds of records to keep and how long to keep them.

You can download the publication "Record-keeping for Individuals" from www.irs.gov or have it mailed by calling (800) 829-3676.

PER DIEM EXPENSES

The per diem is the tax-deductible amount the IRS assumes you spend on meals, beverages and tips when you're away from home on an overnight business trip.

The new tax law, the Tax Cuts and Jobs Act (TCJA), effective Jan. 1, 2018, does not allow a taxpayer to deduct unreimbursed business expenses as an itemized deduction on Schedule A.

For company drivers, per diem is considered an unreimbursed business expense and therefore is no longer deductible. The only way a company driver can benefit from per diem under the TCJA is if the carrier reimburses per diem as part of the driver's pay.

For owner-operators, though, per diem is an ordinary and necessary business expense. It's reported not as an itemized deduction but as a business expense on Schedule C. It directly reduces the self-employment taxes and income taxes owed on the return.

It's important to realize you can't deduct your total per diem from your tax bill dollar for dollar. But owner-operators still can deduct 80% of the total per diem of $66 a day, or $52.80.

There's the option of direct expense deductions, but meals are deductible at only a 50% rate, so an owner-operator would have to consistently spend more than $105.60 per day to exceed the per diem's $52.80 (80% of the $63).

To claim the per diem on any trip, you must be away from home for the night, which you can prove through your logs. A trucker who leaves the terminal before dawn, works a 14-hour day and then returns that night has worked for a day, but not in a way that qualifies for the per diem deduction.

DEPRECIATION

The standard depreciation for a Class 8 truck, commonly called "straight-line" depreciation, is an evenly paced three-year deduction that's spread over four tax years: year one, 17% of the cost of the truck; years two and three, 33% each; year four, 17%.

Also common is a variation of the four-year formula known as accelerated depreciation. It takes 77% of the equipment's value in the first two years, 23% in the final two.

As a result of the new TCJA legislation, an owner-operator can choose to deduct 100% of truck and trailer purchases until the end of 2022.

Starting in 2023, this bonus depreciation deduction dwindles 20% a year until 2026, and it's eliminated in 2027. However, the bonus depreciation deduction can be taken only in the year the equipment was purchased.

Another change made under the new tax law is that bonus depreciation can be used for both used and new assets. Under the previous tax law, bonus depreciation was allowed only on new assets.

Should equipment expenses exceed operators' income for the year, which is likely for the year the equipment is bought, the bonus depreciation deduction cuts income to zero. The new legislation allows them to carry that loss forward into the next year, which could help lower their tax bill for that year and even subsequent years. When the bonus depreciation rate begins to fall in 2023, owner- operators likely will return to using the standard depreciation deduction.

Accelerating depreciation like this, however, is no magic bullet. It's not for everyone, given it could speed the higher tax bills that come when depreciation runs out. That also could move the taxpayer into a higher tax bracket. Too

TAX CALENDAR

EXPENSES
Individual tax returns:
original due date
APRIL 15

Filing extension due
APRIL 15 (EXTENDS TO OCT. 15)

Estimated tax payments
1st quarter - ***APRIL 15***
2nd quarter - ***JUNE 15***
3rd quarter - ***SEPT. 15***
4th quarter - ***JAN 15***

Federal Highway Use Tax
AUGUST 31 ($550)

many owner-operators have used a similar tactic attempting to catch up after they've failed to make their estimated quarterly taxes.

Owner-operators with a full tank of financial self discipline can use bonus depreciation to zero out tax bills as long as possible while also diligently saving enough each year — typically 8% of gross revenue — for the inevitable day when the IRS comes calling.

LEASE VS. PURCHASE: A TAX ANALYSIS

If you are leasing your truck, you can deduct the entire amount of the payment each month.

EXAMPLE 1:
Tom leased his truck Jan. 1. He is paying $2,000 per month. His total deduction is $24,000 ($2,000 x 12).

On the other hand, if you are purchasing your truck, you can deduct the depreciation on the total cost of the truck and the interest charges that are included in your payment. The truck is depreciated through accelerated depreciation over three years.

EXAMPLE 2:
Tom purchased his truck Jan. 1. The price is $60,000. He is paying $2,000 per month for four years to pay off the truck, 80% of which is interest in the first year.

His depreciation deduction in year one is 33% of $60,000, or $19,800. His interest deduction is $19,200. His total deduction is $39,000.

As these examples illustrate, the owner-operator who is purchasing his truck has deductions in the first year that are $10,200 greater than the lease driver. But in the fourth year, the lease driver still will have his $24,000 per year, and the purchaser will have $19,800 of depreciation left plus interest of $4,800 to deduct.

The purchaser gets higher deductions in the first three years with the fourth year close to equal. The net effect is a tax delay for the owner-operator purchasing

TAX MYTH	TAX REALITY
"In the year you start your business, you will owe no tax."	This is not true, especially if you are leasing your truck.
"You will get a big refund your first year."	You potentially can get a refund to the extent of taxes paid. Example: If your withholding as a company driver was $100 before you became an owner-operator, and you paid no additional taxes during the year, the most you normally can receive as a refund is $100.
"You should be incorporated."	Not necessarily. Incorporation only makes sense when the tax savings are greater than the additional costs.
"You don't have to make estimated tax payments."	Payments are required quarterly.
" 'Tax-deductible' or 'write-off' means getting something free."	Most of the time it reduces your federal taxes only from between 15% and 30% of the value of the item purchased.
"You can deduct deadhead mileage and days off because of illness."	Because you deduct only your actual expenses while working and are taxed only on the profit you make while working, you're already getting a deduction for deadhead and time off.
"You can deduct the cost of your dog."	Generally the dog is deductible, as a security measure, as long as it is part of the trucking operation. Typically this means that the dog lives in the truck and is always with the truck.
"You can deduct out-of-route miles."	You deduct your actual expenses while working, which already includes out-of-route miles, as with deadhead, and you can't deduct anything twice.
"You can deduct the standard mileage rate for every mile you run."	You can deduct actual expenses or the standard mileage rate, but not both. For most owner-operators, the actual expense deduction usually makes sense.
"You can deduct tips for maintenance, tire changes, repairs, etc."	Only if you actually pay the tip. Falsely claiming tips is fraud.
"You can negotiate a deal with the IRS to pay back taxes at a few cents on the dollar."	Such deals, called offers in compromise, may be granted in extreme cases and are based on your ability to pay.

the truck. The tax will be paid in later years, not eliminated by depreciation. Note also that if you trade every three years, erosion of depreciation may have set in by your fourth or fifth trade, and you've lost much of the tax benefit enjoyed by people who buy less often.

On the other hand, considered financially, it usually costs less to buy in the long term. Take, for example, the common five-year lease period measured against the likewise common five-year note on a new truck.

Assuming a purchase price of $118,000 for an aerodynamic truck with a 70-inch sleeper and a comparable lease of the same truck, tax savings are greater with the lease – almost $7,000 more over five years. However, all other things being equal, it makes more sense financially to buy since the total adjusted cost of the vehicle with conventional loan financing is $10,000 less than the cost of the leased vehicle after a 20% buyout at the end of the term. For more on this tough financial choice, see Chapter 10.

MINIMIZING YOUR TAXES

Following are examples of tried and proven tax reduction tips:

GET HELP.
The U.S. Internal Revenue Code is 3.4 million words long. It changes every year, often in ways that directly affect owner-operators.

That's why owner-operators need a business services provider who specializes in owner-operator businesses.

SAVE MONEY TAX-FREE.
If you don't have a retirement account, start one. Up to a point, the money you put into an IRA, SEP or 401(k) is tax-exempt until you start drawing it out many years later. Put money into it regularly.

TRACK PERSONAL VEHICLE MILES.
You cannot deduct mileage on your personal vehicle to get to and from work, but you can deduct it if you make a business-related trip to the bank, the post office, a business meeting, a truck show,

WATCH YOURSELF IN THESE AREAS

Potential audit problems for owner-operators:

NO FIXED RESIDENCE.
Make sure you have an established residence where you collect mail, even if it's a relative's house you rarely visit. Without a home to be away from, you don't qualify for the daily per diem write-off for meals.

QUESTIONABLE HOME OFFICE.
The IRS rules for home offices are so strict that they exclude most owner-operators. Deductible home offices must be used exclusively for the business and nothing else, not even at nights and on weekends. That goes for any equipment in the office, including the computer and the TV set. More of a hurdle to truckers is that the deductible home office must be the operation's primary place of business and must be used regularly. In most instances, the home-office deduction is legitimate only when a driver has a spouse or partner who stays at home and regularly does the load booking, dispatching, handling of multiple trucks or other business functions. You'll also need your business services provider to help you with the paperwork, as the required IRS Form 8829 gets confusing.

MINGLED ACCOUNTS.
No law requires separate business and personal checking accounts or credit cards, but the law of common sense says otherwise. If you've mingled church and state, good luck proving to the tax-man that a grocery receipt was for meals in the truck.

a dealership, a supply store or a parts yard – even to a grocery store – if your purchases were business-related. Keep a log in which you note the date, mileage and purpose of each business-related trip For tax year 2019, the IRS deduction for business miles is 58 cents. There are also smaller deductions for other personal-vehicle miles: 20 cents for medical-related trips, and 14 cents a mile for charitable trips such as Meals on Wheels deliveries.

GIVE TO GOOD CAUSES.
Donations to churches, charities such as the Red Cross and the Salvation Army, and nonprofits such as Trucker Buddy all are tax-deductible if you itemize your taxes.

HIRE THE KIDS.
If you put an adolescent child on the payroll and pay her, say, $4,000 for the year, she pays no taxes on the income because she didn't make enough – but you pay no tax on it, either. Make sure the child is doing age-appropriate work, and keep documentation of it, including filing a W-2.

CLAIM TUITION TAX CREDITS.
If you're paying tuition for yourself or your children to a qualified educational institution, take the tuition tax credit – a dollar-for-dollar savings off your tax bill, up to $2,500. Paying the full tuition by Dec. 31 will allow you to credit the entire amount on your taxes.

This only works for students seeking an undergraduate degree and enrolled at least halftime. There is a four-year limit on this credit.

USE THE CALENDAR.
Keep a trucking-specific tax calendar at your home or in your truck. You can find one on the ATBS website containing important tax deadlines throughout the year and frequently missed tax deductions.

Before Dec. 31, buy whatever big-ticket business equipment you know you need: new tires, a laptop or an in-cab heater. Even if you buy it on credit, you get the tax benefit quickly while postponing the cost.

Deductions must be business- related. Here are a few examples:

- *If you wash your truck at home, you can claim the cost of household water and detergent for washing the truck.*
- *You can deduct a flyswatter for your truck, flashlight batteries, cleaning supplies and a bunk comforter.*
- *You can deduct an entertainment expense if you buy dinner for a driver you are trying to recruit for your company.*
- *You can deduct coveralls, but not blue jeans. You can deduct steel-toed shoes, but not tennis shoes.*

Notably, the new tax law nearly doubled the standard deduction for most tax filers, and ATBS clients in 2018 using the standard deduction increased from 71% to 94%.

IRS AUDITS

The IRS usually has three years to challenge deductions or income stated on your return by requesting an audit, so you should keep your records for at least three years.

The statute of limitations can be up to six years for returns where there is evidence of an understatement of income of 25%. If the return is found to be fraudulent with the intent to evade tax, or if no return is filed, an action can be brought against you at any time.

The fact that the IRS is auditing your return does not mean that you or your CPA made a mistake. The IRS periodically randomly selects some returns to determine compliance with its tax rules.

If you receive a notice you are being audited, the first thing you should do is contact the person who prepared your return.

However, only a Certified Public Accountant or Enrolled Agent can represent you in an audit. The IRS says 4% of tax returns filed by the self-employed with at least $100,000 in revenue get special attention.

Claiming substantial expenses not common to a single-truck owner-operator — such as utilities, advertising or inventory — might draw an audit. The reality of the owner-operator world is that a single engine rebuild can spike expenses for the year; income also can be volatile, especially for independents. If circumstances such as those put you among the one in 25 who meet face to face with the IRS, make sure you've got the documentation.

The ATBS Tax Resolution team specializes in helping owner-operators who get behind on their taxes or otherwise need representation before the IRS. Consultations with the team are free. You ultimately are responsible for your tax return. Some tax preparers are aggressive in claiming deductions; be aware of what's being submitted on your behalf, and make sure you're comfortable with it.