

How Mr. & Mrs. Smith Zeroed Out Their Tax Bill With Their Own Part-Time Business

This is the fictional story of how Mr. & Mrs. Smith formed an LLC, started their own part-time business, and zeroed out their tax bill. This story is not intended to give tax nor legal advice. You are encouraged to get professional help if you need it :o).

Mr. & Mrs. Smith were the typical American family who decided they wanted to “get ahead” and improve their financial situation. They had a combined income from their jobs of \$60,000 a year but, with 3 small kids, they just couldn't seem to make any progress towards their financial goals. They decided to start their own, part-time, business. They weren't very smart business people – in fact, they were pretty dumb! But, in spite of that, they were able to convert their normal living expenses into tax deductible business expenses and zeroed out their annual tax bill in a most unique way...

The first thing they did was form a company named “Big Dreams Enterprises, LLC”. The fees were small to set this up and they created their first, tax-deductible business expense. Next, they had to decide what type of business to go into. They had heard that you could buy things wholesale and sell them retail and make a profit. They didn't have any idea what products to sell so they decided to stick to the items that they were familiar with. They decided to buy and sell the very items that they were already buying as consumers.

Mrs. Smith decided that she wanted to buy and sell a clothing line. She was not a very savvy business person so she paid retail. She bought through her business checking account \$6,000 worth of a family clothing line. They didn't have a retail store so she decided that the next best thing to do would be to have her family wear and model the clothes every time they went out.

The Smiths held a family meeting and decided that the best place to model their clothing line would be where there were lots of families. The unanimous decision was to go to Disneyland! This created a business expense of \$3,200.

Mr. Smith saw a late-night infomercial and decided that he wanted to get into the real estate “sandwich lease” business. This is the business where you lease a home at one price and sub-lease it at a higher price. He and his wife quickly located a beautiful home and leased it for \$2,000/month. They immediately put it back on the market for \$3,000/month in hopes of making a \$1,000 monthly profit. They paid the lease payments from their business checking account.

After 30 days of no offers they realized that they couldn't afford the \$2,000 monthly lease payment in addition to the \$2,200 rent that they were paying on their personal home. They decided to move out of their personal home and into the investment property and take care of it while they continued to advertise it for lease.

Every time they went out to dinner they discussed their business strategies, modeled the clothing line, and tried to recruit the waitresses to become commissioned sales people. This created another business expense. Cost \$300 per month.

So far the Smiths had no sales and were failing miserably in their business. They decided to have a monthly Grand Opening/Customer Appreciate Party and Fashion Show to help stir up business. They invested \$1,000 in enough food to feed 200 people but were greatly disappointed when no one showed up. Reluctantly, they decided to live off of that food for the next 30 days (instead of letting it spoil) and try again. They did this every month for 12 months. This created a \$12,000 expense to their business for the year.

The Smiths decided they needed to become a little more sophisticated in running their business so they set up special business phone line and dropped their home phone line. They had been considering dropping their cable TV and internet service but decided their business could use the cable TV so they could watch the business channel for economic reports. They also figured they could watch the fashion channel for clothing ideas use the internet to do addition research and make sales on ebay. They disconnected these services and had their business start them back up. This created a business expense of \$100 per month.

By the end of the year The Smith's business had failed miserably. Their clothing inventory became old and worn out. They had to finally liquidate the inventory to a second-hand store for next to nothing. This created a \$6,000 loss in their business.

Here is a summary of their business expenses for the year:

\$6,000 – Loss on clothing line
\$3,200 – Modeling trip to Disneyland
\$24,000 – Loss on “sandwich lease” business
\$3,600 – Expense on business meals
\$12,000 – Expense on monthly Customer Appreciation parties
\$1,200 – Expense on monthly Cable TV and Phone service
\$50,000 – Total Business Expenses for the Year

When the Smith's visited their accountant at the end of the year, embarrassed by their business failures, they were in for a surprise Their accountant explained that their business expenses reduced their Adjusted Gross Income to just \$10,000. By contributing the maximum amount of \$5,000 each to their IRA's they were then able to take it all the way down to zero. They now had **no income tax liability!**

Note: If needed, they could have paid up to \$5,700 to each child as employees of the LLC for a total additional business expense of \$17,100 to the LLC.

SUMMARY: By starting their own, part-time business, the Smiths were able to convert money that they were already spending on personal items into tax-deductible business expenses and effectively reduced their annual income tax liability to zero. With a little creativity, you may be able to do the same. Your own, part-time business is one of the ultimate tax shelters!

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