TAA Abstract on Textbook and Academic Writing

Taxes and Authors: What you should know

June 6, 2018 By Eric Schmieder

In his recent TAA webinar, "Taxes and Authors: What You Should Know", Robert Pesce, a partner at Marcum LLP, shared some important information about the new tax law. He also offered advice on two key questions for tax-conscious authors: 1) What type of entity should you be? and 2) Are you keeping good records on your business deductions?

The new tax law and its passthrough deduction

Significant tax reform changes were put in place by the Tax Cuts and Jobs Act on December 22, 2017 that affect nearly every US taxpayer. Pesce began his session with an overview of key changes enacted by this legislation as follows:

- Some very big breaks have been given to C-corporations from tax rates upward of 35% to a flat rate of 21%
- Estate taxes have been eliminated for estates up to $11 million
- Top federal tax bracket for individuals has been lowered from 39.5% to 37%
- Dependency exemptions are gone

The most significant change of potential interest to authors, however, is in the introduction of a passthrough deduction on qualified income. Recognizing that most businesses are not C-corporations (which benefit from the flat tax rate), the IRS created a new deduction that is "generally equal to 20% of the passthrough income from business operations", Pesce noted. In other words, the passthrough deduction allows you to deduct 20% from your business income after expenses and pay taxes on the remaining 80% of the business income instead.

But wait. Pesce remarked, "There is a very broad caveat to this rule that has received a lot of press – the 20% passthrough deduction is applicable to businesses other than specified trades or businesses". He proceeded to define a specified trade or business as "any trade or business where the specified skill is the trade of the owner" which seemingly applies to authors, thereby making them ineligible for the deduction.

Until clarification is provided on how this law should be applied to authors, it is safer to assume that the deduction does not apply. However, Pesce offered additional advice regarding passthrough business entities that may be beneficial to authors regardless of the decision on this new rule.

What type of entity should you be?

Pesce described that an S-corporation is a business entity that serves as a corporation for legal purposes but as a passthrough entity for tax purposes. In these types of businesses, there is no taxable income at the entity level and net income from the business is reported on the individual tax return. The advantage is social security and Medicare tax savings – approximately 15.3% – to which the net income of an S-corporation is not subject.

In order for this to be effective, Pesce notes that the passthrough nature of an S-corporation cannot be used to circumvent self-employment tax obligations. The best way to avoid such concern and audit potential is to determine an optimum salary for the author to be paid by the S-corporation (which is subject to the social security and Medicare taxes at the entity level), while resulting in maximum savings on the net income passed through to the individual.

Challenging the thought that a traditional C-corporation business entity may be a better option for authors, Pesce stated that for most individual earners, the flat tax of 21% associated with a C-corporation does not make this a desirable option. Even for earners in the top tax brackets, the "double taxation" scenario of a C-corporation entity adds complexity without cost-savings benefits.

Pesce advised authors on being some sort of passthrough organization, and – if making larger amounts of earnings from self-employed activities – to consider forming an S-corporation for the benefits listed above.

Are you keeping good records on your business deductions?

Regardless of the way your authoring income is earned and reported, Pesce conveyed the importance of maintaining good records related to the business activities of your authoring efforts. To this end, he shared several tips to make your future tax filings easier for you and your accountant.

Tip #1 – Dedicate a business expense account

Pick a credit card and declare it to be *THE* credit card associated with business activities as a writer. This saves the time and chance of error in separating personal and business expenses at the end of the year. For those using checks or cash, Pesce suggested opening a specific account for the business expenses.

Tip #2 – Maintain a journal of expenses throughout the year

Pesce stressed the importance of keeping up with business expenses as they happen throughout the year. He said that while many people use Outlook, some still prefer paper form journals. Regardless of the method, he encouraged authors to keep receipts for any entertainment, travel, or other business purposes in case of audits.

Tip #3 – Use a bookkeeping software

Pesce stated that Quicken, QuickBooks, and Xero are good software options for keeping books throughout the year. Although software solutions are not necessary for every author, Pesce noted that being organized for your accountant has advantages. Specifically, it allows you to use the accountant's time and services for their unique professional skills rather than for organizing your receipts.

Tip #4 – Keep in mind other deductions and credits

Finally, Pesce shared some advice on deductions and credits that may be overlooked by authors.

- In addition to deducting travel expenses associated with research and writing, think about additional deductions – phone, Internet, Netflix, Broadway tickets, etc. – for things that keep you “plugged in” to your subject matter.
- Don’t forget the home office deduction. Measure the space you are using exclusively for business and divide that by the total square footage of your home. The resulting percentage of your mortgage interest and real estate taxes can be moved to your schedule C as business expenses, thereby reducing your personal obligation and your net income from the business.
- Although deductions can improve your tax situation, credits often have a greater impact. One example of specific interest to authors is the Foreign Tax Credit. If your work is being published in foreign countries, consider the Foreign Tax Credit as a more beneficial option over deducting foreign taxes, as this can benefit as much as dollar for dollar on the foreign taxes paid during the year.

While each individual tax situation will be unique, being aware of the changes to tax law, treating your authoring business for what it is – a business, and keeping good records throughout the year will prepare you for optimal results on tax day.