ASK 1099

Got questions? Good, because we've got answers. We recruit specialists like tax master Bernard Kamaroff and legal eagle Stephen Fishman to help subdue America's most puzzling solo-business problems. Of course, this is our first issue, so we've asked the questions ourselves, but next time around, the Qs could be yours. Go to www.1099.com/ask and ask legal, tax, tech, or other questions about your boss-free life.

Q: My client wants me to sign a nondisclosure agreement. Should I?

A: Many clients require independent professionals to sign nondisclosure agreements (NDAs), also called confidentiality agreements. These agreements bar IPs from disclosing the client's trade secrets—such as marketing plans, information about product development, manufacturing techniques, or customer lists—to others. Unfortunately, many NDAs are so broadly worded that they can make it difficult for you to work for other clients without fear of violating your duty of confidentiality.

The best advice is to avoid signing NDAs whenever possible. If a client insists that you sign one, read it carefully. Insist on an NDA that is reasonable in scope and that defines exactly what information you must keep confidential. Also, the NDA should last only for a limited time—five years at the most.

An NDA is unreasonable when it prevents you from using *any* technical, financial, or business information you obtain directly or indirectly from the client. Specifically, do not sign an NDA requiring you to keep confidential any information that:

- you knew before working with the client
- you learn from a third person who has no duty to keep it confidential
- you develop independently, even though the client later provides you with similar or identical information, or that becomes public knowledge through no fault of your own

From the IP's point of view, the very best NDAs are those that limit an IP's duty of confidentiality to information supplied by the client in writing that's marked "confidential"; or, if disclosed orally, is later written down in a confidential memorandum and delivered to the IP. This way, the IP knows exactly what information the client deems covered by the NDA. *(Stephen Fishman)*

Q: If I create an article, graphic, software program, or other creative work for a client, can I re-sell it to other clients?

A: The answer to this question is governed by the copyright law. When you create an article, graphic, software or other work for a client, it's up to you and the client to agree on what rights the client obtains in your work. The client can obtain all your rights or only some of them.

If the client obtains all of your rights, you cannot reuse or re-sell your work without the client's permission. The client can obtain all your rights only through a written transfer agreement signed by you. This can be a separate agreement or a clause included in an overall client agreement. A client obtains all your rights if you characterize your work in writing as a work made for hire or if you specifically assign (transfer) all your rights in writing.

Clients often want to obtain all your rights, but this isn't always the case. In many cases, clients will agree to license your work —that is, obtain the right to use it—but leave you with many ownership rights. You can divide your copyright ownership rights any way you choose. For example, freelance articles or graphics can be licensed by type of media, time, geography, language, first use, or many other ways. You can give a client the right to publish your article for the first time in North America, but retain all your other rights. This means you can resell your article to others after it's first published.

If you want to reuse your work, it's highly advisable to have a written agreement making clear which rights you're transferring and which you're retaining. *(SF)*

Q: I've heard that claiming a home-office deduction is a sure way to get audited. Is this true?

Bernard Kamoroff, C.P.A., is the author of *422 Tax Deductions for Businesses and Self-Employed Individuals.*

Attorney Stephen Fishman has written numerous books, including *Working for Yourself* and *The Copyright Handbook.*

A: "Taking the home-office deduction is like wearing a huge sign that says *audit me*." What home-based professional hasn't heard that warning? Truth is, it's a myth. The home-office deduction does not invite an audit. For 1998, the last year statistics were available, only 4.7 percent of businesses claiming a home-office deduction were audited, meaning that 95.3 percent of all home-based businesses were not audited. And most of those audits involved businesses that took a large home-office deduction but had a very small income. Claiming large deductions yet reporting low income has always been a red flag to the IRS.

A legitimate home office can produce a large and much-needed tax deduction, but don't grab the carrot before you take a good look at the accompanying stick.

There's tax trouble waiting in the wings for home-based individuals who own their own homes: a surprise tax bill when you sell the home. Those who rent don't have to worry about this; you lucky folks can skip the rest of this answer.

Now, home owners, part of the home-office deduction is depreciation: writing off a portion of the cost of the office each year. When you sell your home, all the depreciation you were allowed over the years must be "recaptured." This term is as unfriendly as it sounds. You must hunt up your old tax returns, add up all the depreciation you were eligible for during all the years you had a home office, and pay income tax on that depreciation when you sell the house. The prior years' depreciation is taxed as though it was income, which can lead to a whopping tax bill.

And there's a second tax trap for homeowners. When you sell your home, $250,000 of the profit on the sale is tax free ($500,000 for a married couple). But if you have a home office, when you sell your home, the office portion is not eligible for the tax-free exclusion. If you sell the house at a profit, you will owe taxes on the portion of the home that is your office.

This second problem can be easily avoided, if you plan ahead at least two years. (In fact, a lot of tax problems can be avoided if you plan ahead, but that's a story for another day.) If you were ineligible for a home-office deduction for at least two of the five years prior to sale, the entire home gets the full $250,000 (or $500,000) exclusion. So if you'll be selling your home in the near future, be sure that at least two years prior to the sale you make your home office ineligible for the home-office deduction. This, however, will not exempt you from the depreciation recapture. You must still pay taxes on the depreciation allowed for all the years that you had the home office. *(Bernard Kamaroff)*

Q: I just figured my taxes for 2000, and I owe a lot more than I thought. Is there anything I can do?

A: Once the new year begins, you have fewer ways to cushion last year's tax blow than you did in December, but there are four things you may still be able to do:

First, see if you can shift income from the old year to the new year. Most independent professionals are on what's called the "cash basis of accounting"—recording income when they get paid, recording expenses when they pay the bills. Make sure you have not included income that you billed out in the old year but did not receive payment for until the new year.

Second, if you purchased office equipment, a computer, furniture, or other business assets last year, you have the option of writing off up to $20,000 in the year of purchase, or "depreciating" the assets (spreading the cost over several years). Choose the immediate write-off over depreciation for a much larger deduction for last year.

Third—and this is an area where just about every business can reduce taxes—make sure you've deducted every allowable expense. Did you include business expenses paid on your credit card or personal bank account? Did you include all of your out-of-pocket business expenses? Did you include your vehicle expenses, all those miles you drove around town on business? Every business deduction you find will reduce your taxes. It's like a treasure hunt.

Finally, one last possibility: You can set up or add to an IRA (Individual Retirement Account), or a SEP-IRA (Simplified Employee Pension Plan), or both, right up until April 15 of the new year. You can put a percentage of your earnings into these special IRS-approved plans and defer paying income taxes on the profits invested until you withdraw the money. Most banks offer IRAs and SEP-IRAs. *(BK)* **1099**

To learn more about IRA and SEP plans, read "Ready or Not" on page 46