

2026 EDITION — FULLY UPDATED FOR THE NEW TAX LAW

The US Small-Business Tax Handbook

Every entity, every deduction, every legal strategy — explained in plain English, with the numbers worked out, so you keep more of what you earn.

The complete guide to legally paying the lowest tax the law allows — written by practicing tax professionals, not lawyers writing for lawyers.

Contents

Foundations: How the US Tax System Actually Works	12
Chapter 1. The Machine: How Your Money Becomes Their Money	13
Chapter 2. The Players: IRS, States, Courts, and Your Rights	15
Chapter 3. The Vocabulary: Twenty Terms That Unlock Everything	18
Choosing Your Business Structure	22
Chapter 4. The Entity Menu: What You're Actually Choosing	23
Chapter 5. Sole Proprietorships and Single-Member LLCs	25
Chapter 6. Partnerships and Multi-Member LLCs	28
Chapter 7. The S Corporation: Small Business's Favorite Tax Break	31
Chapter 8. The C Corporation: Special Tool, Not Default	35
Chapter 9. The Decision Framework: Putting Part 2 Together	38
Filing: Forms, Deadlines, and the Rhythm of the Tax Year	42
Chapter 10. The Forms You'll Actually Meet	43
Chapter 11. Accounting Methods and Recordkeeping: When Income Counts	45
Chapter 12. Estimated Taxes: The Quarterly Rhythm, Mastered	47
Chapter 13. Information Returns: 1099s, W-2s, and the Matching Machine	49
Chapter 14. Statutes of Limitations: When Old Years Finally Close	51
Deductions and Credits: The Complete Catalog	54
Chapter 15. Deduction Fundamentals: The Rules Behind Every Write-Off	55
Chapter 16. The Big Five: Home Office, Vehicle, Travel, Meals, and Health	57
Chapter 17. Depreciation Made Simple: The Golden Age of Writing Things Off	60
Chapter 18. Deductions by Industry: The Checklists	63
Chapter 19. Credits: The Dollar-for-Dollar Money Most Businesses Leave Behind	66
Legal Tax Minimization: The Strategy Playbook	70
Chapter 20. The Five Levers: A Framework for Every Strategy You'll Ever Hear	71
Chapter 21. Entity Optimization: Squeezing the Full Value From Your S Corporation	72
Chapter 22. The QBI Deduction: Your Automatic 20% — and How Not to Lose It	75
Chapter 23. Retirement Structures: The Six-Figure Deduction Machine	78
Chapter 24. Real Estate: The Most Favored Asset in the Tax Code	81
Chapter 25. Family Strategies: Shifting Income to Lower Brackets, Legally	85
Chapter 26. Charitable Giving: Full Credit for Every Generous Dollar	88
Chapter 27. The Advanced Shelf: QSBS, Trusts, Installment Sales, Puerto Rico, and the Schemes to Refuse	90
Payroll, Sales Tax, and the Multi-State Maze	94
Chapter 28. Payroll: The Tax With Your Name on It	95
Chapter 29. Sales Tax After Wayfair: Everyone's Problem Now	98
Chapter 30. Income Tax Across State Lines	100
State Taxes: Playing the Fifty-Board Game	102

Chapter 31. The State Categories and Their Playbooks	103
Chapter 32. Changing States: The Move That's Worth Millions — Done Right	105
Estate, Gift, and Inheritance: Keeping It in the Family	108
Chapter 33. The Basis Game: Estate Planning for the 99%	109
Chapter 34. The Transfer–Tax Game: Strategies Above the Exemption	111
Selling Your Business: The Biggest Tax Event of Your Life	114
Chapter 35. Deal Mechanics: What's Actually Being Sold	115
Chapter 36. The Exit Playbook: Two Years of Runway	117
Property Tax: The Bill You Can Actually Negotiate	120
Chapter 37. Assessments and Appeals	121
When the IRS Writes: Notices, Audits, and Owing Money	123
Chapter 38. Decoding the Mail	124
Chapter 39. Audits: What Actually Happens	125
Chapter 40. Owing Money: The Defined Paths Out	127
Chapter 41. Penalties: How They Work and How They're Removed	128
The Reader Workbook	131
Chapter 42. The Entity Decision Tree	132
Chapter 43. Deduction Checklists by Industry	133
Chapter 44. The Working Worksheets	135
The Personal Side: Investments, Retirement Years, and Life Events	137
Chapter 45. Investment Taxation: Keeping More of What Your Money Makes	138
Chapter 46. The Second Half: RMDs, Roth Conversions, and Retirement–Year Strategy	140
Chapter 47. Life Events: The Tax Playbook for Marriage, Divorce, Houses, College, and Loss	143
Building a Team: Hiring, Benefits, and the Taxes of Growing Up	147
Chapter 48. The True Cost of a Hire — and the Benefits That Beat Raises	148
Chapter 49. Team Retirement Plans: The Benefit That Recruits, Retains, and Deducts	150
The Deduction Encyclopedia, A to Z	153
Chapter 50. A Through L	154
Chapter 51. M Through Z	156
Ten Readers, Ten Playbooks: Complete Worked Scenarios	160
Chapter 52. The Earning Years	161
Chapter 53. The Asset Years	162
Chapter 54. The Harvest Years	164
The Owner's Tax Year, Month by Month	166
Chapter 55. January Through December	167
Sixty Questions, Straight Answers	171
Chapter 56. Questions 1–30: Business, Deductions, and Entities	172
Chapter 57. Questions 31–60: Money, Family, Investments, and the IRS	175

Working With Professionals (and Without Them)	180
Chapter 58. The DIY Line, the Hiring Guide, and the Price of Things	181
The State-by-State Owner's Directory	184
Chapter 59. Alabama Through Missouri	185
Chapter 60. Montana Through Wyoming	191
The Real Estate Investor's Manual	200
Chapter 61. Buying and Operating: Getting the Foundation Right	201
Chapter 62. Exits: The 1031 Walkthrough, the Selling Math, Syndications, and Vacation Homes	203
Year One: Starting a Business Without Tax Regrets	207
Chapter 63. The Launch Sequence	208
Chapter 64. Bookkeeping 101: The System Behind Every Strategy	210
More Industry Guides: The Second Shelf	213
Chapter 65. The Second Shelf	214
Reading Your Own Tax Return	219
Chapter 66. The Guided Tour	220
The Family Chapters: Kids' Money, Aging Parents, and Teaching Wealth	223
Chapter 67. Kids, Parents, and the Caregiver's Toolkit	224
Protecting Yourself: Scams, Identity Theft, and the Notice Decoder	228
Chapter 68. The Defense Manual	229
Forty More Questions: The Deep-Cut FAQ	233
Chapter 69. Questions 61–100	234
The Retirement Account Rulebook	240
Chapter 70. Account by Account	241
Ten More Playbooks: Scenarios, Volume II	244
Chapter 71. Scenarios Eleven Through Fifteen	245
Chapter 72. Scenarios Sixteen Through Twenty	247
The "I Missed It" Almanac: Fixing What's Already Late	250
Chapter 73. The Fifteen Fixes	251
Playbooks by Income Level	254
Chapter 74. The Five Levels	255
Audit Stories and the Tools You'll Run It All On	258
Chapter 75. Six Audits, Six Lessons	259
Chapter 76. The Tool Stack: An Honest Buyer's Guide	261
The Workbook, Volume II: Calculators on Paper	263
Chapter 77. The Five Calculators	264
The Law You're Living Under: What's Permanent, What Expires, What to Watch	268
Chapter 78. Permanent, Expiring, Indexed	269

Vehicles: The Complete Owner's Guide	271
Chapter 79. Everything Automotive	272
Health Coverage Decisions: The Owner's Complete Map	275
Chapter 80. The Routes and Their Tax Clothes	276
Debt, Financing, and Insurance: The Money Behind the Money	279
Chapter 81. Borrowing and Its Tax Shadows	280
Chapter 82. Insurance: Deductibility by Design	281
The Income Encyclopedia, A to Z	284
Chapter 83. A Through Z	285
Married, With Money: The Couple's Complete Tax Guide	289
Chapter 84. The Couple's Levers	290
Twenty Myths, Retired	293
Chapter 85. The Debunking	294
One Family, One Year, One Return: The Complete Walkthrough	297
Chapter 86. The Delgado File	298
Quick-Start Playbooks: Ten Situations, One Page Each	301
Chapter 87. The Ten	302
The Negotiation Playbook: Winning the After-Tax Deal	305
Chapter 88. The Five Conversations	306
The Money Around the Taxes: Paychecks Explained and Cash Flow Managed	310
Chapter 89. The Paycheck, Explained (Hand This to Your Team)	311
Chapter 90. Cash Flow and the Tax Line: Never Surprised Again	312
The Master Finder: Every Question, Routed	315
Chapter 91. Say It Like You'd Say It	316
Thirty Final Questions: The Edge Cases	319
Chapter 92. Questions 101–130	320
The Twelve-Month Implementation Plan	325
Chapter 93. The Installation Year	326
The Conversations: Scripts for the Talks That Move Money	329
Chapter 94. Eight Scripts	330
How We Got Here: A Short, Useful History of American Taxation	333
Chapter 95. Two Centuries in Six Moves	334
By Hand: Twelve Computations Every Owner Should Be Able to Do	337
Chapter 96. The Twelve	338
Back Matter: Key Numbers, Deadlines, Forms, States, and Glossary	342
Key Numbers — 2026	343

The Full 2026 Rate Tables	344
The Deadline Calendar	345
Forms Mentioned in This Book	346
State Directory — At a Glance	346
Glossary	349
Glossary, Volume II — The Working Terms	351
Index of Worked Examples	352
About the Author & Production Notes	354
Notes, Numbers, and Next Steps	356
My Numbers (update each January)	357
Decisions Log	357
Questions for My Professional	359
Bulk Orders, Updates, and Feedback	359

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2026 EDITION

*For every owner who ever signed a return
they didn't understand — and decided that
this year would be the last time.*

The US Small-Business Tax Handbook

Every entity, every deduction, every legal strategy — in plain English

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Important notice: This book provides general educational information about United States tax law as of the 2026 tax year. It is not legal, tax, or financial advice, and reading it does not create a professional relationship with CPA Cloudbooks or any of its professionals. Tax law changes constantly, dollar thresholds adjust annually, and the right answer for any real situation depends on facts this book cannot know. Before acting on anything you read here, consult a qualified CPA, enrolled agent, or tax attorney about your specific circumstances.

How to Use This Book

Nobody reads a tax book cover to cover, and you don't need to. Here is the fastest route to what you came for.

If you're starting a business, read Part 1 (how the system works) and Part 2 (choosing your structure), then use the decision tree in the workbook section. Those hundred-odd pages will save you from the expensive mistakes that are hard to undo later.

If you already run a business, go straight to Part 4 (deductions and credits) and Part 5 (the strategy chapters). Part 5 is the heart of this book — the legal strategies that separate business owners who pay the sticker-price tax rate from those who pay the lowest rate the law allows. Skim the chapter summaries first; each one tells you whether the chapter applies to you.

If you have employees, sell products, or operate in more than one state, Part 6 covers the taxes that catch growing businesses by surprise — payroll, sales tax, and the multi-state rules that changed dramatically in the last decade.

If a letter from the IRS brought you here, take a breath and go to Part 11. Most IRS letters are routine, most problems have a defined process, and knowing the process is most of the protection.

If you're thinking about selling your business or passing wealth to your family, Parts 8 and 9 cover the two biggest tax events of most owners' lives — events where planning a year or two ahead is routinely worth six figures.

Three features run through every chapter. **Worked examples** in gold boxes show the actual arithmetic — if a strategy is worth \$11,000, you'll see the eleven thousand dollars computed, not asserted. **Common mistakes** boxes flag where real people actually go wrong, drawn from decades of cleaning up after those mistakes professionally. And each chapter ends with a **summary and action items** — the whole chapter compressed to what you should actually do.

One promise about honesty: this book tells you when a popular strategy doesn't work, when a "loophole" you saw online is actually a trap, and when the right answer is to hire a professional. A tax book you can trust on the exciting ideas has to be trustworthy on the boring warnings too.

A NOTE ON THE NUMBERS

Dollar figures in this edition — brackets, limits, thresholds — are the official 2026 tax-year amounts unless a different year is stated. Most are adjusted annually for inflation. The tables in the back of the book collect the key numbers in one place; when in doubt, verify the current year's figure at irs.gov or with your tax professional.

PART 1

Foundations: How the US Tax System Actually Works

Before the strategies, the machine. This Part explains how American taxes actually work — the different taxes you pay, who runs the system, and the vocabulary that makes the rest of this book (and every conversation with an accountant) suddenly make sense.

Chapter 1. The Machine: How Your Money Becomes Their Money

1.1 The taxes you actually pay

Most business owners think "taxes" means income tax. In reality, you're standing under several separate spigots, and the strategies in this book work by turning different ones down. Here's the full set.

Federal income tax is the big one — a progressive tax on your taxable income, with rates from 10% to 37% in 2026. "Progressive" means the rates apply in layers: crossing into the 32% bracket does not mean all your income is taxed at 32%, only the dollars above that line. This single misunderstanding causes more bad decisions than any other in personal finance — people turning down income, refusing raises, or fearing that "a big year will push me into a higher bracket" as if the bracket reaches backward. It never does.

WORKED EXAMPLE — HOW BRACKETS ACTUALLY WORK

Sarah is single and has \$105,700 of taxable income in 2026 — exactly at the top of the 22% bracket. She's offered a project that pays \$10,000 more. Her fear: "it'll push me into the 24% bracket." The reality: only the new \$10,000 is taxed at 24% (\$2,400). Every dollar she already earned keeps its old rate. Her total tax rises from about \$17,700 to about \$20,100 — she keeps \$7,600 of the new \$10,000. There is no income level, anywhere in the bracket system, where earning more money leaves you with less. (There are a few benefit phase-outs that can create that effect — we'll flag them when they appear — but the brackets themselves never do it.)

Self-employment and payroll taxes fund Social Security and Medicare, and for many small-business owners they're bigger than income tax. Employees split 15.3% with their employer (7.65% each) on wages up to \$184,500 (2026), plus 2.9% Medicare above that with no cap, plus a 0.9% additional Medicare tax at high incomes. Self-employed people pay both halves themselves — the full 15.3% — which is why a freelancer netting \$80,000 often owes more in self-

employment tax than income tax, and why Chapter 21's S corporation strategy exists.

Capital gains tax applies when you sell something for more than you paid. Hold it more than a year and the gain gets preferred rates — 0%, 15%, or 20% depending on your income, far below ordinary rates. Hold it a year or less and it's taxed like ordinary income. A great deal of tax strategy is simply moving income from the ordinary column to the long-term capital gains column, or timing sales so gains land in low-rate years.

The net investment income tax (NIIT) adds 3.8% on investment income once your income passes \$200,000 (single) or \$250,000 (married filing jointly).

State and local taxes add their own layer — anywhere from zero (nine states have no general income tax) to over 13% (California) — and Part 7 shows why your state matters as much as your strategy. **Payroll taxes as an employer, sales tax as a seller, and property tax as an owner** round out the set; Parts 6 and 10 cover them.

1.2 The number that actually matters: your marginal rate

Two rates describe your situation. Your **effective rate** is total tax divided by total income — interesting for cocktail parties. Your **marginal rate** is what the *next* dollar earns or the next deduction saves — and it's the only number that matters for decisions. A \$10,000 deduction is worth \$2,400 to someone with a 24% marginal rate and \$4,600 to someone at 37% plus state tax. Every strategy in this book should be run against *your* marginal rate, which includes federal, state, and — for business income — often self-employment tax stacked together. When this book says a move "saves \$X at a 35% rate," that's the arithmetic being done.

1.3 How money flows through the year

The US runs a pay-as-you-go system. Employees prepay through withholding; business owners prepay through quarterly estimated payments (April 15, June 15, September 15, January 15). The annual return you file in April isn't when you pay your taxes — it's when you settle up, reconciling what the year actually produced against what you sent in. Get the prepayments close

and April is boring; ignore them and April brings a penalty that works like interest on a loan you didn't know you took. Chapter 12 shows the safe-harbor rules that make the whole issue manageable with one calculation a year.

COMMON MISTAKES TO AVOID

Confusing a refund with winning. A big refund means you overpaid all year — an interest-free loan to the government. The goal is paying in almost exactly what you owe. **Treating the April deadline as the payment deadline.** For business owners, the real payment deadlines are quarterly; April is just the reckoning. **Making decisions on the effective rate.** Deductions and extra income live at your marginal rate — always compute there. **Believing bracket-phobia.** More income always leaves you with more money after tax.

CHAPTER 1 — SUMMARY & ACTION ITEMS

You pay several distinct taxes — income, self-employment/payroll, capital gains, NIIT, state — and strategy means knowing which one a given move reduces. Brackets are layers, not cliffs; only your marginal rate matters for decisions; and the system collects as you go, not in April.

- Compute your combined marginal rate (federal bracket + state rate + 15.3% SE tax if it applies to your next dollar of business profit). Write it down; you'll use it throughout this book.
- Check last year's return: did you owe a penalty on line 38 (Form 1040)? If yes, Chapter 12 is your first stop.
- If you got a refund over \$3,000, adjust your withholding or estimates — that's your money working for someone else.

Chapter 2. The Players: IRS, States, Courts, and Your Rights

2.1 Who's who

The **Internal Revenue Service** administers federal tax law — it processes about 260 million returns a year, and the overwhelming majority of its contact with taxpayers is automated: computers matching the W-2s and 1099s it receives against what you reported, and mailing letters when the numbers disagree. Understanding that the IRS is mostly a giant matching machine

explains most of its behavior: report everything that gets reported about you, and the machine stays quiet. The IRS does not write the law — **Congress** does that in the Internal Revenue Code; the **Treasury Department** fills in details with regulations; and the **courts** (Tax Court, where you can dispute a bill before paying it; district courts and the Court of Federal Claims if you pay first and sue for a refund) referee disputes. Each of the fifty states plus DC runs its own parallel system with its own agency, rules, and audits — and the states share information with the IRS, so a federal audit adjustment ripples to your state automatically.

2.2 Your actual rights

The Taxpayer Bill of Rights is real and practical. The ones that matter most in practice: the right to **representation** — you never have to face the IRS alone; a CPA, enrolled agent, or attorney with a power of attorney can handle every interaction, and (as Part 11 explains) usually should; the right to **challenge the IRS's position and be heard** — nearly every proposed bill comes with appeal rights and deadlines printed on the notice, and meeting those deadlines preserves enormous leverage; the right to **pay no more than the correct amount** — including interest and penalty rules the IRS itself gets wrong sometimes; the right to **finality** — the time limits in Chapter 14 that close old years forever; and the right to a fair collection process — the IRS cannot simply empty your bank account tomorrow; a defined sequence of notices and hearing rights (Chapter 40) stands between a tax bill and your assets, and every step has a deadline that protects you if you act and expires if you don't.

KEY POINT

The system runs on deadlines in both directions. The IRS has deadlines to assess and collect; you have deadlines to respond, appeal, and claim refunds. Nearly every horror story you've heard involves someone ignoring mail. The single most protective habit a business owner can have costs nothing: open every government envelope the day it arrives, and calendar the deadline printed inside.

2.3 Who can help you, and how to choose

Three credentials can represent you fully before the IRS: **CPAs** (state-licensed, broad financial training), **enrolled agents** (licensed by the IRS specifically for tax), and **attorneys** (necessary when privilege matters — serious disputes and anything with criminal shading). Uncredentialed preparers can fill out returns but can't represent you and are — statistically — where most preparer fraud lives; if a preparer won't sign the return they prepared, walk out. What to look for: year-round availability (a tax strategy conversation in November is worth ten in April), experience with your entity type and industry, and a philosophy conversation — ask "how do you think about gray areas?" and listen. You want someone who takes every position they can defend and none they can't; the preparer who promises the biggest refund in town is describing their client's audit exposure, not their skill. This book will make you a dramatically better consumer of professional advice — you'll know what to ask, what things should cost, and when the answer you're getting is lazy — but for entity elections, sales of businesses, audits beyond correspondence, and everything in Parts 8 and 9, it works best alongside a professional, not instead of one.

COMMON MISTAKES TO AVOID

Ignoring IRS mail — deadlines expire and options vanish; the letter is almost never as bad as the imagination. **Hiring on refund promises. Using a ghost preparer** who won't sign. **Calling the IRS unprepared** — have the notice, your return, and specific questions; better, have your representative call. **Assuming the state knows nothing** — federal and state systems talk to each other constantly.

CHAPTER 2 — SUMMARY & ACTION ITEMS

The IRS is mostly a matching machine; Congress writes the law; states run parallel systems that share data with the feds. You have real rights — representation, appeal, finality — and they all run on deadlines that reward the person who opens the mail.

- Set up your IRS online account at irs.gov — you can see your balance, payments, and transcripts in minutes, and verify any letter's legitimacy.
- If you don't have a tax professional, interview two before you need one. November, not April.
- Adopt the envelope rule today: government mail gets opened same-day and deadlines get calendared.

Chapter 3. The Vocabulary: Twenty Terms That Unlock Everything

Tax law is easier than it looks once you hold about twenty concepts. Everything else in this book builds on these; come back to this chapter whenever a later page feels dense.

Gross income is everything you receive from any source — the law starts from "it's all taxable" and works backward through exceptions. **Adjusted gross income (AGI)** is gross income minus a favored list of "above-the-line" deductions (retirement contributions, half of self-employment tax, HSA contributions, student loan interest). AGI matters beyond the tax it computes: dozens of benefits, credits, and surcharges phase in or out based on it, which is why strategies that reduce AGI punch above their weight. **Taxable income** is AGI minus either the **standard deduction** (\$16,100 single / \$32,200 married for 2026) or your **itemized deductions** (state and local taxes up to the cap, mortgage interest, charity, big medical bills) — whichever is larger. About nine in ten households now take the standard deduction, which changes charitable and mortgage math in ways Chapter 26 exploits.

A deduction reduces the income being taxed — worth its amount times your marginal rate. **A credit** reduces the tax itself, dollar for dollar — which makes a

\$1,000 credit worth two to four times a \$1,000 deduction. When you have a choice, you almost always want the credit. **Refundable** credits can push your tax below zero and generate a check; nonrefundable ones stop at zero.

Basis is what you have invested in something for tax purposes — usually what you paid, adjusted over time. It's the quiet hero of tax planning: when you sell, you're taxed on price minus basis, so every dollar of basis you can document is a dollar that escapes tax. Keep records like basis matters, because it does — home improvements, reinvested dividends, capital you put into your business. **Depreciation** spreads the cost of long-lived business property across years as deductions (though Chapter 17 shows that current law lets most equipment deduct immediately); it also reduces basis, setting up **recapture** — the rule that claws back depreciation deductions at sale, at ordinary-ish rates. Depreciation is usually a good deal anyway; it's a deduction now for tax later, and "now" is when your money compounds. And basis has one magnificent quirk: **the step-up at death** — inherited assets reset their basis to market value, erasing a lifetime of taxable gain. This one rule reorganizes all of Part 8.

Ordinary income vs. capital gain is the character question: wages, business profit, interest, and rent are ordinary (up to 37%); sales of investments held over a year are long-term capital gains (0/15/20%). **Realization** is the trigger: gains are generally taxed only when you sell, not as things grow — which is why "buy, hold, borrow if needed, and die with the step-up" is the tax description of how much old wealth works, and why timing sales is a strategy at every wealth level. **Withholding and estimated payments** you know from Chapter 1. **Filing status** (single, married filing jointly, married filing separately, head of household) sets your brackets and standard deduction — head of household is the commonly-missed one for single parents supporting a household.

Pass-through taxation means a business's profit lands on its owners' personal returns without an entity-level tax — sole proprietorships, partnerships, LLCs, and S corporations all work this way, and the profit is taxed whether or not you take the cash out (the "phantom income" surprise every

YOU'VE READ THE FREE SAMPLE

Keep going — 500+ pages are waiting.

The full handbook covers every entity, every deduction, and every legal strategy — with the arithmetic worked out in dollars, chapter summaries, action items, and a complete workbook.

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