



Small Business Taxes

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Considerations for New Business Owners

Starting a new business comes with many responsibilities and considerations;

- Selecting a business structure and understanding what the legal structure means for your taxes
- Obtaining an Employer Identification Number (EIN)
- Opening a bank account
- Set up process and procedures for your operations, including record keeping and bookkeeping
- Do the hobby-loss rules apply to your business
- Determining the different taxes you need to pay and/or collect, including;
 - Income Tax
 - Self-Employment Tax
 - Sales/Use Tax
 - Excise Tax
 - Payroll Tax

Income Tax

What is Income Tax?

- It is an annual charge levied on earned income, such as wages or business profits, and unearned income, such as interest and dividends.

Who files tax returns?

- All individuals and business file an annual tax return or informational return, depending on how your business is organized.

How does your organizational structure impact your tax filings?

- The IRS has default classifications for each entity type
- Without any elections to be taxed differently, you will be taxed according to this default classification

Income Tax-Default Classification

Default Classifications by Common Entity Type:

- **Single Member LLC:** Disregarded entity, files a schedule on your personal return (Sch C or Sch E for example).
- **Multi Member LLC:** Partnership, files Form 1065 by March 15th
- **Incorporated (Inc):** C Corporation, files form 1120 by April 15th (Note, this is NOT an S Corp)

What about an S Corp?

- An S Corp is not a legal entity. There is no such thing as an S Corporation under state law. S Corporation is a tax election that is available to **ANY** entity type as long as the election to be taxed as an S Corporation is timely filed.

Income Tax Deductions

Common question that comes up, What Can I Deduct?

To be deductible, a business expense must be both ordinary and necessary, which is defined in the tax code as follows:

- An ordinary expense is one that is common and accepted in your trade or business
- A necessary expense is one that is helpful and appropriate for your trade or business

Unless of course there is another code section that disallows or prohibits the ordinary and necessary expense.

Confused yet?

Income Tax Deductions

Suggest that you think of costs in 3 broad categories:

1. **Personal Expenses:** These would be nondeductible for your business. Things like groceries for your house and toiletries
2. **Business Expenses:** Think “would I have incurred this cost if I didn’t have a business?” This isn’t a bright line infallible test but can help to not miss anything that is potentially deductible.
3. **Mixed Expenses:** This would be stuff that fits into both category 1 and 2 above. Things like cell phones, home office, or vehicle expenses would fit here. Items in this category are likely partially deductible, but not fully deductible.

This can help guide you in how to determine what may be deductible while gathering records and doing your bookkeeping.

Income Tax Deductions

How do I separate business expenses?

- It is important to keep good categories of business expenses.
- There is a line between enough detail to manage your business and know where your money is going vs. time management and ease of use

Important to analyze your business and determine where your major categories of expenses are and set up your record keeping to track your expenses and manage the use of funds.

Cost of Goods Sold

- Cost of good sold is the cost to acquire, build, make, or otherwise develop a product being held for resale.
- Understanding what is costs to make each unit of property is key to being profitable

Income Tax Deductions

Types of expenses included in Cost of Goods Sold:

- The cost of products or raw materials, including freight
- Storage
- Direct Labor Costs
- Factory costs

Uniform capitalization rules also require that indirect costs for certain production and resale activities are capitalized and included in inventory/cost of goods sold as well.

This rule does not apply if your average annual gross receipts for the preceding 3 tax years are less than \$25 million

Income Tax Deductions

Some expenses to acquire certain assets must be capitalized rather than deducted. These are referred to as **Capital Expenses**

Capital Expenses are considered assets in your business and must be written off over a number of years (maybe). Common types:

- Start up expenses
- Machinery or equipment
- Building improvements

De Minimis Rule

- Personal property under \$2,500 individually can be expensed under IRS rules, if the proper election is made

State Income Tax

State could have a couple different types of taxes.

- Income Tax
- Franchise Tax
 - Sometimes referred to as Business Privilege Tax

Which state do you pay tax to?

- Can be a difficult, and costly, question
- Economic presence will require you to register in a state and pay all applicable state level taxes
 - Requires \$100K in sales, once that is reached, you have an economic presence
- Physical presence can also trigger filing requirements
 - Employees in multiple states
 - Some exclusions based on employee activity

State Income Tax

All revenue is taxed to your residence state

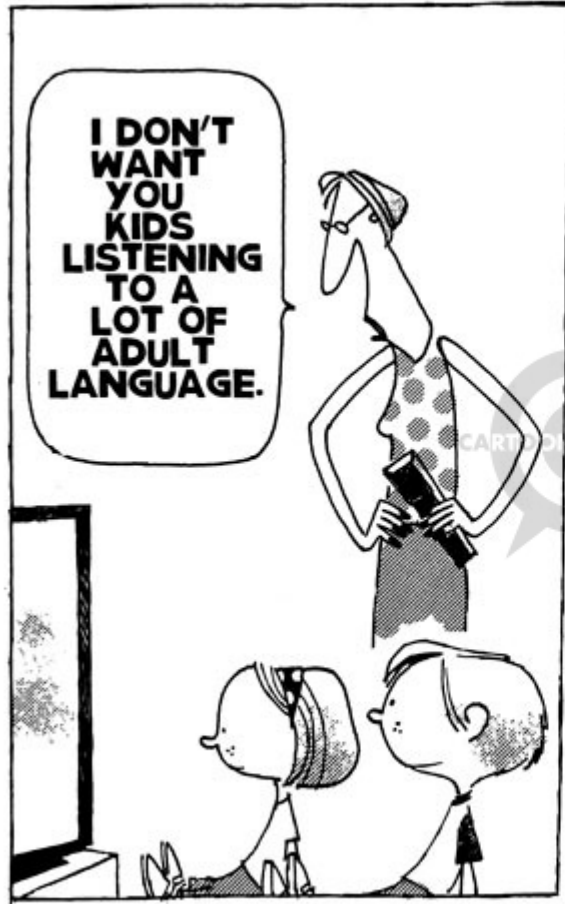
Income allocable to other states is taxed to that state

You receive a tax credit in your resident state for any taxes paid to other states

- The credit is computed at your resident states rate
- This means you pay the higher rate of the 2 states, but you are not double taxed

Individual states have their own filing requirements and forms that need to be completed.

Some states piggyback off the federal return, others do not.



Sales Tax Overview

What is sales tax

- It is a tax assessed and collected on the sales price of certain products, rentals, and other items
- The taxes that are collected is based on where the product is delivered
- Could be collecting and remitting taxes to multiple jurisdictions within CO

Who does sales tax apply to?

- If your business will be selling, renting, or leasing tangible property, you must obtain a sales tax license and file sales tax returns

Colorado generally does not impose sales tax on services. However, some home-rule cities charge sales tax on certain services.

Sales Tax Overview

How frequently you file is determined by the amount of sales tax you collect monthly

\$15 or less per month

- Filing annually by January 20th

Over \$15 but less than \$300

- Returns are filed quarterly
- Due on April 20th, July 20th, Oct 20th, and January 20th

More than \$300

- Returns are filed monthly
- Due by the 20th of each month

Sales Tax Deduction

The following are some of the deductions allowed on a retail sales tax return:

- Service sales (sales that were exclusively for services, not tangible personal product)
- Sales to governmental agencies, religious or charitable organizations (these sales should be documented, and records kept)
- Sales of gasoline
- Sales of drugs by prescription and prosthetic devices
- Trade-ins for taxable resale
- Bad debts charged-off, returned goods, trade discounts and allowances where tax as paid (cash discounts are not allowed)
- Cost of utilities, excluding tax (restaurants only)
- Sales of agricultural compounds and pesticides

Sales Tax Exemptions

Common exemptions from Sales Tax are as follows:

- Food, including food sold through vending machines
- Machinery
- Farm Equipment
- Sales of low-emitting vehicles
- School Related Sales

Sales Tax Common Mistakes

Common Mistakes:

Obtained a sales tax license because I thought I had to....

- Problem: If you do not file a sales tax return, even if you have no sales subject to sales tax (i.e. a zero return), the State will assume you had taxable sales and send you a bill.

Point of Sale System has an incorrect sales tax rate, so the collected taxes are not correct

- Problem: There are 2 potential problems here:
 1. You under collect sales tax, meaning the rate is lower than it should be. You will have to pay the difference out of your own pocket
 2. You over collect sales tax, meaning the rate is higher than it should be. You have to remit what is collected or return it to the customer. You cannot keep the excess

State Nexus

Which states do I pay income tax to and where do I collect sales tax?

Nexus determines where you have an economic presence

Economic Presence is determined by:

- \$100,000 in sales sourced to a nonresident state, or
- 200 transactions in a state annually (some state do not use this rule)

If you meet either of those, you may be required to register in a state and pay/collect all applicable taxes

Excise Tax

Excise taxes generally apply to specific activities.

Levied on the producer or merchant

Be sure to be aware of any excises taxes that apply to your industry.

Common types

- Environmental taxes
- Communication and Air Transportation
- Fuel
- Sale of heavy trucks, trailers, and tractors
- Manufacturers of a variety of different items

Use Tax

What is “Use Tax”?

Use Tax is essentially sales tax that was not collected by the retailer.

Common on online purchases from out-of-state retailers.

As a business, you are still required to pay sales tax on the items purchased, even if the retailer did not collect it

The same tax rate, same as sales tax, must be remitted

This includes state, county, city, and any special district taxes

Use Tax

Special District taxes apply to the following (not a complete list)

- Denver area regional transportation district (RTD)
- Cultural district (CD)
- Rural Transportation Authority ← Applies to Colorado Springs area. Pikes Peak Rural Transportation Authority (1.0%)

Filing Frequency is determined by the amount of use tax due

- Under \$15 per month – annually
- Between \$16 and \$300 per month – quarterly
- Over \$300 per month – monthly

Fun Note: This applies to individuals too, not just businesses!



When I die,
please cremate me and
send my ashes to the
tax office.

Write on the
envelope, Now, you
have everything.

CARTOONSTOCK

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Flantoons

Self-Employment Tax

Self-Employment Tax (SE Tax) is Social Security and Medicare tax assessed on individuals who work for themselves. Your payments contribute to your coverage under the Social Security System (in theory)

You are subject to SE Tax if your earnings from Self-Employment exceed \$600

If you have never been self-employed before and have no experience with this tax, it may lead to a very difficult surprise at tax time

It is similar to what is withheld from paychecks of wage earners, it just isn't being withheld anymore and will show up on your tax return – BE PREPARED

The rate is 15.3% assessed on your net self-employment income

Self-Employment Tax

Bookkeeping is crucial to avoid surprises. Recommend keeping track of your net income on a monthly basis, if not more frequently.

You figure your net income by:

- Totaling up your income
- Totaling up your various expenses
- Subtracting expenses from your income, gives you your net income
- If you have a not loss, no self-employment tax is levied

Quarterly estimates are due as follows

- April 15th
- June 15th
- September 15th
- January 15th

Self-Employment Tax Strategies

Through good tax planning, you may be able to limit the impact of SE Tax

S Corporation elections are a good strategy to limit exposure somewhat

As a reminder, most entity types can elect to be taxed as an S Corporation at any time.

- You do not need to change your legal structure

There is a cost benefit analysis that needs to take place.

- Electing to be taxed as an S Corp will add complexity and cost to your tax filing and payroll
- The potential benefit needs to outweigh the costs

Keep in mind, if you reduce what you pay into Social Security, you reduce your credits in retirement. So, retirement planning is a crucial component of S Corp status

S Corp Savings Example

	S Corp	Sch C
Gross Revenue	100,000	100,000
Total Expenses	(30,000)	(30,000)
Owner Wages	(35,000)	0
Net Income	35,000	70,000
Self-Employment Tax	0	10,710
Payroll Tax on Wages	5,355	0
Total SE/Payroll Tax	5,355	10,710
S Corp Savings	5,355	
Less: Compliance Cost	(2,500)	
Net Savings	2,855	

Payroll Tax

Payroll taxes apply when you have employees

As the employer, you have certain employment tax responsibilities that you must pay

In addition, you must withhold certain taxes from the employee and remit on their behalf. As well as file various forms throughout the year

Employment taxes include the following

- Social Security & Medicare Taxes
- Federal income tax withholdings
- State income tax withholdings
- Federal and State unemployment tax

Payroll Tax

Social Security & Medicare Taxes

- Employers must withhold half of the total Social Security and Medicare taxes from employees' wages and you pay a matching amount as the employer.
 - Employee Portion
 - Social Security Tax – 6.2% of gross wages
 - Medicare Tax – 1.45% of gross wages
 - Employer Portion
 - Social Security Tax – 6.2% of gross wages
 - Medicare Tax – 1.45% of gross wages

Federal & State Income Tax

- Employers must use Form W-4, completed by the employee, to determine the amount of wages to be withheld for federal and state income tax. You are responsible for remitting the taxes withheld

Payroll Tax

Federal (FUTA) & State (SUTA) Unemployment Tax

- Employers report and pay FUTA and SUTA tax separately from the taxes mentioned previously
- The employer pays both of these taxes, they are not withheld from the employees pay

Your state unemployment tax rate is provided by the state, based on the industry you are in and your history of unemployment claims.

- Your rate will be updated every year

You pay the assessed rate on the first \$13,600 of wages to each employee

- The wage base is also increased slightly every year by the state

Payroll Tax

New Employees:		Page	Annually (see Calendar for due dates):		Page
<input type="checkbox"/>	Verify work eligibility of new employees	5	<input type="checkbox"/>	File Form 944 if required (pay tax with return if not required to deposit)	31
<input type="checkbox"/>	Record employees' names and SSNs from social security cards	5	<input type="checkbox"/>	Remind employees to submit a new Form W-4 if they need to change their withholding	21
<input type="checkbox"/>	Ask employees for Form W-4	5	<input type="checkbox"/>	Ask for a new Form W-4 from employees claiming exemption from income tax withholding	22
Each Payday:			<input type="checkbox"/>	Reconcile Forms 941 (or Form 944) with Forms W-2 and W-3	33
<input type="checkbox"/>	Withhold federal income tax based on each employee's Form W-4	21	<input type="checkbox"/>	Furnish each employee a Form W-2	9
<input type="checkbox"/>	Withhold employee's share of social security and Medicare taxes	24	<input type="checkbox"/>	File Copy A of Forms W-2 and the transmittal Form W-3 with the SSA	9
<input type="checkbox"/>	Deposit:		<input type="checkbox"/>	Furnish each other payee a Form 1099 (for example, Form 1099-MISC)	9
	• Withheld income tax		<input type="checkbox"/>	File Forms 1099 and the transmittal Form 1096	9
	• Withheld and employer social security taxes		<input type="checkbox"/>	File Form 940	9
	• Withheld and employer Medicare taxes	26	<input type="checkbox"/>	File Form 945 for any nonpayroll income tax withholding	9
Note: Due date of deposit generally depends on your deposit schedule (monthly or semiweekly)					
Quarterly (By April 30, July 31, October 31, and January 31):					
<input type="checkbox"/>	Deposit FUTA tax if undeposited amount is over \$500	37			
<input type="checkbox"/>	File Form 941 (pay tax with return if not required to deposit)	31			

Payroll Tax

The filing requirements can vary widely depending on numerous factors

I do not recommend trying to do payroll yourself. At a minimum, you need software to assist with the various calculations and preparation of forms

Payroll processing costs vary depending on the amount of automation

- The more you do, the lower the cost
- The less you do, the higher the cost

Payroll penalties for failure to follow the rules are some of the most punitive in the tax code

- This is because it is considered a trust fund. Most of the dollars paid are the employees that you are responsible for remitting.

Be Prepared for Tax Season

Be prepared to provide your CPA with everything they need.

With COVID and the various stimulus bills that have passed this year, tax season may be a mess this coming year.

So, don't wait. It may be difficult to find a CPA if you do not have one and CPA's are going to be tremendously busy. Give as much time as you can to allow for your work to be completed.

Focus on record keeping and bookkeeping. This is crucial to paying the right amount of taxes

If you unsure if something is deductible, be sure to ask!

Be Prepared for Tax Season

If you are using a CPA, be prepared to provide the following:

- If you are a first-time client, be ready to provide:
 - Copies of prior returns
 - Organizing documents
 - Employer ID Number
 - Financial statements
 - Detail for capital acquisitions
 - List of questions for your CPA
 - Follow-up questions

Be Prepared for Tax Season

Returning client to same CPA? Be prepared to provide the following:

- Financial Statements
- Detail for capital acquisitions
- List of questions for your CPA

Your CPA will likely have additional questions as well. Please be prepared to answer as timely as possible to prevent delays!

Be Prepared for Tax Season

Going it alone? Please be aware of the numerous changes, including Section 199A and 168(j).

Familiarize yourself with the various elections and disclosures that are required this year

Be aware of the forms that need to be filed and the due date they must be filed by

Consider a consultation with a CPA to make sure you have included everything that is needed.

Notices

You may receive IRS and/or CO/state tax notices

IRS letters have more errors this year than every before.

This is due to COVID shutdowns and how far behind the IRS is as a result

Make sure you thoroughly read the letter, understand what is saying, and respond accordingly.

We have seen many balance due notices that were not accurate. If you are assessed a balance due and feel you have already paid the tax, you will need to provide proof of payment.

Key take away – most notices are not scary or major issues. They are routine or inquires that can easily be addressed, but do not avoid or ignore.

Tax Traps

Be aware of a few fairly common issues that pop up:

Here are a few for discussion

- Cancellation of debt
- Passive activity losses
- Distributions in excess of basis
- At-risk limitations
- High year-end inventory
- Missed QBI deductions

Recommendations

Things to consider doing for your business:

- Set up policies and procedures for your entire business. Include everything from initial contact with the customer/client to recording the activity in your accounting system
- Set up an accounting system. Excel will get burdensome overtime. So will paper and many other methods. Learn how to use an accounting system and update it regularly. Add time to do this to your schedule so it actually happens
- Do tax planning. Whether with a professional or on your own. Make sure to keep up to date with your tax liability and make quarterly payments to avoid getting behind.
- Get a record retention guide. I call it the document of despair. Every time I want to get rid of something, it tells me no. Nevertheless, understanding how long you should retain various types of documents is important

QUESTIONS???