

Taxes



For Small Businesses 101

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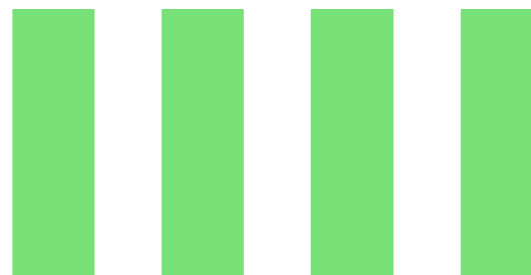


Table of Contents

Introduction	03
1. Birth and Taxes: Business Structure Matters	04
2. Dotting Your I's and Crossing Your T's: The Right Business Tax Forms	08
3. The Plusses and Minuses: Business Tax Deductions	12
4. Getting the Business Tax Credits You Deserve	16
Tying It All Together	19

Introduction

Small business owners are typically very talented at certain tasks within their particular industry. However, most have very little training or experience when it comes to business taxes—through no fault of their own. That’s why, even if you have an accountant who handles your small business taxes, it is so important to understand the basics of small business taxation.

Business taxes are more complicated than personal taxes. There are additional forms to complete and submit, various business tax deductions and business tax credits that can reduce how much you owe the IRS each year, and more filing deadlines.

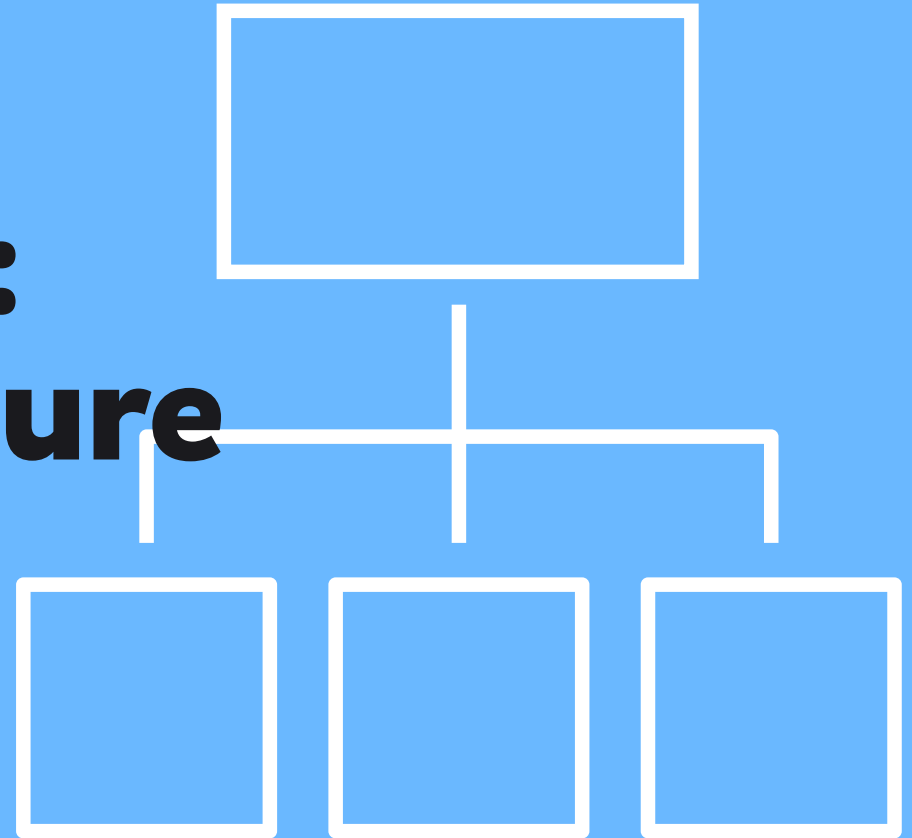
The decisions you make about your business—from its initial formation through how you manage its day-to-day operations—will greatly affect your tax liability. In this guide, you’ll learn:

- Why your choice of business structure matters
- The right business tax forms for each type of business entity
- Some of the most common business tax deductions
- Potential business tax credits available to you

If you’re a new small business owner, it’s critical to learn these basics about taxes for small businesses to ensure you stay compliant and keep every last penny you deserve.

Birth and Taxes: Business Structure Matters

The type of business entity or structure you choose has a direct effect on the taxes you pay, as well as whether you pay those taxes on your individual tax return or on a business tax return. There's enough to say about the IRS forms to give them their own section, so let's begin with understanding how your choice of business entity will affect your taxes.



Sole Proprietorship

The simplest of the business entity choices you can make, a sole proprietorship, has an informal business structure. You do not have to register your business with your state or file any paperwork, although you may choose to apply for a fictitious business name with your state or county, or obtain a federal tax ID number to be able to open up a business bank account.

For the sole proprietor, all income taxes, deductions and losses are reported on the individual's personal income tax return. In addition, sole proprietors are responsible for making estimated tax payments throughout the calendar year, which include Social Security and Medicare taxes.

General Partnership

A general partnership is structured like a sole proprietorship. Thus, all financial activities within the business pass through to the company's owners, who report his or her share of the income on their personal returns.

There is an information return—Form 1065—that must be filed each year with the IRS for partnerships as well. That return includes a schedule reflecting each partner's share of business income and other information to be reported on their individual returns.

“Sole proprietors are **3x** more likely to be audited than individual taxpayers.”

-Reuters

LLC

There are a number of different ways LLCs can be treated for tax purposes. Depending on the number of owners, an LLC can be considered a sole proprietorship, partnership, C corporation or S corporation. Here's an overview of the various scenarios:

- **Sole proprietorship:** An LLC structured as a sole proprietorship means all LLC-related taxes are passed through to your personal tax return and there is no additional return required. You are still required to make estimated tax payments throughout the calendar year.
- **Partnership structure for LLC:** Taxes on an LLC arranged as a partnership pass through to each partner. This means each owner's respective income must be reported on a personal return as sole proprietors do. However, a separate return must be filed by the LLC.
- **S corporation structure for LLC:** Net income earned by an LLC structured as an S corporation (S corp.) is also passed on to the owner to be reported on his or her individual income tax returns, since S corps. are pass-through entities. This setup helps entrepreneurs who desire that the corporate structure avoid double taxation. Further, shareholders who work for the company can be classified as employees, which can offer tax benefits.
- **C corporation structure for LLC:** An LLC arranged as a C corporation (C corp.) incurs income taxes directly as a separate business entity. Further, distributions to its owners are taxable on their individual tax returns. Establishing an LLC as a C corporation often allows for increased opportunities to save on business taxes through deductions and other tax reduction methods and allows the LLC to retain earnings.

S Corporation

An S corporation is a business entity that is not required to pay federal corporate income taxes. However, its owner is responsible for reporting all S corp. profits, losses, deductions, and other relevant financial information on his or her personal income tax return.

With the pass-through nature of this business structure, the shareholders in an S corp. pay income taxes based on their individual IRS tax rates. This taxation method helps business owners avoid double taxation on their income.

However, keep in mind that S corporations may be on the hook for paying taxes on passive income and built-in gains they generate.

Any losses incurred by an S corporation can offset other types of income on a taxpayer's personal return. S corp. owners can be classified as employees while receiving dividends.

C Corporation

C corporations are often eligible to claim a greater number of deductions than those who own sole proprietorships or partnerships.

All profits in a C corp. are taxed by the IRS at the corporate level. After this first line of taxation, any profits distributed to each shareholder as dividends are taxed a second time. C corps. are not eligible for a deduction when distributing these dividends. As a result, C corp. shareholders may not claim corporate losses as a deduction. C corporations often pay income taxes, estimated taxes, excise taxes, and employment taxes.

Nonprofit Organization

Tax-exempt nonprofits do not incur federal income taxes like their for-profit corporate counterparts. However, nonprofits are still required to file annual information returns with the IRS. Most tax-exempt 501(c)(3) organizations report their financial activities on Form 990.

Dotting Your I's and Crossing Your T's: The Right Business Tax Forms

Depending on the type of business entity you operate, you may be required to file several income tax returns and/or information returns with the IRS.

In this chapter we'll take a look at some of the most common business tax returns and forms.

Form 1099-MISC: Miscellaneous Income

This form is utilized to report 1099 income earned through contract work, such as playing guitar at local restaurants or working as a freelance Web developer. This income is classified as a separate form of income and is different from W-2 income from which taxes have been withheld.

After receiving a 1099 from your employer or client, you must report the income listed on it on Schedule C of Form 1040 when you file your personal return.

Form 1065: U.S. Return of Partnership Income

General partnerships are required to file Form 1065 in order to report their business-related income. An example of a partnership could be a walk-in clinic set up by two doctors who have yet to establish a formal LLC or corporation for their health care company.

Form 1065 must be submitted by April 15 for partnerships that operate on a traditional calendar year basis. The partnership return will include a form, referred to as a K-1, reflecting each partner's share of income and losses. The partner reports that information on his or her personal tax returns.

Form 1120: U.S. Corporation Income Tax Return Form

C corporations are responsible for filing this federal return to report income their companies generate at the corporate level. Anything from a fast-food restaurant to an accounting firm could be a C corporation.

Form 1120 is due to Uncle Sam by March 15 for corporations that operate on a calendar year basis, and all income from the previous tax year should be included on this return.

Form 1120S: U.S. Income Tax Return for an S Corporation

Owners of S corporations, such as a hotel or mom-and-pop clothing shop, must file Form 1120S with the IRS to report business income. This return is due March 15 for S corporations operating on a calendar year basis.

In addition to using this return, S corp. income has to be reported on Form 1040 of each owner since the S corporation is a pass-through entity. The Form 1120S includes a Form K-1, reflecting each shareholder's share of income and deductions.

“Nearly **50%** of all small business owners who file for bankruptcy face some amount of tax debt.”

-[Small Business Administration](#)

1040-ES: Estimated Tax for Individuals

If you owe estimated taxes—which includes both taxpayers who earn contract income and formally registered small business owners—use this form to make your quarterly tax payments.

Estimated tax deadlines fall on four days throughout the year: January 15, April 15, June 15, and September 15.

Form 990: Return of Organization Exempt From Income Tax

While tax-exempt nonprofit organizations don't pay the income taxes required of other corporations, most nonprofits must still file Form 990.

This information return simply communicates to the IRS what your nonprofit is doing in terms of financial activities. The form is due May 15 for nonprofits running on a calendar year basis.

“Small businesses that report a **net loss** are more likely to be audited than those that show a profit.”

-Intuit

The Plusses and Minuses: Business Tax Deductions

Numerous types of business deductions are allowed by the IRS. By deducting certain expenses, you can significantly cut down your business tax bill each year. Next up we'll look at a few sometimes overlooked deductions you may want to consider claiming for your small business if they apply to you.



Startup Costs

If your bank account is feeling the pain of mounting expenses in the startup phase of a business, there is a silver lining. You can deduct up to \$5,000 in startup costs you pay to research a particular industry or market, train new employees on your processes, or other initial actions you must take to make your enterprise functional. In general, startup costs are incurred before a business makes its first transaction.

Ongoing Business Expenditures

All businesses incur ongoing expenses. For example, if you're a private investigator, you may need to invest in the latest tracking technology over time. As a restaurant owner, you may have to upgrade your location in due time.

Worker salaries and wages, electricity, rent, and professional business services are just a few of the many other ongoing expenses business owners incur. In most cases, all costs under this category are for business purposes and can be deducted as such on your business's tax return.

By deducting certain expenses, you can significantly cut down your business tax bill each year.

Business Use of a Vehicle

To claim vehicle-related expenses as a write-off, you must use the vehicle for business trips and activities. You must travel from your home-office or a separate place of employment to a different location in order to perform a business-related task for the trip to qualify.

You can deduct either miles driven or actual vehicle expenses—not both. To claim mileage, use a mileage log to document your business trips, and then you can deduct a predetermined amount for each mile you drive. If you deduct actual vehicle expenses, you can include gas, tolls, vehicle maintenance, and insurance when calculating your write-off. Be sure to explore both options to determine the best tax savings for you.

Home-Office Expenses

Entrepreneurs who perform any significant work-related tasks from home often qualify for the much-desired home-office deduction. Eligible expenses that can be deducted include home mortgage interest, homeowners' insurance, rent, electricity, water, repairs, a home phone service, and broadband Internet access. These expenses must be incurred for any business you conduct within your residence. It's best to designate a specific spare bedroom or unused area of your home as a place for your work.

You can either deduct a percentage of your bills based on how much of them are for business purposes, or you can use the flat-rate deduction option. Using this alternative write-off, small business owners can deduct \$5 per square foot of home-office space, with a maximum of 300 square feet and a \$1,500 deduction limit.

Meals and Entertainment

Food and fun are far more enjoyable when they're deductible. In the business world, meals and entertainment qualify for a 50% write-off if they are ordinary, necessary, and directly associated with a business activity.

Let's say you discuss a new marketing project with your business partner over a hearty meal at your favorite barbecue restaurant. You can write off half of your bill as a business expense. Just make sure you keep any receipts, and document who was present at the meal or event and what type of business activity was conducted.



“Only 50% of small businesses survive 5 years or longer, and about a third are around for 10 years or longer. A big reason for this is **poor accounting.**”

-Small Business Administration

Getting the Business Tax Credits You Deserve



A tax credit—as opposed to a tax deduction—is a tax-saving measure taken to actually reduce how much an individual or business owes to the IRS in tax payments. Unlike a deduction—that reduces taxable income—a tax credit gives taxpayers a financial boon by lowering their tax bills.

Let's take a quick look at several business tax credits on the books that may apply to you and your business.

Disabled Access Credit

The Disabled Access Credit recognizes employers who hire individuals with disabilities.

This credit is intended to cover most of the costs a company incurs to provide a reasonable workplace environment for employees who have disabilities that require accommodation.

There are a few basic limitations to the Disabled Access Credit. Employers can earn up to \$1 million to qualify, and they can only employ a maximum of 30 full-time workers. Employers have the option to claim this tax credit for every tax year in which they incur any relevant costs, but the credit is not refundable.

Employer-Provided Childcare Tax Credit

The Employer-Provided Child Care Tax Credit can be claimed by employers that partner with separate childcare facilities in order to provide childcare to any parents who work for the employer.

Keep in mind that employer reimbursements given to employees to help cover childcare do not qualify for this particular credit.

This tax credit is worth 25% of all childcare costs that an employer incurs. The maximum value of the credit is currently \$150,000.

Tax Credit for Increasing Research Activities

You may be eligible to take advantage of a tax credit to help cover various research-related expenses you incur in your small business.

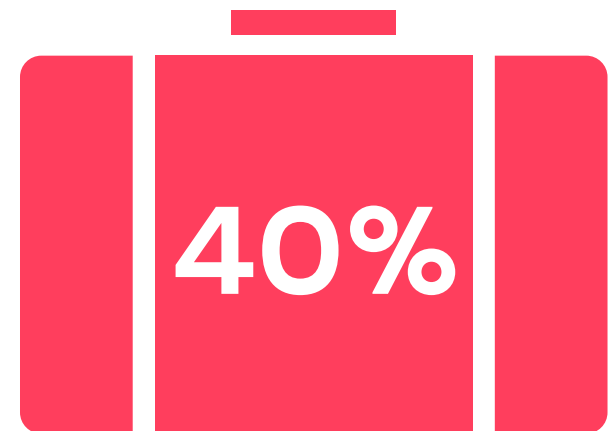
Most business activities that are intended to “eliminate technical uncertainty” generally qualify as an eligible form of research and experimentation to claim this credit.

Qualifying research should help to improve a certain process or help to reduce expenses a business incurs for production or manufacturing purposes. Engineering, computer science, and the medical field are common industries in which this tax credit is often claimed.

Work Opportunity Tax Credit

The Work Opportunity Tax Credit is designed to give businesses a credit worth up to 40% of the first \$6,000 in salaries or wages that are paid to a new employee hired to work in a company. In this case, the employee has to fall under the “targeted group” category, which encompasses disabled employees and military veterans.

The Work Opportunity Tax Credit is available to employers after a specific employee has held a new position within a business for a minimum of 120 working hours or 90 days of work.



Tying It All Together

Taxes can be a big hassle and a financial burden for businesses just getting off the ground. Being aware of these business tax basics can lessen that burden while at the same time enabling you to get ahead—all keys to growing your business.

With your new knowledge, you'll be able to:

- Help ensure that you fulfill all of your filing requirements
- Claim deductions and credits to save you money
- Stay compliant to avoid unnecessary tax and financial headaches you simply don't deserve

Doing so will allow you to focus 100% of your attention on your true passion—growing your business and making money.



Thank you.

About the Author

Greg Lindberg is Editor-in-Chief at 1-800Accountant, the nation's leading tax and accounting firm for small business owners and individuals. He writes about taxes, finance, and small business. Membership to 1800Accountant's unique tax advisory plan is available through the LegalZoom legal plan.

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