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Small Business Taxes

LEARNING OBJECTIVES

- Obtain an EIN and know its purpose
- Differentiate between businesses subject to double taxation and pass-through entities
- Distinguish among the different tax deductions allowed for small businesses
- Record the necessary data for performing payroll as well as quarterly and yearly tax filing
- Describe the small business audit
- Communicate effectively with others using writing skills in a business setting
- Demonstrate analytical and critical-thinking skills when comparing business decisions
- Evaluate ethical decisions for entrepreneurs by applying relevant rules, laws, and regulations
- Practice ethical behavior by demonstrating trustworthiness, responsibility, and good citizenship

Get Identified! Obtaining an EIN

- An Employer Identification Number (EIN) identifies a business for tax purposes, much like a Social Security number identifies an individual.
- Any business that hires employees must have an EIN. It is also required for formal structures like LLCs, corporations, and cooperatives.
- Benefits of an EIN:
 - Many suppliers require an EIN to offer business/wholesale pricing.
 - It helps a business owner separate their personal finances from their business's credit and banking.
 - It prevents the owner's Social Security number from having to be shared on invoices or order forms, possibly leading to identity theft.

Get Identified! Obtaining an EIN (cont.)

- How to Obtain an EIN:
 - Online:
 - This is the easiest method.
 - The application is processed instantly via the IRS website.
 - By Mail:
 - Use Form SS-4.
 - The application takes approximately one month to process.

Small Business Taxes

- Double Taxation:
 - Income is taxed at the corporate level and again as dividends to stockholders.
 - This is common in C corporations.
- Pass-Through Entities:
 - Tax obligations pass through to the owner's personal income-tax filing.
 - These include sole proprietorships, partnerships, S corporations, and most LLCs.
 - A disregarded entity is a formal structure with a single owner whose business income is treated as personal income for tax purposes.

Small Business Taxes (cont.)

- Classifications of Corporations:
 - C corporations: The owners are stockholders, and the businesses are subject to double taxation.
 - S corporations: The businesses must have fewer than 100 employees and be U.S.-based, and the businesses are treated as pass-through entities.
 - B corporations: These are businesses certified by B-Lab for commitment to societal and environmental good alongside profit.

Small Business Taxes (cont.)

- Tax Deductions:
 - These are legitimate business expenses that reduce taxable income.
 - Common examples are salaries, marketing, rent, raw materials, and maintenance.
 - Business trips (travel/lodging) outside the local area are 100% deductible.
 - Business meals are 50% deductible.
- Tax Credits for Small Businesses:
 - These directly reduce federal tax liability.
 - They are often awarded for good business practices.
 - Examples: Work Opportunity Tax Credit (WOTC), R&D credits, and energy-saving credits (e.g., solar panels or Energy-Star equipment).

Professional Skills for Entrepreneurs

- Demonstrating strong character:
 - Trustworthiness: Be honest with customers and keep promises.
 - Responsibility: Follow laws, pay taxes, and correct mistakes.
 - Good Citizenship: Contribute to the community and operate ethically.
- The three types of requirements for making ethical business decisions:
 - Rules: These are workplace expectations or company policies.
 - Laws: These are legal mandates created by governments.
 - Regulations: These are detailed agency rules, such as OSHA safety standards.

Professional Skills for Entrepreneurs (cont.)

- Using Critical and Analytical Thinking
 - Analytical thinking involves breaking a decision into parts and examining specific data.
 - Critical thinking involves evaluating the "big picture" and the long-term impact on reputation and goals.
- Professional Email Etiquette:
 - Use clear subject lines and professional salutations/closings.
 - Use the "sandwich method" for negative news: Start and end with positive statements and include the negative news in the middle.
 - Writing should be clear, concise, and respectful.

Recordkeeping for Tax Filing

- Recordkeeping: What to Save for Tax Filing:
 - Income: Cash-register tapes, invoices, and deposit information
 - Expenses: Canceled checks, credit card statements, and paid invoices
 - Assets: Receipts for new equipment, upgrades, or items sold
- The burden of proof is on the entrepreneur to justify income and expenses to the IRS.
 - Retention periods:
 - General business files: At least four years
 - Tax returns: Three years
 - Employee files: One year after the employee leaves

The Small Business Tax Audit

Type of Audits:

- Correspondence Audit:
 - This is conducted via mail/phone.
 - The IRS requests specific files or proof of deductions.
- Office Audit:
 - This is conducted at an IRS office.
 - Business owners can request a break to seek counsel.
- Field Audit:
 - An IRS representative visits the business location to review operations and equipment.

The Small Business Tax Audit (cont.)

Audit Triggers:

- Earnings over \$100,000
- Unusually high meal or entertainment deductions
- Large fluctuations in annual income
- Large mileage or equipment expenses

CHAPTER SUMMARY

- An EIN serves as a business's unique identity, protecting personal privacy and enabling separate business banking.
- A business's structure determines its tax liability, ranging from the double taxation of C corporations to the pass-through status of LLCs and S corporations.
- Maximized savings come from properly identifying and documenting tax deductions and overlooked tax credits.
- Ethical decision-making requires an understanding of rules, laws, and regulations, alongside professional communication skills.
- Meticulous recordkeeping is essential to protect the business and provide proof during routine IRS audits.