

SAVVY ENTREPRENEURSHIP

8

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
- Detail the small business audit

Case Study: Willa Applies for an EIN



Willa knows she will need an EIN, an employee identification number. After all, she has decided to hire employees, so she will need one for payroll and tax purposes.

She's sure there are many other details related to taxes that she's about to unwrap . . .

Get Identified! Obtaining an EIN

EINs

- Necessary for companies with employees
- Optional for sole proprietorships
- Allow for legal separation of business and personal funds
- Enables the opening of a bank account 100% in the company's name
- Builds the company's credit history
- Builds credibility among stakeholders

Small Business Taxes

Double taxation

- Characteristic of C corporations
- Taxed **twice** on same income
 - Net income
 - Dividends



Small Business Taxes (cont.)



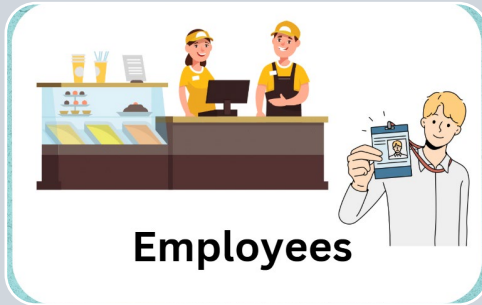
Pass-through entities

- Sole proprietorship
 - File on personal income tax return or on separate one for business
 - Personal return: The pass-through entity
 - Business return: Requires an EIN
- LLC
 - File on personal income tax return or on separate one for business
 - Personal return: The pass-through entity
 - Business return: Requires an EIN
 - Can elect to file as corporation, which allows the owner's salary to be a deduction; otherwise, the LLC divides earnings among the members as per the LLC's policy

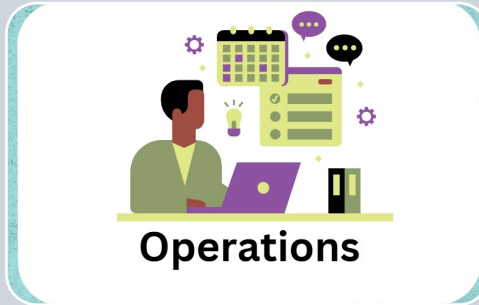
Classifications of Corporations

- C corporation
 - Follows “C” subchapter of corporate law
 - Establishes ownership through shares
 - Taxes: double taxation
- S corporation
 - Can act like C corporation if fewer than 100 employees
 - Follows “S” subchapter of corporate law
 - Taxes: file as a corporation or a pass-through entity
- B corporation
 - Certified for the company’s commitment to social, educational, and environmental focus

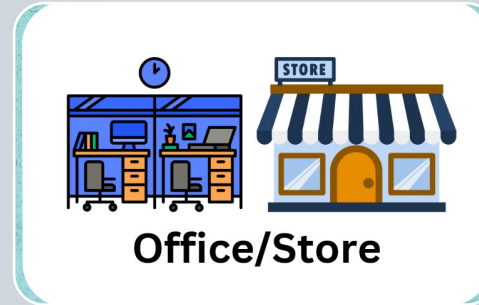
Tax Deductions



- Medical benefits
- Retirement accounts
- Salaries
- Uniforms
- Bonuses



- Professional fees
- Marketing
- Transportation
- Depreciation
- Financing
- Admin/bookkeeping
- Training



- Property insurance
- Repairs
- Expansions/ additions
- Rents
- Mortgage payments



- Ingredients
- Raw materials
- Supplies
- Direct labor

Tax Credits for Small Businesses

- Work Opportunity Tax Credit (WOTC)
 - For underserved hires and nontraditional employees
- R&D tax credits
 - For key software and technology research
- SECURE 2.0 Act tax credits
 - For 401(k)/retirement/saving plans for employees
- Plug-in electric vehicle tax credits
 - For recharging stations
- New market tax credits
 - For low-income communities
- Energy-saving tax credits
 - For solar panels, heat pumps, Energy Star equipment

Recordkeeping for Tax Filing

- The journal for a business
- Accounts for all income and expenses

RECORDKEEPING: WHAT TO SAVE FOR TAX FILING		
Income	Expenses (Purchases)	Assets
<ul style="list-style-type: none">• Cash-register tapes• Deposit information (credit sales and cash)• Receipt books• Invoices• Forms 1099-MISC	<ul style="list-style-type: none">• Canceled checks, other proofs of purchase• Credit card statements• Paid invoices• Reconciled purchase orders	<ul style="list-style-type: none">• Receipts for purchases (new equipment, real estate, vehicles)• Receipts for additions or upgrades to existing assets• Receipts for items sold, the value of items gifted

Recordkeeping for Tax Filing (cont.)


How long to retain records

- Receipts, etc., used for filing: 4 years (per IRS)
- Employee files: Term of employment plus 1 year
- Tax returns: 3 years

NOTE! The burden of proof is on the business owner, so keep good records.

The Small Business Tax Audit

- Official review of a business's bookkeeping
- Types
 - Correspondence audit
 - Business mails requested documentation to the IRS for remote review
 - Office audit
 - Business visits a local IRS field office for an in-person meeting
 - Field audit
 - An IRS representative visits the place of business

 Department of the Treasury Internal Revenue Service Small Business and Self-Employed 1180 Veterans Memorial Hwy Hauppauge NY 11788	Date:
	Taxpayer ID number (last 4 digits):
	Tax year: December 31, 2020
	Form number: 1040
	Person to contact:
	Employee ID number:
Contact telephone number:	
Contact fax number:	

Dear Taxpayer

Your federal income tax return for the year shown above has been selected for examination. We examine tax returns to verify the correctness of income, deductions, exemptions, and credits.

What you need to do
Please call the individual listed above **WITHIN 10 DAYS** to schedule an appointment. Please call between the hours of 8:00 AM- 4:30 PM, Monday through Friday.

Issues to be reviewed during the Examination

1. Sch C1 - Gross Receipts or Sales
2. Sch C1 - Other Expenses
3. Sch C1 - Meals and Entertainment
4. Sch C1 - Car and Truck Expenses
- 5.
- 6.

What to bring with you to the Examination
Attached to this letter is an Information Document Request that lists the items on your return to be examined and the supporting items you need to provide. Please include complete copies of your 2019 and 2021 individual income tax returns. You should organize your records according to the issues identified above. For additional information see the enclosed Publication 1, Your Rights as a Taxpayer, and Notice 609, Privacy Act Notice.

Why the Information Document Request is important
It is important that you read and fully understand the attached Information Document Request. It lists the items you should bring with you to the appointment. To ensure an efficient examination and to save you time, please organize the requested items according to the issues identified above in this letter. If you have any questions or

NOTE! Fewer than 5% of business tax returns are audited.

Audit Triggers

1. More than \$100,000 in earnings
2. High meal and entertainment deductions
3. Large fluctuations in earnings
4. Large mileage deductions
5. Other large expenses
 - Equipment
 - Vehicles
 - Real estate



KEEP RECEIPTS!

CHAPTER SUMMARY

- The IRS requires an employer tax number (EIN) for any business that has employees; sole proprietors can also get EINs.
- C corporations are taxed on earnings and dividends, which is called *double taxation*.
- LLCs and S corporations can be pass-through entities that allow business taxes to be paid on the owner's personal tax return.
- Tax deductions include equipment costs; employee income; costs for medical benefits, utilities, and computers; and even entertainment and meals.
- Any expenses and income that a business records need to be supported with documentation.
- An audit is an official analysis by the IRS of a business's recordkeeping; they can be done via correspondence (most common), in the IRS's offices, or at the business itself.