

# BUSINESS TAX

## PREP & PLAN

BY **ACCOUNTINGPLAY.COM**



**John Gillingham, CPA**

Small Business | Individuals | Deductions | Planning

**Business Tax | Prep & Plan | by Accounting Play**  
John Gillingham, CPA

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## Business Tax Basics & Ye Ol' Disclaimer

[Audio Narration](#)

*Why*

*Education Empowerment*

*Unlock this App*

*Why*

This is for the business owner who wants to know more about the taxes that affect everything from strategic decision making, all the way down to what kind of car you can afford to drive. Welcome. I am John Gillingham, CPA and I made Business Tax | Prep & Plan | by Accounting Play along with other apps, videos, and a membership site for business owners. I own Gillingham CPA, a San Francisco firm dedicated to our philosophy: Value Added. Being in San Francisco I am uniquely positioned to serve consultants and early stage businesses from the onset... where the questions and issues repeat themselves with regularity – Do I need to pay estimated taxes? Should I be an S-corporation or a C-corporation? What can I deduct? I am renting out my closet for \$200 a night, do I need to claim this income? Continue on and to learn the fundamentals, as well as how to research the most current rules which vary year to year.

Clients of mine, sometimes MBAs and PHDs from the world's most elite universities and incubators are asking me how to make estimated tax payments. I am here to reassure my listeners and readers that you needn't an Ivy League education and price tag to *not* understand business tax and bookkeeping fundamentals. You have Accounting Play. All kidding aside, we are here to bridge the gap between the traditional classroom and the small business world. And while your recent talented grad might not know a 1040 from an 1120, they do understand the importance of learning the difference. That is where we come in for the small business owner.

Who *is* a business owner? Self-employed consultants, freelancers, and solo entrepreneurs. Maybe you only have a vision of starting your own business or you may already have a large staff. In either scenario, you will need tax compliance, planning, and advice. Through my experience I have been able to notice trends of educational shortcomings in this area, that I usually solve through a few hours of one on one meetings. This resource serves as a substitute for the pricey and non-scalable conference room



alternatives. Allow this to be a head start in your personal and business tax journey, whether that involves figuring it out yourself or working more effectively with a qualified advisor.

Entrepreneurs need to grow their businesses. Professionally, I do this by implementing impactful accounting, reducing tax paid as much as legally possible, and recommending tax-efficient retirement accounts – or what I like to call strategic accounts. Unfortunately, accomplishing all of that is not always easy due to two constraints: time and money. As they say in Italian *ci vuole solo tempo y soldi...* One should only want time and money, but rare is it that we have both. My “hack”—or way to work creatively around these constraints—is client education. Welcome to [Accounting Play](#). Enter into the nest, no bastion, nay beacon of tax and education and learning – that leverages business owner intelligence (you) alongside software and technology driven education.

### Key Points

- Grow business by implementing impactful accounting, reducing tax paid as much as legally possible, and utilizing tax-efficient retirement accounts.
- “Hack” constraints (time and money) through education.

**Practical Disclaimer:** This is a broad resource and not advice, not specific to one tax year or the next, but rather an educational tool. Often times I will employ hypothetical rates, credits, and amounts to educate. This is not prepared for specific tax years or tax law interpretations. In fact, consider this entire piece my personal opinion. Use at your own risk. The contents are strictly that of the author and narrator. Mention of other company names are just that, mentions of other companies. No other association is implied nor should be applied to the app, book, video, audio, website, or other form of consumption. Use at your own personal and entrepreneurial risk. And as an entrepreneur, risk should be your middle name anyway. Please see [further disclaimers](#) and [terms of service](#).

### Education Empowerment

Early stage entrepreneurship is mostly one person struggling to make it happen. Your business is not a charity and you need to make money to survive, grow, and someday thrive. Since 98% of statistics are made up on the spot or are inaccurate, I will say that approximately 50% of my audience cannot afford quality accounting, let alone value-added services. So hack it! Use this information to educate and empower yourself. Tax code is dynamic so I teach in broad strokes and guide you to current online resources. This is far from comprehensive and not tax advice, but rather a foundation so you can take your business further.

Dream with me for a second: Most early businesses have a survival-level income, but those that leverage technology, self-educate, and push the boundaries can succeed. Most of my financially successful sole proprietor clients are constantly educating themselves by using intelligent apps, online forums, podcasts, books, and other peer-to-peer content from professionals worldwide. The more educated my clients become, the faster they work themselves up the [Hierarchy of Business Owner Needs](#)—moving away from “food and shelter” (i.e. basic tax compliance) and on to planning and advising.

The Business Tax App, Premium Course, Coaching, and Preparations services are largely the efforts of John Gillingham, CPA, (“this guy”). Gillingham writes and speaks in the third person occasionally. A sincere thank you to all of the diffused global team of Accounting Play artists, designers, growth hackers, and developers. And for anyone who has gained value from these efforts, thank you allowing me to be a part of your entrepreneurship journey.

### Key Points

- Use self-education to become “rich,” not only monetarily but also in time, freedom, flexibility and purpose.
- The level of business and planning sophistication available to individual business owners on the Internet is greater than ever via intelligent apps, online forums, podcasts, books, and other peer-to-peer content from professionals worldwide.

### Unlock This App

I wanted to make this app affordable. With most California CPA rates around \$200 an hour, it is just too much for a lot of my boot-strapped, or broke-strapped self-funded brethren and sisteren. Please support and [Unlock the App Now](#) or if listening in other channels, checkout more at [AccountingPlay.com](#). For the price of a San Francisco coffee, just imagine how much you can learn. Please [SHARE](#) and [subscribe to allow me to](#) get you more resources like videos, checklists, and templates.

## Solo Entrepreneurs and Taxes

### Audio Narration

*Everyone is an Entrepreneur, Abstract*  
*The Entrepreneurship Future, Extra Abstract*

### Intro

This section is dedicated to the most basic solo operator and the booming micro entrepreneurship opportunities available to nearly everyone. So you work for yourself, by yourself, or are considering it: You are a solo entrepreneur or, in the eyes of the law, a sole proprietor. Others may refer to you as a freelancer, contractor, independent, or consultant. By definition you are the sole owner of the business, personally liable for all taxes, and even potentially liable for lawsuits. While sole proprietors can have employees, we assume you do not so that we may focus on your tax strategy and compliance in the good ol’ United States of America.

**Disclaimer: This is not advice of any kind. Please consult an Attorney or Certified Public Accountant. While this content is designed to be relevant for the next years, tax laws are constantly changing and these products make no claim to be timely.**

Solo entrepreneurs have the pleasure, pain, and full responsibility to perform the following: pay expenses; estimate tax; file local, state, and federal taxes; create a tax plan; setup retirement accounts;

have insurance; negotiate contracts; do marketing; and take out the trash. And yeah, let's not forget about making money and doing the impactful things you do. It would be great to have a person or even a team to perform all of those tasks to grow your business. But die-hard solopreneurs do it all and contract out when they can afford it. The most successful are voracious autodidacts, i.e. self-educators that never stop learning and improving. Since we solopreneurs are super busy and learn in different ways, all of the Business Tax lessons are narrated and include a variety of other delivery methods.

### **Key Points**

- A solo entrepreneur (or sole proprietor) is the sole owner of a business. Also referred to as a freelancer, contractor, independent, or consultant, the solo proprietor is personally liable for all taxes.
- Solo entrepreneurs are responsible for: paying expenses; estimating tax; filing local, state and federal taxes; creating a tax plan; setting up retirement accounts; having insurance; negotiating contracts; and marketing.
- The most successful solo entrepreneurs are voracious autodidacts, i.e. self-educators that never stop learning and improving.

### **Everyone is an Entrepreneur, Abstract**

For our purposes, an entrepreneur is anyone making income or operating a business. We go by many names: consultant, freelancer, business owner, and hustler. Driving for dollars? Entrepreneur. Selling knit socks? Entrepreneur. Selling apps? You get the picture.

The Internet and smartphone technology have given the average person unprecedented market access to do business, even for free. (Think Craigslist®, Airbnb®, Fivrr®, Amazon®, eBay®, Upwork®, Lyft®, Uber®, Kickstarter®, Indigogo®, and many other sites.) Grandma is renting out her living room for pocket change, Billy does some design work while in school, Crystal is selling creative apparel, and Joey is driving his Prius during free nights. The trend of miniature, side-gig entrepreneurship and fulltime replacement of traditional wage jobs continues.

This is a “New” new economy filled with new opportunity and new challenges. So what do your taxes have to do with this? Taxes play a large part in how much money you keep, greatly impacting your long-term stability and future.

### **Key Points**

- An entrepreneur is anyone making income or operating a business with the goal of income that is subject to self-employment tax.
- We live in a “New” new economy: The Internet and smartphone technology give the average person unprecedented market access to do business. As a result, miniature side-gig entrepreneurship is exploding.
- Taxes play a large part in how much money you keep from this new form of business, greatly impacting your long-term stability and future retirement.

## The Entrepreneurship Future, Extra Abstract

The dynamism of the rapidly evolving world economy creates unprecedented opportunity. This opportunity is not a nuclear one – that is, in the 1950s sense of the word: marriage, family, mortgage, three kids, white picket fence and a dog (although this rare result may still be attained). The future is more of a self-empowered one: working in PJs, access to multi-million dollar production equipment for monthly fees, nearly unlimited computing power, billion dollar software packages at your fingertips, and a trillion dollars of media entertainment for free. Access to most things is available—and you can even be King or Queen by literally renting your own castle for a day—without concern of ownership.

The venture into the future may be a designed one. Understanding this changing environment and the opportunities it presents can allow you to “hack” your career and life, so that you may ultimately live your own fulfilled existence. It is the goal of Accounting Play to push and embrace these trends by empowering you, the entrepreneur of the future. And if taxes are to be a certainty in life, it seems like an appropriate thing to know more about.

### Key Points

- Opportunity in our “New” new economy is a more self-empowered one.
- Take advantage of the changing environment and its opportunities by learning cost-efficiently and rapidly.

## Goals and Different Tax Situations

### Audio Narration

#### *Realistic Goals*

#### *Know Your Own*

#### *Exceptions Apply, Buyer Beware*

### Realistic Goals

As a CPA, sometimes knowing when I need to research or seek outside help is the most valuable thing I do. This approximately four-hour course cannot compare to a four-year education or tutelage. The tax and accounting software industry spends millions annually marketing to consumers that, “Tax and accounting is easy with our software if you are a competent person.” Don’t believe the hype-- study up and know when to seek advice. Here are some goals for us:

- Learn the language of tax to facilitate research and communication.
- Improve your basic self-prepared tax return by maximizing deductions.
- Understand basic tax planning opportunities.
- Implement basic, real-time accounting to make compliance easier. This will allow you to make better business decisions.
- Communicate and plan effectively with your advisors when the time comes.

## Know Your Own

Tax advice is difficult to commoditize because every tax return and situation is different. Business Tax lessons are designed to educate you generally about tax reporting, planning, and tips for sole proprietors without employees; your potentially unique state, dependents, marital status, investment portfolio, rental properties, and the other million potential other exceptions are not addressed. Understand your own exceptions so that you can research and seek individualized advice.

### Key Points

- Lessons are designed to educate you generally about tax reporting, planning, and tips – mostly in the context of sole proprietors without employees.
- Understand your own tax exceptions so that you can research and seek individualized advice.

## Exceptions Apply, Buyer Beware

Unfortunately tax codes and rates have created complexity to the point at which meaningful generalized advice is difficult. A good tax return is far more complex than a game of chess because there are many more variables and potential outcomes. Rules are mostly based around congressional intent, Internal Revenue Service (IRS) interpretation, practitioner interpretation and implementation (i.e. your CPA or tax preparer), and human error. BUT WE WILL NOT GIVE UP. The average intelligent entrepreneur (you) is more than capable of understanding most of what is relevant and applicable. That is why this material exists. Understand your potential exceptions (good and bad) and when to seek help.

## Tax System USA

### Audio Narration

### *State & Federal Tax*

### *Federal Forms*

### Intro

Life, death, and taxes are three guarantees in the United States. Everyone is affected by the taxation system, which includes tax on sales in some localities, income for some states, federal income, property, highly specific items such as fuel and booze, and on and on and on. Even barter transactions are taxable. If you have ideas of cheating on taxes because “big corporations do that” or it is “unconstitutional” or want to protest the government, please forget about them. These types of schemes will likely have painful consequences and are not worth it. What we will do is deduct ordinary and necessary business expenditures, use retirement accounts to our advantage, pay estimated taxes, and grow legit businesses. Included in the cost of business must be a provision not only for taxes, but the other associated compliance such as accounting.

### State & Federal Tax

This resource is mostly about U.S. income tax (i.e. federal tax). Most states have an income tax largely based on the U.S. income tax return, but some states have no income tax. Any mentions of state taxes or planning will be for California, as it is where I practice as a CPA and has perhaps the highest tax costs

in terms of rates and compliance. Sales, property, and payroll-related tax can vary state to state. Some states have assessments on service income as well. Research your state and local particulars and seek help as needed.

### Key Points

- Most states have an income tax largely based on the U.S. Income tax return (i.e. Federal tax), but some states have no income tax.
- Sales, property, and payroll-related tax can vary state to state.
- Research your state and local particulars and seek help as needed.

### Federal Forms

IRS forms look like they are from outer space and have correspondingly strange names and numbers attached to them. Memorizing the names and numbers of the forms relevant to you can be useful when communicating to advisors or seeking assistance in Internet forums. This is part of your tax knowledge base which should grow each year. Most of my readers will likely file 50 times in their life, so commit a few things to memory. Filing taxes is one of the most important financial activities in our life (sad, but true), so here are some intros to the most relevant forms:

Form 1040 - U.S. Individual Income Tax Return: Reports income, deductions, and calculates tax due. This form reports total figures from underlying schedules which provide the detail.

Form Schedule A – Itemized Deductions: Reports deductions that may create deductions against ordinary income.

Form Schedule C - Profit or Loss From Business: Reports business income and expense to arrive at taxable business income.

Honorable mention: Schedule SE to calculate self-employment tax, Schedule B for interest and dividend detail, Schedule D for stock and investment sales, Schedule E for some rentals, some investment income, some partnership income, some S-corporation income.

Dishonorable mention: There are hundreds of other forms which may appear that can produce deductions, calculations, and even tax credits. These forms should be understood when generated from software, but are outside the scope of our small business focus.

Get comfortable with the forms, because they are what are actually filed. Review the PDFs page by page to ensure the numbers make sense. Use unfamiliar forms as an opportunity to study up.

## Using Your Resources

[Audio Narration](#)

*Tax Preparation Software*  
*IRS and State Websites*  
*Picking up the Phone*  
*Paid Professionals – Tax Preparers, Enrolled Agents, CPAs*  
*Alternative Methods – Using Contractor Websites*  
*Posting Questions for Free*  
*Free Preparation Services*  
*Tax Preparation Course*

## Intro

Understanding how to utilize free and paid resources may be the most valuable section. Tax professionals understand how to research, because there are so many exceptions to the rule. We only cover broad theory and use hypothetical numbers, or else this would be a tax preparation course. Use these resources with caution.

## Tax Preparation Software

If you are going to self-prepare your tax return I highly recommend using tax software. Software takes your inputs and creates a tax return from it. To avoid a garbage in and garbage out scenario, you must be very careful with the inputs and use your research tools. Automated features such as W-2 imports can be helpful, but these must be double checked. Items like investment sales may also have convenient import features, but it is possible that the brokerage information may not be complete. Therefore you must check the outputs. Print your tax return to PDF prior to filing. The forms are intimidating, but actually show what is being handed to the IRS. Go line by line and understand generally what is happening.

## IRS and State Websites and Publications

Taxes are based on tax code, inspired by tax laws, and are enforced by the IRS and state authorities. Real nasty tax interpretation goes into analyzing the tax code, regulations, or even congressional intent. As this is basically the most confusing stuff in the world, the IRS issues publications annually referred to casually as “Pubs.” Technically you cannot base a tax position off of a publication, but they do a decent job of outlining the rules. Let’s say you want to learn about itemized deductions. A search of “IRS itemized deduction publication” should yield the PDF. This same information may also be on the site, but the publications do a great job.

There are a lot of both IRS and state publications that have summaries, bullet points, and even examples. A search for “IRS schedule C publication” is for sole proprietors and outlines common business deductions. “IRS publication automobile expense” and “IRS publication home office” can be particularly useful.

## Key Points

- Taxes are based on tax code, inspired by tax laws, and are enforced by the IRS and state authorities.
- These authorities post summaries and publications of these tax codes online.

## Picking up the Phone

What is a phone? Phones are designed to call humans that can answer questions. Revolutionary. You can actually call the IRS or state taxing authorities. Now while the IRS will likely not answer specific questions or say anything that borders on tax advice, they can be very helpful if you get the right person. The key part of this strategy is patience and multi-tasking. Have your prior returns ready if you need to identify yourself and be prepared to hold for a long time, like, maybe even hours long. I find that calling for state and local issues like sales tax, entity compliance, and payroll issues can be extremely helpful. Even I do it.

### Key Points

- You can actually call the IRS or state taxing authorities. I find that calling for state and local issues like sales tax, entity compliance, and payroll issues can be extremely helpful.

## Paid Professionals – Tax Preparers, Enrolled Agents, CPAs

There are several advantages to working with a professional, especially for business owners and high income earners. The cost versus the potential benefits should be considered carefully. Does a highly capable single filer employee that makes \$40,000 in a nine-to-five job need a CPA to prepare his or her tax return? Probably not. However, if it is a CPA that also encourages tax advantage accounts, teaches the client and is a resource for future business endeavors – then the calculation becomes a bit more difficult. The decision, like taxes at times, can be rather convoluted. A self-employed person with kids making only \$15,000 may seem like someone who should be doing their own return, however with proper guidance, they could have a significant tax credit if filed properly. It is difficult to find the “right” professional because sometimes the benefits of working with one over another can be intangible at best. The designations of the professional is important, but not everything, as we will discuss.

Paid preparers can be surprisingly variable in their skills. Ask questions to see if your potential professional has experience in your area. The general hierarchy and corresponding bills will go: general preparer, Enrolled Agent (EA), and Certified Public Accountant (CPA). Generally there is a better chance of a compliant tax return as you go up this ladder, but not always. A general tax preparer that learned their craft from a reputable tax firm is much more likely to be better than an audit CPA with no tax experience. There are a lot of CPAs that have never signed a tax return and high rates do not always mean high quality. Ask about what industries the preparer serves. I happen to have a specialty in working with equity compensated employees, but there are several areas which I completely avoid. Relatively low cost tax returns from a CPA, say \$300, may also put you at the bottom of someone’s client base. Seek to find help using resources that are in line with your needs. Using online self-prep services might be great for someone with just one job and no complication, but could be a disaster for a business entity filing in multiple states and having to do foreign disclosures.

Tax preparers prep taxes and do not necessarily have any other designation. Preparers may work under CPAs with limited licensing from boards. More recently, preparers have been further regulated by the IRS and state organizations. A tax preparer might be your aunt that does your return for free and kinda likes doing it (strange I know). A significant amount of commercial and nationally recognized tax prep shops may employ tax preparers with almost no experience – or a ton. The main issue with tax preparers is the high variance in quality, relatively low education requirements, and rather limited professional standards – although the IRS is changing this. Another issue may be how the average preparer is compensated. Getting paid on a per-form basis is a common industry practice that can misalign incentives. Unlike your average taxi ride, faster does not always equal better.



Enrolled Agents (EAs) are tax preparers that also take a significant test and certification process with the IRS. They may also have additional powers to represent you in front of the IRS. Oftentimes there are skilled bookkeepers who pursue this designation to better serve their clients. There might be a significant value proposition for working with the right EA.

CPAs have the most stringent general testing and educational requirements in the general accounting industry. Likely they have an undergrad degree, a year of tutelage under a CPA firm, and have passed a notoriously difficult test. These are all great things unless it is someone who didn't learn anything in undergrad, only performed audit at the CPA firm, and is a great test taker. Remotely comparable to the medical profession, find someone you can communicate and grow with.

### Key Points

- Paid preparers can be variable in their skills. Ask about what industries the preparer serves.
- The general hierarchy of preparers-- and the corresponding price tag-- will go: General preparer, Enrolled Agent (EA), and Certified Public Accountant (CPA). Generally there is a better chance of a compliant tax return as you go up this ladder, but not always.
- Tax Preparers: Prep taxes and do not necessarily have any other designation. Preparers may work under CPAs with limited licensing from boards.
- Enrolled Agents (EAs): Tax preparers that also take a significant test and certification process with the IRS.
- CPAs: Have the most stringent general testing and educational requirements in the general accounting industry.

### Alternative Methods – Using Contractor Websites, Or Gillingham CPA

Tax software is pretty good, but rarely tells you what you don't tell the software... What does that mean? There could be complication, compliance, or tax benefits the software can't "see" because you have not provided all of the data points. A novel idea to reduce anxieties and seek advice in other areas might be to hire a tax pro from a contractor websites. There are CPAs working around the world that would be happy to take a peek at your self-prepared return. Sites like Upwork®, Fivr®, and countless other sources have contractors that are ranked, sorted, and ready to work. Note that ideally you want someone knowledgeable about specific state and local tax compliance. [I also offer a two 50 minute phone consultation for \\$300](#). Please check the in-app purchases to get in touch if this is of interest. (Note - unfortunately due to the volume of requests I do not answer tax questions until an engagement letter is signed – fee is paid).

### Key Points

- Tax software is pretty good, but rarely tells you what you don't tell the software.
- There could be complication, compliance, or tax benefits the software can't "see" because you have not provided all of the data points.

### Posting Questions for Free

The Internet has an abundant amount of resources where people post questions and receive answers from users. Some of these sites are credible, while others are frighteningly inaccurate – to the point at which I have trouble recommending any. I had a very intelligent client of mine post to a site (hint starts

with R) and I was amazed at the quality answers. Basically there are CPAs out there answering these inquiries in hopes of getting a new client. Also large software companies typically provide decent Q&A sections and articles to address common questions

### Free Preparation Services

If your income is relatively low there are several organizations with real humans that will prepare your return for you! Oftentimes these volunteer organizations are run by highly qualified people. Search “Free tax preparation services (insert city name).” There are also several programs to provide free or low cost preparation software. A lot of companies will advertise a free federal tax return, but charge for the state return. If you are feeling saucy you could use the software for the federal and then take that data to a handwritten state return. That is pretty cheap, but hey, just throwing it out there.

### Tax Preparation Course

Of all the courses you have taken in school, how many still benefit you today? Se Habla Español? How are those cursive skills? Interestingly, general financial, accounting, and tax education are rarely prerequisites for a general diploma or degree. This is a conspiracy to keep the man and woman down. Just joking. Just strange how I learned how to make clay pots (and other unmentionable objects), but I never used Excel until I was 21. I digress. Your local junior college likely offers an evening tax preparation class for less than I would charge to prepare your return. This is an opportunity to refine your tax knowledge that can be applied for decades. Local highly seasonal tax prep shops might actually pay for this education if you are looking for a career shift. This could lay the foundation for a tax prep career or picking up extra hours during the season. Just a thought, but I do digress.

## Federal Tax Filing Basics I: filing requirements, status, dependents

Audio Narration

*Who Needs to File?*

*Filing Status*

*Coordinating Dependent Deductions, Financial Aid and Separated Parents*

### Intro

Each year most working Americans are required to file a tax return, Form 1040 or a variant (such as the 1040-EZ), to calculate tax on worldwide income received. This form will summarize income items from things like wages (i.e. earnings from jobs), income subject to self-employment tax (a.k.a. sole proprietor business earnings), rental income, and investment income (e.g. interest, dividends, capital gains). There are several other key components that will have a tax effect and will be introduced below: filing status, dependents, standard or itemized deductions. These items will drive how tax is calculated.

Form 1040 has morphed year by year to incorporate changes in tax rates and other politically-motivated adjustments, so that it now resembles something created on another planet. Don't let this form intimidate you. In all likelihood you will be using tax preparation software, so check the form outputs line by line. Boxes and income will be checked and filled. Reading this form is like an introduction to braille—it is not easy at first, so dedicate some time to research parts of it that make no sense.

## Key Points

- Common income totals that appear on Form 1040: wages (earnings from jobs), income subject to self-employment tax (sole proprietor business earnings), rental income, and investment income (interest, dividends, capital gains)
- Other key components: filing status, dependents, standard or itemized deductions.

## Who Needs to File?

Not everyone needs to file.

- No income? No need to file.
- If you have low wages or no taxable income, then you are not likely required. However, lots of low income Americans with no filing requirement still file because they may qualify for refundable tax credits, especially if they have lots children of dependents.
- Almost everyone with business income should be filing a return.

## Filing Status

The two major filing statuses are single and married filing jointly. Filing single is for those unmarried (close relationships between humans or otherwise do not count as marriage). There is also a filing status of married filing separate, but this rarely results in an overall tax benefit and is more for less pleasant situations like a pending divorce. The qualified widower status is worthy of mention (kinda), but out of scope for this resource. Filing status will mostly determine the rate at which tax is applied to taxable income. Other subtle differences can apply to loss limitation rules and various other anomalies which can create subtle benefits of choosing a filing status. Not married? You are single. And if married, odds are you should be filing jointly (at least that is what the numbers say).

Total income is calculated and possible adjustments and deductions applied to arrive at taxable income. The rate applied to taxable income is determined by the filing status. A joint filing status will effectively create a tax rate about one half that of a single filer. If there are two income streams from the legal marriage of two people, then these are combined to one tax return and tax bucket.

Generally the married filing joint status is of particular benefit to taxpayers that have different income levels because married filing joint return effectively combines two potential income sources to a single return. Let's just say, for example, \$10,000 of total income is taxed at 10% for a single individual and 5% for a joint filer. The joint status effectively reduces the rate in half – assuming that the total income figures are the same. In other words \$10,000 of total income on a single return is resulting in \$1,000 of tax and \$10,000 of total income on a joint return is resulting in \$500 of tax.

Married filing joint when the couple has nearly equal income does not result in much or any tax savings versus the two people filing separate. Let's now say the joint rate is 5% and single rate is 10%. If Jane makes 5K and Dick makes 5K the total income is 10K. If Dick and Jane file separate they will pay \$250 each, or  $5K \times 10\%$  plus  $5K \times 10\%$  for a total of \$500. If they file joint they will have a total income of 10K x 5%, which also equals the overall total \$500. Since Dick and Jane had identical income, the married filing joint status resulted in the same overall tax as did the two single filing combined statuses.

Since two people typically have a variance in income, the filing joint status allows the higher income to effectively fill some of the other person's lower bracket if that were the case. Let's add in a variable to the last example, saying that anything over 5K of taxable income for a single filer is now taxed at 50% and for a joint filer over 10K of income is now taxed at 50% - a total exaggerated hypothetical. Now if Jane made a taxable 10K and Dick made, well, um, 0, then Jane would owe \$250 on the first 5K and \$2,500 on the second and Dick would have zero tax for an overall combined tax for \$2,750. Now if the incomes combine to 10K again, the 10K would still be taxed at 5% for a total tax of only \$500. Jane is effectively utilizing Dick's otherwise unused tax bracket.

### Filing Status and Dependents

Dependents are mostly what the word sounds like: People you support. Dependents are not your husband or wife, nor are they your kid's friends constantly eating the lunch supplies. The most typical dependents will be children and family members that you provide significant support for. Claiming dependents on your tax return typically results in additional deductions referred to as exemptions. Dependents will appear on the first page of the Form 1040 and the exemption calculation and corresponding deduction will be on the second page.

A single and filing as dependent status is typical for, say, 18 year-old Crystal, who is supported by her parents and had a summer job. Because her parents claimed her as a dependent on their tax return, Crystal will not have that same exemption benefit. But because Crystal's income is so low though, she might not owe any tax regardless. Therefore it would benefit the parents most to claim Crystal in this scenario. More on dependents in later sections.

Determining who qualifies as a dependent can be shockingly difficult. Mechanically, a dependent may only be claimed by one person. Kids supported by parents are the most common, but the definition of dependent is much greater reaching and could possibly, depending on the tax year, extend to supporting others in specific countries. This is worth some Internet research if you are supporting others.

### Key Points

- The filing status will mostly determine the rate at which tax is applied.
- Married Status: Allows for combining two incomes on a single return. Generally a benefit to taxpayers that have different income levels.
- Single Status: Just you.
- Dependents: People your support. (They do not include your husband or wife.) Dependents may only be claimed by one person.

### Coordinating Dependent Deductions, Financial Aid and Separated Parents

Two common areas that can create conflict with dependents are with separated parents and children that are working.

In the case of separated parents, one spouse might decide to claim a child for the tax benefits, and the other spouse won't. Who is legally entitled to take the deduction may be a combination of IRS rulings and the divorce agreement. It is common for the parents to switch off year to year or intelligently plan to see who might have the greater benefit – if they are provided that flexibility under the law and if they

can stand to communicate with each other. The first person to mechanically claim the deduction will typically receive the tax benefit, unless the other spouse fights it or if the IRS somehow questions the claim at a later date.

In the case of dependents who also work, there may be some flexibility as to who should claim the deduction. If it is reasonable—and legal—for either the child or parents to claim the deduction, then the family can plan to see who should claim it. Decisions such as these are most easily made when the entire family uses the same tax advisor. Who is claiming the dependency could have major impacts on how a student may qualify for financial aid. Seek assistance.

### Key Points

- Two common areas that can create conflict with dependents are with separated parents and children that are working.
- If parents are separated, who is legally entitled to take the deduction may be a combination of IRS rulings and the divorce agreement.
- Who is claiming dependents could have major impacts on how a student may qualify for financial aid. Seek assistance.

## Federal Tax Filing Basics II: getting to taxable income

### Audio Narration

*Arriving at Basic Taxable Income*

*Adjustments to Income*

*Personal Deductions versus Credits*

*Intro to Personal Deductions*

*Intro to Tax Credits*

*Intro to Tax Brackets, Flat Tax (non-existent) and Phase Outs*

*Tax Organizer and Software Prompts*

### Arriving at Basic Taxable Income

Trying to understand an entire tax system in three hours is not easy, and arriving at taxable income is far from straightforward.

In the most basic example, a taxpayer might have \$50,000 of ordinary wage income (not subject to additional self-employment tax like business profits). So you would think that you would apply a tax rate to \$50,000 and you could go on with your day, right? Unfortunately that scenario only exists in your American Dream.

Let's take a super basic example of an individual filer with no complications. At the beginning of the 1040 the \$50,000 is reported as wages, then there is a deduction on the next page for an exemption – let's just say \$3,000—and then take a standard deduction of around \$7,000. So just for breathing air, the federal government has allowed the taxpayer a \$10,000 deduction. \$50,000 minus \$10,000 – the taxable income is \$40,000. Bam! You are taxed on that. Now, on the \$40,000 you would think you could just apply a simple percentage to calculate the tax—think again. To figure out the tax (likely a software

program will do this), you can look to a tax table or do it manually using a fairly difficult calculation. This is almost as simple as it gets. Add a spouse, additional child, investment income, or even a sneeze, and this calculation becomes more difficult. Of course, this is why we use software. But to effectively use software, you need to know the theoretical construct of USA taxation. Note that self-employment income adds multiple layers of complication.

- To effectively use tax software, you need to know the theoretical construct of USA taxation. Self-employment income adds multiple layers of complication.

### Adjustments to Income

Adjustments to income are very specific types of deductions appearing on the face (page one) of the Form 1040. For the self-employed person with profits, half of the self-employment tax for the year will appear as a deduction. This particular deduction should largely flow-through from the software. Other significant common adjustments (i.e. deductions that appear on the 1040) may include health savings account, moving expenses, self-employed health insurance, alimony paid, IRA deduction, student loan interest deduction, tuition and fees, and others. (However, these are all subject to limitations, changing laws, and lots of rules.) Income minus these types of adjustments will result in Adjusted Gross Income, or AGI.

#### Key Points

- Adjustments to income are very specific types of deductions appearing on the face (page one) of the Form 1040.
- For the self-employed person with profits, half of the self-employment tax for the year will appear as an adjustment to income.
- Other significant common adjustments (i.e. deductions) may include: health savings account, moving expenses, self-employed health insurance, alimony paid, IRA deduction, student loan interest deduction, tuition and fees.

### Personal Deductions versus Credits

As discussed, different income is subject to different types of tax. Business income may be reduced by ordinary and necessary business expenses. Other types of deductions further explained later may be applied – such as exemptions (simply for being alive or having dependents) as well as standard or itemized deductions. These personal deductions do not reduce business income, but they do reduce the income subject to regular tax. Tax credits can actually reduce your tax liability dollar for dollar. In other words, if a person owes \$1,000 before tax credits, and receives a \$200 credit, the total amount owed will be \$800.

#### Key Points

- Different income is subject to different types of tax.
- Business income may be reduced by ordinary and necessary business expenses.
- Personal deductions, like dependent exemptions and standard or itemized deductions, do not reduce business income, but they do reduce the income subject to regular tax.
- Tax credits can actually reduce your tax liability dollar for dollar.

## Intro to Personal Deductions

Personal deductions may be taken whether a person is a regular employee, self-employed, or both. For most people these deductions can include: state and property taxes, mortgage interest, and charity. These are reported on Schedule A, Itemized Deductions. Depending on the year and tax circumstances there may be other opportunities such as employee business, medical, tax preparation, and certain other expenses – subject to limitations. It is critical to understand that a taxpayer may take the higher of the standard deduction or the itemized deduction.

Just because something is tax deductible does not mean that a tax benefit is actually received. Let's say that an employee paid in \$2,000 of state tax withheld and did a "tax deductible" contribution of \$500 to a qualified local charity, also referred to as a 501 C 3 organization. Total itemized deductions are \$2,500 and for our illustrative purpose, the single itemized (a.k.a. optional and automatic deduction) is \$7,000. The tax filer will claim the \$7,000 and the \$2,500 will be unused. In this scenario, the itemized "deductions" did not actually reduce taxable income. Deductions such as medical and employee business expenses may also be reduced or eliminated depending on the adjusted gross income of the taxpayer more covered in the itemized deductions section. If the taxpayer has the ability to group deductions in one tax year or another, it could be a potential tax strategy (covered later).

### Key Points

- Personal deductions may be taken whether a person is a regular employee, self-employed, or both.
- Personal deductions can include: state and property taxes, mortgage interest, and charity. These are reported on Schedule A, Itemized Deductions.
- Depending on the year and tax circumstances, other personal deductions may include: employee business, medical, tax preparation, and certain other expenses.
- Just because something is tax deductible does not mean that a tax benefit is actually received.

## Intro to Tax Credits

Tax credits can be generated by a myriad of things, but most people will benefit from the more mundane tax credits generated from a having a child, paying tuition, healthcare payments, or contributing to a retirement account. Tax credits are constantly evolving and warrant a search each year for "current federal tax credits." Business owners need to pay particular attention to potential credits surrounding the ever-evolving world of employment and healthcare. Different states and even different localities can offer significant tax credits. For this reason alone, I generally advocate for people to work with a local tax professional. Research potential credits and ask your advisor – they will not always know everything or may not have enough information from you.

- Tax credits can be generated by a myriad of things and are constantly changing, even within states and different localities. Make sure to search each year for "current federal tax credits."

## Intro to Tax Brackets, Flat Tax (non-existent) and Phase Outs

Generally tax rates are not applied evenly (linearly), but rather they increase disproportionately as income goes on (exponentially). For all the non-math people out there this means that a lower income taxpayer may pay 0 or 10% tax whereas a high earner could get close to 40%+. Tax rates are therefore not "flat"

or evenly applied. This makes it difficult to ballpark your taxes and reliance on software is the norm. To complicate things further, a taxpayer may have tax credits, which can also change the effective rate a person actually pays.

Additionally, deductions and credits can be limited as income increases, known generally as “phase outs.” Let’s say hypothetically, Congress gives a \$1,000 tax credit for having a kid to offset the costs of raising a child. Congress may not want to extend this benefit to households making over \$250,000 and therefore can initiate limitations or phase outs so that certain taxpayers do not have benefit. Manually calculating these types of income limits, especially with several credits, variables, and graduated tax rates (including different income types) has made software pretty much the only way to go.

- Tax rates are not applied evenly (linearly; rather, they increase disproportionately as income goes on (exponentially).
- Deductions and credits can be reduced as taxpayer income increases, known as a “phase out.”

### Tax Organizer and Software Prompts

Tax organizers and software programs ask seemingly endless and mindless questions. These questions are important for determining taxable income but also may help generate tax credits. Items such as foreign accounts and businesses are outside of the scope here, but have incredibly stringent requirements. So don’t just robo-click or check no to every question. Read carefully, take notes, research, and then discuss with your advisors. Look for checklists both free and paid at <http://accountingplay.com/shop/>.

- Questions asked by tax organizers and software programs help determine taxable income and may also help generate tax credits.

## Federal Tax Filing Basics III: income tax, self-employment tax, withholding

[Audio Narration](#)

[Tax Rates and Self-Employment Tax](#)

[Intro Self-Employment Tax](#)

[What is Self-Employment Tax and How is this Fair?](#)

[Paychecks and Social Security payments](#)

[Paychecks and Income Tax Withholding](#)

[Paychecks Tax Withholding and Complication](#)

[Self-Employed Individuals Rarely Have Any Tax Withheld](#)

### Tax Rates and Self-Employment Tax

The basic tax return arrives at taxable income after factoring in various deductions. Then a tax rate is applied, and it is not a flat or simple rate. Tax rates can be as low as 0% and nearly as high as 50% when state, federal, and self-employment taxes are combined. Tax rates are graduated, meaning they increase as taxable income increases. The basic idea here is that if someone can barely make enough to survive, it is not cool to tax them a ton. Investment income can create income tax and have additional taxes if not



deemed tax free income—but this is out of scope. What is in scope is the dreaded... the terrible... the scary (hold your breath), self-employment Tax.

- The basic tax return arrives at taxable income after factoring in various deductions. Then a tax rate is applied, and it is not a flat or simple rate.

### Intro to Self-Employment Tax

Self-employment (SE) tax is assessed on business, i.e. self-employed profits. SE tax is in addition to any income tax and can create a lot of trouble. How much trouble? For purely illustrative purposes, let's call self-employment tax 15%. Let's discuss a dangerous situation. Take a freelance writer who makes a total of \$25,000 and has about \$5,000 in business expenses. Business profit is income minus expenses and therefore the writer has a \$20,000 of profit (\$25,000 income - \$5,000 expense). If you apply a 15% SE tax rate to \$20,000 it will be \$3,000 ( $\$20,000 \times .15$ ). At this level there might be very little regular income tax and very little money to even pay rent. Still, at the end of the year, our writer friend now owes \$3,000 in federal tax because the income is subject to self-employment tax. The actual calculation and rates will vary, however the point is that this is scary.

- Self-employment (SE) tax is assessed on business, i.e. self-employed profits.
- SE tax is in addition to any income tax and can create a lot of trouble.

### What is Self-Employment Tax and How is this Fair?

Self-employment tax is comprised of Social Security and Medicare (combined may be referred to as FICA) and is not the same as income tax. Social Security is a federal government benefit for retirees and Medicare is generally a medical benefit for retirees. What is a retiree? Think very old person. While the ages at which people actually start collecting these benefits continues to rise, there are certain cases such as injury that allow people to collect early. Bottom line is that SE tax is a burden for many people and must be budgeted for.

### Key Points

- Self-employment tax is comprised of Social Security and Medicare (combined may be referred to as FICA).
- SE is not the same as income tax.
- Social Security: A federal government benefit for retirees.
- Medicare: A medical benefit for retirees.
- FICA Taxes: The combination of Social Security and Medicare taxes.

### Paychecks and Social Security Payments

When a person works in the USA, even at a very small wage, FICA taxes are automatically withheld (paid from the check to the government). A key difference is that the employee (i.e. person who is working) only pays half, about 7.5%, and the employer (i.e. company) pays the other 7.5% along with some other various taxes and benefits. (Remember these rates are strictly hypothetical and do not correspond with reality). Simply put, employees are paying into social security tax automatically, so they don't feel the sting of a year-end tax bill created by FICA taxes.

- When a person works in the USA, FICA taxes are automatically withheld (paid from the check to the government).
- The employee (i.e. person who is working) only pays half of the FICA tax and the employer (i.e. company) pays the rest along with some other various taxes and benefits.

### Paychecks and Income Tax Withholding

Let's say someone earns \$4,000 a month through an employer, but they only receive, say, \$3,000. Where did all that \$1,000 go? In this simplistic example, about \$300 went to FICA taxes (\$4,000 x 7.5% hypothetical example rate) which leaves about \$700 for state and federal withholding. Withholding is tax that is paid in from the paycheck behalf of the employee (this is money from the employee pocket) – designed to cover your federal and state income tax liability (i.e. the amount you owe). The amount actually owed \$700 might be about \$500 federal withholding and \$200 state withholding, but it will entirely depend on the circumstances. The actual amount due at the end of year could be more or less which either generates a tax refund or tax due. The general system is designed so that employees are getting their social security obligations taken care of and there is tax withheld.

- Withholding is tax that is paid in from the paycheck on your behalf – designed to cover your federal and state income tax liability (i.e. the amount you owe).

### Paychecks Tax Withholding and Complication

The amount of income tax that is withheld (i.e. paid to the government) is largely determined by how employees fill out new hire forms, primarily the W-9, where typically a "0" or "1" exemption is claimed. The more exemptions claimed, the less tax is withheld. If you claim too many exemptions, you will take home more money each paycheck, but likely will owe money when you file the return. This system is well intentioned, but easily breaks down when an employee may have multiple income sources, is married and filing joint, or has other tax complications. A qualified accountant can run a projection to determine if you have too much or too little withholding if your situation is complicated.

- The amount of income tax that is withheld (i.e. paid to the government) is largely determined by how employees fill out new hire forms, primarily the W-9, where typically a "0" or "1" exemption is claimed.
- The more exemptions claimed, the less tax is withheld.

### Self-Employed Individuals Rarely Have Any Tax Withheld

Employees have the luxury of FICA taxes being paid and income taxes withheld, but the self-employed do not. In a simple example, if a self-employed person makes \$4,000, they get \$4,000. No withholding. So it is up to the person to save whatever may be required to pay at the end of the year or during the year. This requires knowledge, planning, and discipline – three things that many of us consider a headache. In order to reduce the burden, deductions are allowed for ordinary and necessary expenses. However, since we are in business in order to make money, eventually there must be profits—and tax. Barring a few exceptions, self-employed will need to be paying these estimated taxes for any federal or state liabilities.

- Remember: It is up to the person to save whatever may be required to pay at the end of the year or during the year.

## Federal Tax Filing Basics IV: estimated tax payments

### Audio Narration

*The “Pay-Go” System*

*Exceptions to Pay Late*

*Penalties, Interest, Fees*

*Who Pays Estimated Taxes*

*Ways to Pay Estimated Taxes*

*Planning for State Tax Payments*

### Intro

Taxes are often not paid automatically from the source. In the case of an employee, taxes are usually withheld on the income, which are designed to cover taxes due at the end of the year. If the employee over-withheld they are entitled to a refund and if they are under-withheld they must owe. For most business and investment income, however, taxes are not withheld on the source. Having current records will help you determine how tax liability is building up, aka, how much you are going to owe. Tax planning and projections for this reason are particularly important to the self-employed.

### The “Pay-Go” System

Generally speaking, US citizens are required to pay taxes on earnings as earnings happen, which is relatively straightforward when employees have taxes “taken out of their pay.” Entrepreneurs and anyone with fluctuating income, however, will need to do current year projections to determine where they stand.

### Exceptions to Pay Late

Depending on the income levels, a taxpayer may pay tax after the year is over, generally before April 15<sup>th</sup> if they have paid in at least as much as what they owed last year. This exception known as “estimated tax safe harbor” only applies in some circumstances and must be researched. Also state tax authorities can vary on exceptions to pay late.

For the very high income taxpayer with fluctuating income, there may be options to adjust the quarterly payment depending on how much profit / income was actually received. An attorney that receives most of their income, for example, in the 4<sup>th</sup> quarter may elect a higher 4<sup>th</sup> quarter payment and file the required forms with their tax return to prove their eligibility for this methodology. Generally though, taxes will be paid quarterly, mostly equal throughout the year. Some dates may require unequal estimated tax payments.

### Penalties, Interest, Fees, and Installment plans

If you are late, then you may be subject to penalties interest, and fees. It is important to weigh such costs in relationship to other borrowing costs. However, it is important to note that of all debts, tax debt may be the most difficult if not impossible debt to absolve and should therefore receive special attention. If you are behind on taxes first catch up on filings and file any current year extensions if

applicable. Contacting the taxing authorities directly may be the best way to establish a payment plan within your budget.

### Ways to Pay Estimated Taxes

Taxes may be estimated using checks with vouchers, one time online payments, and recurring payments with signups. State by state will vary. Proceed with extreme caution if you are interested in paying taxes using a credit card. The fees can be extremely high.

### Planning for State Tax Payments

State tax payments can provide a valuable deduction on your individual income tax return when timed right. It may be a good strategy to consider paying early or late state tax payments depending on the circumstances. There is no easy rule to this, as sometimes accelerated state tax payments provide a deduction and other times it may not be a good strategy to pursue, due to Alternative Minimum Tax issues (AMT) or simply not having enough state tax to itemize. Consult your advisor.

## Income in General

[Audio Narration](#)

### Income Types

#### Intro

Not all income is created or taxed equally—largely because of lawmakers. Income comes in several categories that can be tax-free or subject to both income and self-employment tax. Tax rates are applied differently depending on the category of income. To make your head explode, it is also important to note that these rates fluctuate depending on how much income there is, and different deductions or losses apply to different income types. Please make it stop, right? Your average solopreneur does not need to know everything about income, but only that there are different categories to know about which we will introduce below.

#### Key Points

- Not all income is taxed equally.
- Income fits into several categories that can be tax-free or subject to both income and self-employment tax.
- Tax rates are applied differently depending on the category of income.

### Income Types

Here are the overall categories, listed generally from zero to higher tax rates:

**Tax free income:** Inside or paid from certain retirement accounts, some types of disability payments, some types of pensions (sometimes), and some types of municipal bonds. A return of the original investment may also be return of capital and therefore is not taxable income. Payments due to injury may also qualify in certain instances.

**Qualified investment income:** Certain investment income that may be subject to lower rates than ordinary because it meets certain qualifications, which may change. Examples of past qualified income may be certain stock held more than a year, certain dividend income, and other incentives that may come and go. This is loosely referred to as long-term capital gains or qualified dividend income.

**Ordinary income:** Paid out of certain retirement accounts, short-term gains from stock sales, interest income, certain pension such as most retirement income.

**Wage Income:** Wage income is taxed at ordinary rates, but a certain amount of Social Security and Medicare tax (referred together as FICA - Federal Insurance Contributions Act) will be paid direct from the check and remitted by the employer. There is also an employer FICA tax portion that is paid by the employer.

**Self-employment (“SE”) Income:** Business profits and guaranteed payments from partnerships. This income is subject to income tax, as well as Social Security and Medicare tax (FICA). But in the case of the self-employed, the solopreneur will owe both the employee side and the employer side of the tax.

## Deductions and Adjustments in General

[Audio Narration](#)

### *Common Adjustments*

#### Intro

There are two main types of tax deductions: Personal and Business. This gets further complicated depending on what type of business entity (e.g. LLC, Corp, etc.) is involved. We focus on regular individual itemized deductions and business deductions for sole proprietors (i.e. self-employed individuals, also called sole props, on Schedule C, which flows to the main individual tax form, the 1040).

Individual deductions may be taken whether a person is a regular employee, self-employed, or both. For most people these deductions can include: state and property taxes, mortgage interest, and charity. These are reported on Schedule A, Itemized Deductions. Depending on the year and tax circumstances there may be other opportunities such as employee business, medical, tax preparation, and certain other expenses – subject to limitations. It is critical to understand that a taxpayer may take the higher of the standard deduction or the itemized deduction. You can think of a standard deduction as an “automatic” deduction of about \$7,000 for an individual filer and about \$14,000 for married people filing joint. This figure changes year to year, but this is just an example. So if you are single and only have paid \$3,000 of state tax, have no home (therefore no property tax or mortgage interest) and gave \$500 of cash and non-cash to charity, then your itemized deductions don’t come close to the standard deduction, so you will take the standard deduction.

Business deductions reduce your taxable, self-employed income. Business deductions for your sole proprietor will appear on the Schedule C. There is no type of standard deductions for business. Note

that you can have business income, take business deductions to lower your taxable business income, and still take the higher of the standard or itemize deduction. Sounds like a casino? I agree. Read and listen on.

Business deductions can include anything “ordinary and necessary” in the course of business, subject to federal and state rules. Common business expenses include office supplies, cost of goods sold, wages, contractors, professional services, meals & entertainment (subject to limitation), business loan interest, home office (subject to lots of rules), travel, internet cost, phone bill, depreciation (expensing the cost of assets over time), insurance, local taxes and fees, and many other possibilities often subject to specific rules.

### Key Points

- The two major deduction categories are: *Itemized Deductions* reported on Schedule A and *Business Deductions* reported along with business income on Schedule C.
- For individual deductions, a taxpayer may choose the greater of the standard or itemized deduction.
- Business deductions that reduce business income would otherwise be subject to regular and self-employment tax.

### Common Adjustments

Adjustments to income are very specific types of deductions appearing on the face (page one) of the Form 1040. Total income is calculated on page 1 of the 1040 and then adjustments are deducted from this total to arrive at Adjusted Gross Income, AGI.

Common adjustments may include half of the self-employment tax for the tax year, for sole proprietors. This particular deduction should populate automatically when using software. Other significant common adjustments may include (subject to limitations, changing laws, and lots of rules) health savings account, moving expenses for work, self-employed health insurance, alimony paid, IRA deduction, student loan interest deduction, tuition and fees, and others... all subject to lots of rules. The IRA deduction stands for Individual Retirement Account – which for the right income levels provides an excellent savings tool.

### Key Points

- Adjustments to income are very specific types of deductions appearing on the face (page one) of the Form 1040.
- Common adjustments may include: half of the self-employment tax for the year for business owners.
- Other significant common adjustments may include: health savings account, moving expenses for work, self-employed health insurance, alimony paid, IRA deduction, student loan interest deduction, tuition and fees, and others.

## Individual Itemized Deductions

[Audio Narration](#)

## *Limitations*

### *Medical and Dental Expenses*

### *Taxes You Paid*

### *Interest You Paid*

### *Gifts to Charity*

### *Smoking Hot Sketchy Deduction*

### *Casualty and Theft Losses*

### *Job Expenses and Certain Miscellaneous Deductions*

### *Other Miscellaneous Deductions*

## Intro

US taxpayers have the option of claiming the standard deduction, which you can think of an optional automatic deduction—or a simplified way of filing your taxes. There is also an option to itemize deductions in which certain items may be added up, such as qualified charity contributions (donations), state and local taxes paid and mortgage interest. Most of the time, a taxpayer will pick the larger of either the standard or itemized deduction, but can't have it both ways.

For example, a single filer might have a standard deduction of \$7,000 (hypothetical example amount), whereas a joint filer would have a standard deduction of \$14,000 (hypothetical example amount). Let's say, under these hypothetical rates, a married couple has \$4,000 of state & property taxes paid, \$15,000 of mortgage interest, and \$1,000 of charity. Total itemized deductions are \$20,000 – far exceeding the standard deduction example of \$14,000 (hypothetical example amount). The filer in this case should take the itemized deduction which will be deducted from Adjusted Gross Income, AGI.

**Keyword searches** for current terms, rates, amounts, and deductions: standard deduction single filer, standard deduction joint filer, itemized tax deductions, charitable deduction, itemized deduction limitations

Each tax deduction is subject to its own set of special rules. Pull up a copy of “IRS Schedule A” and read it from top to bottom to get an idea of what might qualify. Charitable contributions, for example, require that the organization be qualified, that you have proof of payment and a confirmation receipt, and that you may not deduct any personal benefit. A summary of main deductions is provided, however deductions beyond those listed are not practical to cover in this lesson. Understand that the right to deduct anything is a result of internal revenue codes, hundreds of pages of IRS guidance, and thousands of pages of case law. Please use the Resources and Research sections as practical guides, but remember that they are far from comprehensive. Get help with this.

## Key Points

- Standard deduction: An optional automatic deduction.
- Itemized deductions: Certain items may be added up, such as qualified charity, state and local taxes paid and mortgage interest.
- Each tax deduction is subject to its own set of special rules.

Please refer to the following resources:

- Instructions for Schedule A
- IRS online Publication 529 Miscellaneous deductions

### Limitations

Other common but itemized deductions may be out of pocket unreimbursed medical expense, employee business expenses, casualty and theft losses. Unreimbursed qualified medical expense, for example must exceed around 7.5% of AGI (adjusted gross income) or even 10% or more depending on age and current rules which are constantly changing. Let's say someone has \$100,000 of income and is itemizing their deductions. If they have \$4,000 of medical expense they will receive no benefit for the deduction, given the limitations above. Furthermore, depending on the tax year and income levels, total itemized benefit may be reduced. Employee business deductions, a part of "Job Expenses and Certain Miscellaneous Deductions," have similar limitation rules as medical expenses, only that these must typically exceed 2% of AGI.

### Key Points

- Other common itemized deductions may be out of pocket unreimbursed medical expense, employee business expenses, and casualty and theft losses.
- Depending on the tax year and income levels, total itemized may be further reduced.

### Medical and Dental Expenses

Qualified medical and dental expenses may be claimed as an itemized deduction, however, due to limitations it makes it a difficult deduction to qualify for. While most people understand what constitutes as qualified, some folk have taken more questionable deductions to court. Let's just say if it is legal in Las Vegas does not make it deductible on your federal tax return.

### Taxes You Paid

State and property taxes are common large federal itemized deductions on the Schedule A. In states like California, State Disability Insurance (SDI) may also be included. Other taxes should also be considered like DMV property taxes paid (usually a small amount of the total DMV fee) and taxes paid in for prior tax years. This is an area where tax planning can provide considerable benefit in the timing of deductions.

### Interest You Paid

Qualified mortgage interest can be a large itemized deduction for many people. Often overlooked on the purchase statement, the HUD-1, are qualified points, which can also be named loan origination fees, but this determination can be difficult to make. Seller based mortgages may also qualify and you must enter the seller's information on your tax return in that case.

### Gifts to Charity

Both cash and non-cash gifts can be a valuable deduction. Always get receipts and appraisals for high value donations. Stay current as the rules often are adjusted, generally more stringent year to year. Different donation categories and dollar amount levels have different rules and requirements. On a stinky note, old socks donated to charity are not a tax deduction. While this seems obvious, the IRS has



issued guidance for taxpayers deducting worthless junk to charity. Common now, charities accept donated household items to resell and are not a glorified recycling bin.

### Smoking Hot Sketchy Deduction

Please note that anyone donating their house to a local fire department so they burn it down for training purposes is not the best of deductions. There have been cases around this, true story. Please consult your local tax attorney or CPA before burning your house down... Which hopefully you are doing to get out of the neighborhood, as last time I checked, good neighborhoods do not allow prescribed home burnings.

### Casualty and Theft Losses

Well document significant thefts and nasty unreimbursed disasters like a tornado ripping through your corn field, may give rise to personal and business losses. Note that insurance reimbursements reduce the potential tax benefit. These losses are also subject to limitations and must be well substantiated – a brutal requirement when a home has suffered significant damage.

### Job Expenses and Certain Miscellaneous Deductions

Employees may deduct certain items that they purchase for work, that are not reimbursable by the employer, and are ordinary and necessary. This deduction is subject to a limitation and therefore rarely viable. Your individual tax prep and safe deposit box fee can also fall into this category.

### Other Miscellaneous Deductions

There are obscure deductions that are beyond the scope of this. When in doubt, ask your CPA.

## Tax Credits

### Audio Narration

*Refundable versus Nonrefundable*  
*Common Individual Historic Tax Credits*  
*Refundable Earned Income Tax Credit*  
*State and Local Credits*  
*Business Specific Credits*  
*Complication and Carryovers*

### Intro

Tax credits can reduce your tax liability, as they say, “dollar per dollar.” This means that if you have a tax credit, say \$1,000 that this has the potential to reduce your tax liability \$1,000. Congress may have tax credits to incentive certain types of behavior or provide tax breaks (benefits) for whatever political reasons there may be. Credits change year to year and it is important to be aware of them as they have a lot of potential value. Items that have historically created credits include: children, tuition, retirement account contributions, and low income taxpayers - especially with dependents. These tax benefits change year to year, and have several rules associated. The amount of credit allowable may also decrease as income goes up, known as a phase out.

Deductions reduce taxable income, while credits reduce the tax that is calculated dollar for dollar. Let's say tax before credits is \$5,000 and then there are credits of \$1,000. The tax will be  $\$5,000 - \$1,000 = \$4,000$ . Tax credits are therefore very valuable and each year must be researched to see the changing rules.

### Refundable versus Nonrefundable

Most tax credits are nonrefundable which means that unless there is tax before credits, then the credit provides no actual benefit. Let's say someone has no taxable income and has a kid that generates a \$1,000 tax credit. Because there is no tax to offset, the tax credit that is generated provides no tax benefit. A refundable tax credit provides benefit regardless if the taxpayer has any tax liability at all. The most common refundable tax credit is the Earned Income Tax Credit. This credit is generated mostly for low income taxpayers with dependents, but the details change year to year. In this case, let's say a taxpayer has no taxable income and generates a \$500 earned income tax credit. Even though there is no actual tax, the taxpayer will receive a refund of \$500.

### Common Individual Historic Tax Credits

Credits change year to year, but the following are credits that have been historically valuable for your average taxpayer. This list and general associations attached is not exhaustive and further research should be taken. Each credit has its own nuances, rules, limitations, and **likely change year to year**.

- Child Tax Credit (Pub 972): If you have dependent children under a certain age
- Earned Income Tax Credit (EITC) (Pub 596): Low earnings, having dependents helps
- Child and Dependent Care Credit (Pub 503): Younger kids
- Retirement Savings Contributions Credit (Pub 4703): Low earnings, made retirement contributions
- Energy and Appliance Tax Credit (Pub 530): Highly variable, for specific years and appliances
- Education Tax Credits (Pub 970): Several different and variable tax benefits for specific education types
- Adoption Credit (Pub 968): Specific rules and benefits for adoptions
- Foreign Tax Credit (Pub 514): When you have foreign tax, often paid from mutual funds

### Refundable Earned Income Tax Credit

The Earned Income Tax Credit is a refundable credit, meaning that a taxpayer can receive a refund even though there may be little or no tax calculated. For example, there might be a family that makes relatively little cleaning houses being self-employed and has three child dependents. They have no money to spare and made no estimated tax payments. Depending on the rules at hand, the family might qualify for a refund from the government.

This credit is an area where a significant amount of fraud exists. It is also somewhat of a strange credit because if income is too low or too high than the credit gets reduced or eliminated. You may not decide to pick and choose income and expenses to optimize the credit, which is still a practice of some preparers.

## State and Local Credits

Each state and locality may have its own brand of credits to incentive business or individual activity. For this reason alone I almost always recommend tax preparers to have significant experience in the area you do business. One state might give a tax break if you are an individual renter. If you are business owner there are several different credits that might revolve around specific industries like film, new hiring, specific areas to incentivize urban revitalization, and a host of other politically motivated items. State and local tax, referred by the big firms sometimes as "SALT" is a specialty unto its self. The larger the business or complicated the return is, the more important it is to seek qualified help in this area.

## Business Specific Credits

Congress and other lawmakers are often adding and subtracting business tax incentives (mostly credit) in areas such as: research and development, employment, health care, and many other areas. The larger the business, the more significant (and difficult) these credits become. Fill out your organizers, pay attention to every software prompt, and specifically ask your tax preparer what credits might you qualify for. Also ask the preparer what credits you do not qualify for and why. This may open a dialogue of other credits you can plan for in the future. If you receive a blank stare or hear silence on the other end of the line, maybe it is time to find a new tax person.

## Complication and Carryovers

There exist other complicated credits way outside the scope of this writing. Some credits if not taken in one year can also carry over to the next. For this reason it is important to try and be consistent with your software and tax preparer if possible.

# Self-Employment (business) Income and Tax Payments

## Audio Narration

*Income Subject to Self-Employment Tax*

*Making Estimated Tax Payments*

*Self-Employment Tax Assessed*

## Intro

Self-employed people are responsible for estimating their own taxes. As an employee Social Security taxes and Medicare taxes are automatically withheld, along with state and federal tax most likely. As a small business owner you will need to be paying these amounts in. Some small business owners receive a wage if they own a corporation, but sole proprietors and LLC owners do not. It is imperative to have current books and records in order project out amounts due.

## Income Subject to Self-Employment Tax

The profit on the income is what is actually subject to income and Social Security and Medicare tax.

## Making Estimated Tax Payments

Estimated tax payments are due quarterly, unless you have a very minimal annual tax due. This can be done via paper check and voucher or through electronic means direct on government websites. Be extremely cautious of fees surrounding the use of credit cards to pay taxes.

## Intro to Business Deductions

### Audio Narration

### *Ordinary and Necessary Expenses*

### *Travel and Automobile*

### *Nondeductible and Commutes*

### *Home Office*

### *Depreciation and Amortization*

### *Using Existing Assets*

### Ordinary and Necessary Expenses

The IRS loosely describes eligible business deductions as those “ordinary and necessary.” This has been further defined through mountains of case law. What is ordinary and necessary will depend on your industry, but here are a few places to start: cost of goods sold, accounting, advertising, amortization (non-cash expense associated with intangible assets), answering service, bad debts from sales or service (if on the accrual method and specifically identified), bank charges, merchant charges, car and truck, car and truck expenses, cleaning/janitorial services, commissions, contract labor, delivery and freight, depreciation (non-cash expense associated with physical assets), dues and subscriptions, employee benefit programs, very small gifts for customers, insurance, employee benefit programs, internet, mortgage interest, janitorial, employee uniform laundry and cleaning (no personal dry cleaning unless there is a significant exception), legal and professional, miscellaneous, office expense, outside services, parking and tolls, pension and profit sharing, admin, education, postage, printing, rent - vehicles, machinery, & equipment, rent – other, repairs, security, supplies, taxes - real estate, taxes – payroll, taxes -, taxes - other (not entered elsewhere), telephone, tools, travel, one half of meals and entertainment in full, uniforms, utilities, wages, and more.

### Travel and Automobile

You may track mileage and take a standard deduction based on that mileage. Keep a log. Especially with fuel efficient cars, the standard mileage is the overwhelmingly most popular and valuable deduction. If the vehicle is a fleet vehicle or a massive 100% business use truck, then actual expenses will likely come into play. Actual expense involves adding up every gas, maintenance, and depreciation type of expense. Since the IRS limits the depreciation on most vehicles, even when you have a high cost vehicle, it is unlikely actual expense will be better and besides, it is more burdensome with record keeping. Track all mileage that is general personal mileage and business mileage. Track manually or with an app.

### Nondeductible and Commutes

As they say in my world “your commute is never deductible” which is mostly true for the small business owner. There is an exception where an employee might receive commuter checks, but that out of the

scope. Basically the IRS does not want deductions for expenses relating to going from home to the business location. If there is a reason to then leave the business location to go to another site, then this may be deductible.

### Home Office

Home office can be a juicy tax deduction that allocates a portion of your rent and related costs to what is exclusively used as a business area. There are several rules worth further researching such as regular and exclusive use, principal place of business and more. Search “IRS home office rules” to yield more information than you would care to know, but should. Using square footage of the total space, say 1,000 square feet and the business portion, say 100 square feet will result in the business use portion of 10%. Now apply this to your total rent of, say \$10,000 and you have yourself a \$1,000 home office deduction. This allocation is dividing the \$10,000 indirect rent expense. If you have a specific expense, such as business interest or a repair to the home office, then you would deduct 100% as a direct expense.

If your business has a loss before the home office deduction, then your home office deduction will not create a greater loss, but rather will be carried over into the future. This can be a great future deduction, but must be tracked. There are several court cases and difficult to determine rules in this area, worthy of qualified advice.

### Depreciation and Amortization

The purchase of an asset, such as a \$2,000 computer is technically not an expense. This is an asset that traditionally has been deducted over a five year time period in the eyes of the IRS. There may be special elections such as the section “179 election” to expense the entire new item, or bonus depreciation, or just an outright expense depending what the specific rules and thresholds have been established for the tax season.

Large dollar items such as a business property purchases are almost always required to have the building portion depreciated. Land does not depreciate. Depending on the year there may be special elections to expense all or portions of leasehold improvements and other high dollar value items.

### Using Existing Assets

Existing assets not previously deducted may provide an opportunity to contribute these assets to the business. This will allow you to take deductions over time in the form of depreciation. When done properly this can be extremely valuable. Seek professional help.

## Intro to Tax Planning

[Audio Narration](#)

*[Timing of Income and Expense](#)*  
*[Accelerating Expenses](#)*

## Intro

Tax planning is about saving money, better business decisions, and savings implementation. Generally speaking it is advisable to lower taxable income when possible or to defer such deductions to another tax year, if that tax year has higher expected income. If for example a friend is making 100K a year and plans on quitting her job to do an MBA program, I would likely accelerate deductions in the 100K year and accelerate income in the year that would otherwise have no income. This is because tax brackets are graduated and you want to take advantage of having income in low or no income tax bracket years. Such planning and action must generally take place during, rather than after the close of the year.

## Timing of Income and Expense

Through discretionary decisions about business spending or retirement account taxable conversions, a taxpayer can legally time income to some degree.

## Accelerating Expenses

The most common personal deduction that is accelerated is state tax and retirement payments. Businesses may purchase equipment or pay bonuses. Such accelerated expense salaries must be taken into account with the larger business plan and the next years projected income.

## Intro to Retirement Accounts

### Audio Narration

*Intro: IRAs, 401Ks, and Others*

*Pre-Tax Versus After-Tax Money*

*IRAs Deductible Traditional – Individual Retirement Accounts*

*IRAs Non-deductible Traditional – Individual Retirement Accounts*

*IRAs Roth – Individual Retirement Accounts*

*401K*

*Common Self-Employed Accounts*

*Intro: IRAs, 401Ks, and Others*

Retirement plans provide an excellent opportunity to defer tax on contributions, adjust taxable income, and have the opportunity for tax free income.

*Pre-Tax Versus After-Tax Money*

Pre-tax means a deduction was taken, as in a traditional 401K or IRA while after-tax money provided no deduction, such as a Roth IRA.

*IRAs Deductible Traditional – Individual Retirement Accounts*

This has been a traditional savings vehicle providing a tax deduction for certain qualified taxpayers at certain income levels.

### [IRAs Non-deductible Traditional – Individual Retirement Accounts](#)

This has been a vehicle generally for higher income taxpayers that don't qualify for other IRAs and use this account strategically.

### [IRAs Roth – Individual Retirement Accounts](#)

This after-tax account has great benefits of tax free growth and withdrawals if all the qualifications are met.

### [401K](#)

Common workplace retirement plan where employers sometimes offer matching. Some plans also offer a post-tax Roth option.

### [Common Self-Employed Accounts](#)

Self-employed have several options to choose from such as 401Ks (solo or regular), simple plans, SEP plans, and others.

## [Small Business Structure Tips, USA](#)

[Audio Narration](#)

[Video Presentation](#)

[Small Business Accounting Tips, United States](#)

[Communicating with Your Advisors](#)

[Legal Structure of a Business](#)

[Personal Liability and Business](#)

### [Small Business Accounting Tips, United States](#)

The focus of starting a business in the United States should be quickly finding customers for your goods and services. While liability and intellectual property protection are very important, aspiring business owners get caught up in the details of entity type, operation, and compliance requirements. Moreover, entrepreneurs stress over details and worry about someone copying an idea that few care about and even fewer have the capacity to implement. Thus, the optimal way to conduct business is to strike a balance between cost effectiveness and action by consulting insurance and legal professionals.

### [Communicating with Your Advisors](#)

Seek people who have significant experience in your business area. Interview them and ask for specific examples of their experience. Prior to talking with others, maximize their time by first educating yourself on the basics. Document a business plan, including goals and exactly how to accomplish them. By planning and researching questions prior to meeting with advisors, you will be able to accomplish more with them.

### [Legal Structure of a Business](#)

If there are two or more owners in a business, it is likely worth the associated cost to form a separate legal entity. Without a structure in place, two or more people in business together may be classified as a general partnership. If this is the case, all partners would share unlimited personal liability for the

business. Common business structures that limit liability are corporations, limited liability partnerships, and limited liability companies. These structures provide the legal framework to set ownership and rights on paper. Having only one owner allows more flexibility in the entity choice. One owner may also decide to delay the entity formation and act as a sole proprietor until outside investors are willing to invest, a product is profitable, or employees are hired. Sole proprietors should carefully analyze the costs and benefits in pursuing a separate legal entity.

Having employees creates many potential liabilities for businesses. Employees perform inherently risky things for employers: climb ladders, operate machinery, and perform other tasks. Insurance may cover things like injury, but policy maximums can quickly be reached and the owner held personally liable. Legal structures can help limit this risk and should be strongly considered when there are employees or even independent contractors.

Limiting liability with a corporate or limited liability structure is ideal, but costly. Many California companies in the tech space register a corporation in Delaware and operate in California. In this example, the corporation will generally need to pay fees to Delaware, California, as well as file separate tax returns and hire an accountant. Delaware is a popular state to incorporate in because of the court system and laws. Using this legal structure may make it easier to attract investors and possibly sell a company.

The necessity for outside investment is a very important factor when deciding on a business entity. If the business is seeking outside investment, ask other businesses and investors in the industry which structures are preferable. It is also valuable to seek legal counsel from firms that are experienced in your particular business type.

A lack of legal structure could exclude a business from certain contracts. Large corporations may have a policy of only working with other legal structures (not individuals or sole proprietors). Superficially speaking, a corporation or limited liability company may give a business the image of being legitimate and professional, as outsiders may perceive an “Inc” (corporation) or “LLC” (limited liability company) as a big operation.

### Personal Liability and Business

Legal structures such as corporations or those that limit liability may not protect against all lawsuits. Often, the entity will not protect individuals against professional liability. For example, if a Certified Public Accountant (CPA) operates a corporation that files fraudulent tax returns, the CPA may still be personally liable in a lawsuit. Personal liability can also extend to copyrights. If an artist copies other musicians while operating as a corporation, the artist can still be individually liable for copyright infringement.

Thus, it is imperative to know that limiting personal liability is a combination of careful operation, business structure, and insurance. The first line of defense against liability for a company should be insurance. Insurers can insure nearly everything from professional liability to earthquakes. Generally, large businesses are structured so that insurance provides initial legal protection against lawsuits and defaults. Other underlying business units and assets may be further added as wholly owned limited



liability companies or corporations by the larger business structure. For example, should one hotel structured as an LLC collapse; the larger corporate hotel chain owner would be protected to some degree. Single owners, however, need to be practical in the entity costs, especially if they do not have any personal assets at risk.

An attorney specializing in this area should complete business entity documents and filings. A qualified tax accountant can discuss the tax implications of the entity structure as it relates to your individual tax situation and business entity. The most effective results are achieved when attorneys, accountants, and tax accountants can make informed decisions together. Setup a meeting or conference call with both parties so everyone understands the facts and circumstances and can make the best decision.

- Entity choice depends on many factors such as: number of business owners, business type, necessity for outside investment, customer perception, tax liability, individual assets, business goals, government regulation, and employees
- Limiting liability is very important, but has several associated costs and benefits

### Tax

The tax rules surrounding business structure may impact the owners and the ability to attract investors and raise capital. Generally structures are either taxed at the corporate level such as a C-corporation or at the owner level, such as a limited liability company. Each structure has very specific tax rules, costs, and benefits for the investors and owners. Seek professional guidance to determine the structure best suited for the needs of the business.

## Business Types and Sole Proprietorship

[Audio Narration](#)

[Video Presentation](#)

*[Business Types, United States](#)*

*[Liability Protection and Piercing the Corporate Veil](#)*

*[Sole Proprietorship](#)*

### [Business Types, United States](#)

The legal structure of a business is referred to as the business entity, while Generally Accepted Accounting Principles (GAAP) provides guidance on different accounting methodologies. Under GAAP, a business will be on the accrual method, reconcile cash, and maintain a general ledger regardless of the entity type. Entity choice is driven more by legal, tax, and investment concerns. Most legal benefits and operating rules are governed by the state, while taxation rules will be governed at the federal level. States and cities may also charge fees and tax. While tax is an important feature of entity choice, it may outweighed by other business needs, such as capital investment.

### [Liability Protection and Piercing the Corporate Veil](#)

Different business structures offer different liability protection to owners, depending on the laws of the state. In the case of sole proprietorships and general partnerships, no liability protection is granted

under the law. Limited liability partnerships, limited liability companies, and corporations provide liability protection to owners, but not in all circumstances. Regardless of the business entity choice, insurance can be used to protect owners against professional liability. Entity structure does little to protect individual owners who are negligent or break the law. For example, a self-employed surgeon cannot rely on a corporation to protect personal assets if he or she should kill a patient while performing surgery drunk. In such a scenario, the corporate structure would do little or nothing to protect the doctor's personal assets.

Holding corporate owners personally liable for wrongful acts is referred to as piercing the corporate veil. The courts may hold perpetrators of crime personally liable regardless of the business structure. There are other actions that owners can do that may effectively erode any protections under the law. If an owner does not follow the required entity protocols by co-mingling funds (combining business and personal accounts), neglects to pay state fees, or has fraudulent accounting, the courts may ignore the structure for legal purposes. Individual investor owners, chief executive officers, and chief financial officers may be held responsible for corporate negligence.

### Sole Proprietorship

The sole proprietorship is the most common entity structure in the United States. Only one person may own the business and he or she is personally liable in the case of lawsuits. To become a sole proprietor, an individual need only start operating as a business. By default, the sole proprietorship operates under the individual owner's name. However, a business may establish a "DBA" which stands for Doing Business As in order to operate under a different name. The business may have employees compensated through payroll. The business owner does not receive a wage, but may withdraw or contribute funds at any time. Income taxes are computed at the individual level based on the profit or loss of the business. Typical sole proprietorships do not require outside investors and are small in nature. Examples include consulting services, lawn care, and small dental practices.

### Advantages

Sole proprietorships are low cost and require little to no setup. Some cities require registration and property tax if the sole proprietor has significant business assets. Because it is not a separate entity for tax and legal purposes, business activity is reported on an individual tax return. Business and personal accounts are not required to be separated, but encouraged. Many owners choose to perform non-GAAP accounting at year end to prepare a cash basis profit and loss statement.

### Disadvantages

Owners of sole proprietorships have unlimited personal liability for any actions committed by the owner or employees in the course of business. Should an owner or employee commit harm accidentally or intentionally, all of the owner's assets are subject to seizure in the case of a lawsuit. Sole proprietors can obtain insurance to protect themselves to combat this disadvantage. The entity may assume loans from others, which often are personally guaranteed. No outside equity investment may be received, as only one owner is permitted. There is no continuity of life for the sole proprietorship because the sole proprietorship dies when the owner dies.

## Accounting

Accounting for a sole proprietorship under GAAP requires double-entry, accrual based accounting for financial statement purposes. Relatively few sole proprietorships issue GAAP statements unless they are required to by an outside lender. Because the sole proprietorship and individual are legally one in the same, there is no stock, shareholders, or dividends. Owners may withdraw money from the business in the form of a “draw” which is a distribution of capital. Best practices dictate that draws come in the form of cash withdrawals, but can also take other forms. If an owner spends business funds for personal use, the accountant will classify the transaction as a draw, which is a reduction of equity. The sole proprietor can also take a draw by receiving company equipment, inventory, or other assets. Regardless of whether the owner takes a draw, he or she is taxed on the overall profit or loss. Cash and property used to fund the business are categorized as contributions, not revenue.

## Summary

Sole proprietorships are cost effective and practical for many small businesses that do not need outside investors, since they cannot grant ownership to more than one person. Owners, however, may receive loans to finance operations. Due to the lack of continuity in ownership, loans are generally guaranteed by the business and owner. Businesses may start as sole proprietorships and then change the entity structure at a later date to facilitate investment, limit liability, transfer wealth, or satisfy other needs of the owner.

## Key Points

- The most common business structure
- Owners have unlimited personal liability for their individual and employee actions
- Loans are permitted, but outside investment is not
- Accounting requirements for tax purposes are generally more simple than other entities
- Tax is based on the profit or loss of the business on an individual tax return
- Business dies when the owner dies (no continuity)

## Partnerships and Flow-Through Businesses

[Audio Narration](#)

[Video Presentation](#)

*Flow-Through Entities and Corporate Double Taxation*

*General Partnership*

*Limited Partnership (LP)*

*Limited Liability Company (LLC)*

*Sole Member LLC (SMLLC)*

## Flow-Through Entities and Corporate Double Taxation

Partnerships, limited partnerships (LPs), and limited liability companies (LLCs) are referred to as flow-through entities for tax purposes. LPs and LLCs generally fall under the same tax and accounting rules formally established for regular partnerships. Flow-through entities do not pay federal or state income tax and therefore “flow” income and loss activity to owners. Owners then report income and deductions

on a tax return as an individual or other business entity. The owner of a partnership, limited partnership, or limited liability company can be an individual, another partnership structure, corporation, and certain trusts. Some entities, such as trusts, may be a hybrid between flowing out income to beneficiaries and paying tax at the trust level. In addition to tax at the individual partner level, partnership entities may also pay state and local fees. State and local fees for flow-through entities are generally small compared to tax at the individual level. Fees can create some double-taxation; however, double taxation generally refers to the dual taxation of corporate income and corporate dividends.

Regular corporations are taxed on profits at the corporate level and are therefore not flow-through entities. Once a corporation has paid tax on profits, dividends may be paid to shareholders who are owners of the corporation. Dividends are considered income to shareholders and are taxable. Corporate profits are therefore subject to double taxation because there is tax at both the corporate and shareholder level.

### General Partnership

The general partnership entity structure is comprised of two or more owners referred to as partners. Ownership of a partnership's income, loss, and capital is represented as a percentage or units, which calculate to an ownership percentage. No stock is issued. A general partnership is not a separate entity from the owners. Partners are therefore personally liable for all business debts and lawsuits. If two or more individuals start operating as a business they will likely be considered a general partnership. The partnership establishes a business name by filing documents with the local government. Partners may choose to have a partnership agreement to govern operations of the business. As a flow-through entity, profit and loss for tax purposes are reported on the partner's tax return, whether as an individual or business.

Employees and partners receive compensation differently under the partnership structure. The entity may have employees who are paid wages. Partners generally distribute money to themselves based on profit or loss; however, may also be compensated using guaranteed payments. Guaranteed payments are similar to employee compensation, but without taxes being withheld. Typical general partnerships are small in nature and may be for: property ownership, consulting services, and two or more individuals operating informally.

### Advantages

Partnerships can be setup informally without additional legal or state fees. The structure allows for multiple owners and outside investment. The ownership is very flexible and can divide profit, loss, and capital ownership percentages differently. There is no tax on the federal level, but a separate federal tax return is still required. Similar to draws in a sole proprietorship, partners generally take distributions to receive cash payments. Partners may also be compensated unevenly using guaranteed wages, regardless of overall profit or loss. If properly setup, partners may be able to take unreimbursed partnership expenses on their individual return. Because partnerships are flow-through entities and do not pay income tax at the partnership level, double corporate taxation does not occur.

## Disadvantages

Partners in partnerships have unlimited personal liability for any actions committed by the owners or employees in the course of work. Thus, if an owner or employee commits harm, intentional or otherwise, every partner may be personally liable for damages. Partnerships can obtain insurance to protect owners to combat this disadvantage. Most businesses with more than one owner will elect a different flow-through entity that offers some limited liability, such as a limited partnership (LP) or a limited liability company (LLC). Due to the flow-through nature of partnerships, taxation and accounting can become particularly complex. Different income and deduction types are segregated for tax purposes.

## Accounting

Accounting for partnerships under GAAP requires double-entry, accrual based accounting for financial statements. The ownership is represented as capital, an equity account. Withdrawals of capital are considered distributions similar to that of sole proprietors. Because certain income and expenses are required to be stated on the owner's tax return, there may be a need to maintain accounts differently for GAAP and tax purposes. Partnership ownership can have different percentages for profit, loss, and capital which may require additional recordkeeping.

## Summary

General partnerships allow for outside investment and flow-through taxation. Partnership operations set the precedent for other entities that operate similarly, such as limited partnerships and limited liability companies.

## Key Points

- Default business structure when two or more people or entities operate
- Owners have unlimited personal liability for individual and employee actions
- Outside investment is permitted
- Potentially complex ownership structure allows different allocations of profit, loss, and capital
- Income tax liability is calculated on the individual owner's return
- Partnerships are referred to as flow-through entities for tax purposes

## Limited Partnership (LP)

Limited partnerships (LPs) operate in the same way as partnerships, but offer some liability protection for owners. Depending on the structure and specific legal rules, general partners of the partnership may still have liability for certain actions. LP structures are often formed because it is the only structure that provides limited liability protection for certain professional services groups.

- Greater liability protection than a general partnership
- Similar tax and accounting rules as a general partnership
- Shares similar advantages of a general partnership

## Limited Liability Company (LLC)

A limited liability company (LLC) is typically structured and operated as a partnership. Certain states, however, will allow individuals to operate as a sole member LLC, an LLC with only one owner. Generally the LLC structure provides for the greatest liability protection, flexibility of investment, and ownership

structure of all the flow-through entities. Employees are paid wages and may also be offered LLC units as a form of compensation, although this is somewhat rare. While LLCs offer liability protection, the owners and employees can still be liable for negligence.

- Generally the best liability protection for a flow-through entity
- Similar tax and accounting rules as a general partnership
- Shares similar advantages of a general partnership

### [Sole Member LLC \(SMLLC\)](#)

The sole member limited liability company (SMLLC) provides a single owner similar legal protection as a regular LLC. SMLLC is a legal status that may not be granted in all states. The structure is referred to as a disregarded entity, because tax reporting is on an individual federal tax return. While sole member LLCs offer liability protection, the owner and employees can still be liable for negligence.

- One owner
- Similar legal protection as an LLC
- Income reported on an individual tax return

## Corporations

[Audio Narration](#)

[Video Presentation](#)

[Corporation \(C-Corporation\)](#)

[Share Types and Stock Ownership](#)

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### [Corporation \(C-Corp\)](#)

The C-corporation (C-Corp) is a business entity that is legally separate from owners, referred to as shareholders. Taxation is also separate and occurs on the corporate level. As a separate entity, the owners are not personally liable for business debts and lawsuits. While the corporate structure provides liability protection, owners and employees can still be liable for negligence. Because a corporation is separate from an individual, it can operate in perpetuity. Corporations are an effective structure for outside investors, as they are protected from corporate liability, may have different ownership types, and can operate after the death of the main owner. Company ownership is in the form of corporate stock or shares. Several different share types exist, depending on the needs and size of a corporation. Owners can receive cash from the corporation in the form of dividends if there are retained earnings on the balance sheet due to prior profits.

## Advantages

Corporations are designed to facilitate investment and live in perpetuity. Non-employee investors can own a fraction of the corporation without the concern of personal liability. Shareholders can be paid out profits via dividends or invest for potential capital appreciation. Capital appreciation refers to when stock purchased in a company increases in value over time for the shareholder. Stock held by investors have unrealized gains or losses until sold or become worthless. Large corporate stock is traded daily and the value of the stock is easily determined and realized with a sale. Because publically traded stocks are easy to buy and sell, investors may be more comfortable investing in stocks versus other types of business structures. Corporate law and ownership transfer is well established in court systems which appeals to many investors.

## Disadvantages

The primary disadvantages to the corporate structure are double taxation and other compliance costs. Double taxation refers to the combined corporate tax on profits before dividends and dividend income taxed at the individual level. Dividends are not a tax deduction to the corporation and must be paid in order to transfer cash to shareholders. To reduce double taxation, a company may actively perform tax planning which requires current accounting records and additional professional fees. Owner employees are compensated through payroll, which adds to the cost and complexity of the structure.

## Accounting

Accounting for corporations under GAAP requires double-entry, accrual based accounting for financial statements. Stock appears in the equity section of the balance sheet and different types of stock are outlined in the statement of shareholders' equity. Because corporations are a taxable entity, significant differences may exist in GAAP income and taxable income, which are accounted for in technical ways, such as deferred tax accounts. Payments to non-employee shareholders are in the form of dividends, which reduce retained earnings when declared. An owner may not simply withdraw capital, as owners of partnerships and sole proprietorships can do.

## Share Types and Stock Ownership

Stock in a corporation represents ownership and different rights to a corporation. Various types of stock may be issued that pay different dividends or have different voting rights. Preferred stockholders can have preferential treatment for dividends compared to common stockholders. Corporations have complex financing capacities such as bond issuances, stock warrants, appreciation rights, and other methods. As a form of compensation, corporations may also issue stock options which allow employees the right to company stock at a future date. Corporations may repurchase stock on the open market, which would then become treasury stock. Stockowners can sell shares on public or private markets.

## Corporate Governance

Shareholders exercise power by electing the board of directors who are required to protect shareholder interests. The board of directors is responsible for hiring the chief executive officer (CEO) who is generally in charge of the entire business. The board decides on dividend payments and stock splits. Larger and publicly traded corporations listed on stock exchanges must follow strict governing protocols, which include a board of directors, audited financial statements, and financial controls.

## Summary

Corporations are generally the best business structure to attract investors and provide limited liability to shareholders, but have disadvantages such as double taxation. Non-employee shareholders invest to make money at a future date in the form of dividends and stock sales. Businesses may be required to be a corporation depending on financing needs and investor types. Corporations are highly regulated and have complex tax, accounting, and other compliance requirements.

## Key Points

- Most common structure for large scale investment
- Provides shareholder liability protection
- Income is taxed at the corporate level and dividends are taxed at the shareholder level which creates double taxation
- Employees and employee owners are compensated through wages and sometimes with stock options
- Dividends may be paid to shareholders which reduce retained earnings on the balance sheet

## Subchapter S Corporation (S-Corp)

The S-corporation (S-Corp) is a flow-through corporate structure and is not taxed at the entity level (rare exceptions apply). To become an S-Corp, the entity needs approval by the Internal Revenue Service (IRS) in the United States. The structure has similar legal protection that a regular C-corporation provides. A significant reason S-Corp status is elected is to reduce taxes on the individual return level by limiting income subject to self-employment. Attempting to limit tax via the S-Corporation is a complex and highly regulated area which is constantly changing. There are several laws regulating the tax benefits of S-Corps and significant restrictions on share types, ownership nationality, and division of profits. S-Corps can be a powerful tax planning tool, but may have other distinct disadvantages when seeking investment or dividing equity. Shareholder nationality and quantity limits may be imposed by the IRS.

## Other Business and Not For Profit Structures

There are other business entity types that do not operate as a sole proprietor, partnership, limited liability company, or corporation. Trusts, for example, can own business assets and have hybrid structures of flow-through qualities and tax at the trust level. Cooperatives can allow for different forms of economic cooperation. There are also not for profit structures that have business components. Other structures exist that are specific to wealth transfer, charity, and community benefit.

## Conclusion: Business Types

There are several business types with various advantages and disadvantages. There may be laws that dictate the selection of a business type, but most decisions are driven by liability protection, the need for outside investment, and tax planning. Typically businesses start with a simple structure and then adapt as needs change. The entity decision will be unique to the business type and needs of the owner(s), as well as other stakeholders.



## Consulting Services: Upwork®, Fiverr®, etc

### Audio Narration

#### *Employee or Independent Contractor?*

#### *Maintain Accurate Records*

#### *Website Fees*

#### *Relevant Tax-Related Documents and Tax Payment*

### Intro

Whether full-time, or just picking up some extra income on the side, working for yourself as an independent contractor is a rapidly growing trend. But be aware, just because you are earning income without actually being employed does not mean you do not face tax consequences from this activity.

### Employee or Independent Contractor?

The first question you should be asking is: what is your status with respect to any or all of the work you are taking on independently? The IRS has some pretty clear guidelines and rules regarding “status” and by answering a few questions you can make the correct determination. While determining status falls mostly on the company using your services, you should still be aware of this point especially with regard to potential tax liability.

Federal guidelines are quite explicit and demanding, with the IRS having a 20-point checklist of factors that determine employee/contractor status. However, be advised that many states have even stricter requirements regarding this relationship, so if you feel any doubts you’ll want to look into those requirements for your particular state. We’ll go forward under the assumption that you are in fact an independent contractor.

### Maintain Accurate Records

Once you start working for yourself as an independent contractor you need to recognize that you’re now self-employed and effectively running your own business, regardless of the level of business you are doing. As a business owner you need to manage your business activities in a professional manner, and implement tools and processes that will allow you to manage your business effectively. Critical to doing so is maintaining accurate records of all of your income and expenses related to your contracting/consulting actions.

When working through third-party entities like Upwork® or Fiverr® then you’ll be able to track your revenue fairly easily through their websites and reporting dashboards. But you should still track your income to make sure what is reported is as expected. These eCommerce platforms however will have no idea about the expenses you incurred while providing your consulting services, and you must track these items yourself. How you go about it is your choice – you can use a pencil and paper, a spreadsheet program like Excel, or use dedicated accounting software. Keeping very accurate records of your expenses has two main benefits. You will know exactly just how profitable your consulting work is and you can lower your income tax liability by deducting allowable expenses from your gross income.

## Website fees

Outsourcing companies make money by charging a percentage fee, say 10%, on the contract value of each job performed. These fees are deducted from your gross payment on each job you complete. These fees are 100% deductible expenses and you should still report the gross income, even though that might not be what you received. For example, let's say you did a job for \$1,000 but only received \$900 after fees. Report the \$1,000 as income and \$100 fee as a separate expense (rather than just reporting the \$900 of cash received).

## Relevant Tax-Related Documents and Tax Payment

Online service providers will likely encounter a number of tax-related forms and documents. Form W-9 is commonplace for you to provide the site with your tax identification number. Note that this may be your social or you may obtain a free EIN number under your social security number with the IRS fairly easily. At year-end expect a 1099-Misc or equivalent form which will report income to you or your business.

## Paid Drivers: Lyft®, Uber®, Taxi, etc

### Audio Narration

### *Employee or Contractor Status*

### *Mileage and Accurate Records*

### *Other Deductible Expenses*

### *Relevant Tax-Related Documents and Tax Payments*

## Intro

So you are using your smart phone and driving for dollars. This is a unique and evolving area that can turn you into a miniature entrepreneur on wheels. If classified as an independent contractor you are now your own business, subject to many rules and taxes.

## Employee or Contractor Status

Your "status" in this sense is the starting point for your approach to how you account for this business. Currently, ride-sharing drivers will most often be classified as independent contractor, but be sure to confirm this. While many drivers are contractors, this could change in the future as this area of the law is constantly evolving. The good news is that as an independent contractor you will have work flexibility and deductions. The bad news is that your profit is subject to self-employment tax and regular income tax. The burden of record keeping, tax filing, and tax payments is now on you. This responsibility may extend to local, state, and federal filings. Keep up with local city ordinances and business registration requirements.

## Mileage and Accurate Records

As with other businesses you must save receipts and track expenses in order to deduct them. Keeping accurate track of the miles you travel for this business is essential. The IRS requires a log which may be manually maintained or you may use one of several different apps. Some bookkeeping apps also have mileage tracking integration.

There are two basic approaches for calculating driving expenses: the standard mileage deduction or itemizing actual expenses. You must choose one or the other and cannot use both. Most people find

using the standard mileage deduction to be more easy and convenient, but you may also track actual expenses so you can determine what is best at year end. Please note that switching methodologies of standard mileage versus actual can create issues. Consult a pro to get this right at the beginning. Note that standard mileage, especially for fuel efficient and reliable cars, when appropriate, tends to produce the go-to deduction. But as with all things tax, it depends. You must keep a mileage log regardless of methodology.

The actual expense may seem like a good idea if you drive an expensive car, but the cost of the car may be largely irrelevant when weighing the costs and benefits of choosing standard versus actual automobile expenses. The actual cost of a vehicle purchase, say \$50,000, is not fully deductible in the year of purchase. Automobiles are considered depreciable assets, which means in simple tax terms, that the cost will be deducted over time. Depreciation is typically calculated on years the asset is expected to last, but in case of automobiles, the IRS will limit the deduction to a relatively small amount compared to the purchase price. The IRS limits annual automobile depreciation, so much, that only a fraction of the value of a car gets deducted under the actual expense method. For these reasons and others, a low cost and fuel-efficient car combined, with the standard mileage method usually provides the best overall tax and economic benefit for the driver. Ideally track both methods and decide when it comes time to file, but understand that electing the actual expense method could have future tax consequences. This decision must be made in terms of the prior tax year and projection into the future.

### Other Deductible Expenses

Other expenses may be deductible such as passenger amenities like bottled water or snacks, for example, as well as commissions and fees. You may also try and incorporate your cell phone bill and cell phone business use portion. Remember, that even if you did not purchase your phone the same year you started driving, you may still be able to contribute the phone to the business, which is referred to as placing it in service and then taking deductions using depreciation.

### Relevant Tax-Related Documents and Tax Payment

As part of the sign up process as a contractor you will likely need to submit IRS Form W-9 to provide your tax identification. You may use your social security number or provide an employee identification number, EIN, that may be obtained for free from the IRS. The EIN for an individual may be thought of as an alternative to providing your social security number. Independent drivers face the same estimated tax requirements as other businesses and should generally be making quarterly estimated tax payments.

## Crowdfunding: Kickstarter®, Indigogo®, etc

### Audio Narration

*Type of Funds Raised/Received*

*Accrual versus Cash Basis Accounting*

*Maintain Accurate Records*

*Platform Service Charges*

*Inventory*

*Sales Taxes*

*Get Help Before Your Campaign*

## Intro

Crowdfunding websites, for those a bit out of touch, are platforms for entrepreneurs or really, anyone to raise money for almost any purpose. For our, purpose, we will discuss businesses looking to raise money to design, develop, and ship a physical product. Let's say our character, Bro, wants to invent a keychain that has a bottle opener on it that has a special feature. The keychain will disable your electronic car key if it senses too much booze or other substance through the palm of the user's (pun intended) hand. Bro claims to have a prototype made from surf resin and a homemade drug and alcohol kit. After hastily incorporating using the cheapest online solution, his campaign is born... \$1 to show support, \$20 for a cool T-shirt, and \$100 for the actual product. The crowdfunding site allows Bro to receive money before the product is actually shipped.

Let's say Crowdfunding Bro apparently had a pretty interesting idea and gets \$1,000 in support, \$100 for T-shirts, and \$100,000 in product orders – all in December. Congrats to Bro he now needs to fulfill the actual product as well as figure out the tax compliance. A few major items to introduce will be corporate (or any other entity) filing and filing on federal state, and local levels. There will also be potential requirements to collect sales tax. An accounting method must also be chosen, ideally to match the income and product shipment in the proper year. As a corporation, there may be double taxation issues to plan for. Like any other business, there must also be some form of accounting. Congrats on the funding! Bros reward for all of the hard work will be more hard work.

## Type of Funds Raised/Received

There are three basic classifications for the type of money you're raising (or have raised). For this section it is assumed all funds received are income and not any form of loan or investment.

*Support* – “Gifts” and “donations” to your private business running a funding campaign will be fully taxable. These names are deceptive.

*Reward* – The money for a T-shirt could be a reward, would be income, but the cost of the T-shirt may be deducted, along with other related costs like shipping.

*Sales* – Income earned for the item is income and will have a corresponding cost of goods sold for a physical item.

Loans and investment received are considered just that and are not classified as revenue. The scope of this section is to detail funding campaigns that are support without expectation of any equity or repayment. The business may still receive outside investment and loans from other sources.

## Accrual versus Cash Basis Accounting

A major decision will be whether you will file your tax returns on the accrual or cash basis of accounting. A qualified accountant should help you understand the current costs and benefits, as well as future potential issues. Cash basis mostly follows the flow of cash, so receive a \$100,000 funding in December, then that is the year in which you report that income. Let's say you manufacture and pay for the product

in January, then those cash payments are likely a deduction for next year. As you may see, the cash basis does not match the expenses up well in the proper periods. This can be a disaster because it can create a large taxable event in one year and a loss in the next. The accrual basis accounting also has downsides, but in the case of funding campaigns, it is generally preferable to match the product sales and associated expenses (cost of goods) in the same period. In this way, the \$100,000 would be a liability in December, as prepaid revenue and the income would be reported when the campaign is fulfilled (the item is shipped). This is a big decision, get assistance.

### Maintain Accurate Records

You will want to keep detailed records of all your income and related expense transactions, with particular diligence on the expense side, because you'll want to deduct all of your allowable expenses in order to minimize your income tax liability. Use a separate business bank account, save receipts, and employ an accounting system early.

### Platform Service Charges

Platforms differ in fees and this is critical to the economic decision of pricing and business viability. In the analysis the would-be crowdfunding campaign should take into account commissions, time, sales tax, shipping, legal, insurance, and compliance costs just to give a starting place.

### Inventory

Inventory is complicated, especially in a manufacturing operation. The act of buying inventory or raw materials to make inventory is not an expense transaction. Purchasing inventory is generally trading cash for another asset. The inventory is an expense when it is actually sold. The process of combining different costs such as multiple parts, manufacture labor, and overhead costs to the product can be daunting. Accounting software in the hands of the novice tends to breakdown under the complication of manufactured inventory with so many components that do not flow magically from your online banking. Seek assistance.

### Sales Taxes

Selling in a state such as a California, to other Californian residents is likely to create a sales tax obligation. This may or may not be taken into consideration, depending on the crowdfunding platform, so beware. Make sure you are collecting sales tax if required or have the funds. Contact your state taxing authority for more information. Regarding shipping to other states, this could potentially open you up to other compliance requirements. Get help with understanding these potential liabilities well before pricing the product.

### Get Help *Before* Your Campaign

The time and financial commitment for a crowdfunding campaign can be enormous. This is an area where what you do not know can hurt you very, very, much. Seek assistance early.

## Accounting Solutions: Quickbooks®, Xero®, etc

[Audio Narration](#)

*Understand the Information*

*Operating within the Framework of Cost versus Benefit*

*Inventory based businesses*

## *Tax Preparation and Planning*

### **Intro**

Accounting for small businesses is extraordinarily important not only for the tax return, but to understand what is and is not working. Silicon Valley startups may prefer to talk about “Key Performance Indicators” (KPIs) such as user acquisition, but even they need to track the flow of cash (out). Us mere mortals trying to make profits to fill up first our refrigerator and then our garage need accounting to make sure we are making money.

Accounting software is easier to use than ever before and is finally faster than doing things manually with other solutions. Smart phone users may categorize transactions as they come in and snap pictures of receipts. This information syncs with the data online... Pretty nice.

Web-based accounting software automatically updates entries from your online banking so that you may classify things in general categories such as income and expense. I like to train clients how to do this so they get an idea of their expenses and can get use out of the statements. A solid couple hours of good tutoring and setup is enormously beneficial to small business owners. [Checkout some consultations we offer](#). Once you are current on your accounting, you can start planning and looking towards the future. Be up to date so you understand tax liabilities that might be brewing in the background. Get compliant, get current, and get to value added planning as soon as possible.

### **Understand the Information**

Having good books and records are not very useful unless you know how to use them. Checkout the [Accounting Flashcards](#) app for a solid review. You should understand your profit and loss and basic balance sheet. Understanding this information is empowering for the accuracy of the books and your business decision making.

### **Operating within the Framework of Cost versus Benefit**

There are estimates and inaccuracies inherent in accounting, so expect good books but not perfection. I highly recommend paying for a CPA to tutor you, rather than a robo-bookkeeping service that throw in a free tax return with their monthly packages. This is not the way to go in my opinion. Being trained will teach you how to fish, a technique that might put [Gillingham CPA](#) out of the bookkeeping business, but keeps clients and [Accounting Play](#) strong.

### **Inventory based businesses**

Inventory based businesses must calculate cost of goods sold and inventory costing. This is a challenge for skilled accountants and is not something well automated in online accounting packages. Remember, the act of purchasing inventory is not an expense... so cost of goods must be calculated with more than just the flow of cash. Seek assistance to start this off right.

### **Tax Preparation and Planning**

Tax prep and planning requires good up to date books. You want to know your financial position and performance. This will allow you to understand tax liabilities accruing and other things brewing. Please

see [Gillingham CPA Hierarchy of Client Needs](#) for more information on the different levels of value added tax services.

## Conclusion is To Be Continued...

### Audio Narration

#### Outro

Thanks for listening, reading, and engaging with Business Tax by Accounting Play. The aim of this is to teach you some basics and better yet, empower your own research. Tax law is constantly changing so you must revisit laws each year. I highly recommend working with qualified advisors after educating yourself to achieve maximum financial benefits and peace of mind. More in the app store if you would like to learn about accounting, subscribe, and continue to check on [AccountingPlay.com](https://AccountingPlay.com) for more in-depth courses and resources.