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# “How to Make Sense of Your Business Start-up and Its Taxes”

**Accounting & Tax Solutions**

*Shuwanda Williams, CPA*

*1300 Mercantile Lane, Suite 100, C-2 | Largo, MD 20774 | 301-386-7700 | [www.actsfin.com](http://www.actsfin.com)*

# Overview

- Tax implications are determined by the type of business
- All for profit businesses with taxable income, will pay taxes directly through its corporative entity or through individual “pass through”
- Non-profits are not taxes on income
- All businesses, whether for profit or non-profit, will pay payroll taxes on its employees. Businesses should be careful in classifying “employee” and “independent contractors”
- Businesses should make all tax payments promptly to avoid excessive penalties/interest
- Business owners who incur tax liabilities as a result of business pass throughs should make estimated tax payments on a quarterly basis
- Consult with your CPA/tax advisor/business planner as your business grows and tax needs change.

# Overview (Continued)

- Existing and start-up business both require financing
- Decisions made in the financing of a business impact the ultimate success or failure of the venture
- Use assistance in determining the appropriate amount and type of financing
- Preparing for financing is an essential step to financial planning



## Entity Types

- Sole Proprietorship
- C Corporation
- S Corporation
- Partnership
- Limited Liability Company



# Sole Proprietorship

- Organization & Administration
  - The easiest business to organize. Intermingling of business and personal funds is allowed (although not recommended). Business income is reported on Schedule C, which is filed with the owner's Form 1040.
- Entity Description
  - Consists of one individual. If husband/wife are partners, File 1065 (Partnership Return). EXCEPTION: Married couples residing in community property states may file as a sole proprietorship.
- Taxation
  - Net profit/(loss) is computed on Schedule C. Reported as income/(loss) on Form 1040.

# Sole Proprietorship (Continued)

- **Wages & Self-Employment (SE) Tax**
  - Owner subject to SE tax of 15.3% of net earnings.
  - Computed on Schedule SE; reported as “other taxes” on Form 1040.
- **Losses**
  - Can offset other income, i.e., interest, capital gains or spouse’s wages if filing jointly. NOTE: subject to hobby, passive activity and risk loss rules.
- **Personal Liability**
  - You are liable for all business debts and actions.
- **Tax Year/Tax Form**
  - Normally calendar (December 31)/fiscal year, Form 1040
- **Return Due**
  - 15th day of 4th month following close of tax year.
- **First Extension**
  - Form 7004 extends deadline 5 months



# C Corporation

- **Organization & Administration**

Difficult, expensive to organize. Must hold periodic board meetings; keep minutes; comply with federal and state regulations.

- **Entity Description**

Carries its own legal status, separate from the owners. Cannot elect out of corporate taxation.

- **Taxation**

Pays tax on its profits. When shareholders take profits, the distributions are usually taxable dividends (double taxation). Personal service corporations are taxed at a high, flat rate. (35%)

- **Wages and Self-Employment (SE) Tax**

Shareholders who perform services, including officers, are treated as employees. Wages are subject to payroll tax and withholding. Wages should be reasonable. Dividend distributions are not subject to SE tax.

# C Corporation (Continued)

- **Losses**

Capital losses are allowed only to the extent of capital gains. Net operating loss is carried back/forward against income, but is not passed through to shareholders. NOL back 2 years. Forward 20 years.

- **Personal Liability**

Shareholders not liable for debts. Liability generally limited to amount invested.

- **Tax Year/Tax Form**

Normally calendar (December 31)/Fiscal, Form 1120

- **Return Due**

15th day of 3rd month following close of tax year

- **First Extension**

Form 7004 extends deadline 6 months

- **Tax Payments**

Federal tax deposit (Form 8109) made to authorized financial institution quarterly (15th of month following quarter's end).



# S Corporation

- **Organization & Administration**

A regular corporation. Must make election with the IRS by filing Form 2553. Certain events will cause automatic termination of S status.

- **Entity Description**

Only domestic corporations with one class of stock are eligible. Limited to 100 shareholders; may not have another corporation as a shareholder. Exception: for qualified subchapter S subsidiaries. Other restrictions apply.

- **Taxation**

Taxed similar to partnership. Income/expenses flow through to shareholders. Pass-through items retain the character in shareholder's hands as in the corporation.

# S Corporation (Continued)

- **Wages and Self-Employment (SE) Taxes**

An employee-shareholder receives reasonable wages for services rendered. Additional profits pass through to shareholders and are taxable as income but not for SE tax. Double taxation of profits is avoided.

- **Losses**

Flow through to shareholders. Recognition of loss is limited by shareholder's basic, at-risk rules/passive activity rules.

Subject to "hobby loss" rules.

- **Personal Liability**

Shareholders not liable for debts incurred by corporation. Liability generally limited to amount invested.

- **Tax Year/Tax Form**

Calendar year, Form 1120S

Return due 15<sup>th</sup> of 3<sup>rd</sup> month following close of business

First Extension: Form 7004 extends deadline 6 months



# Partnership

- **Organization & Administration**

Easy to organize. A written agreement is recommended but not required. Agreement determines how income/losses are allocated. If agreement does not exist, items pass through based on partner's ownership interests.

- **Entity Description**

Has two or more owners that functions as a trade or business. Joint undertaking merely to share expenses or ownership of property does not necessarily constitute a partnership.

- **Taxation**

Income/expenses flow through to partners. Income taxed to the partner whether or not distributed. Pass-through items retain the same character to the partner as they had in the partnership.

# Partnership (Continued)

- **Wages and Self-Employment (SE) Taxes**

A general partner's share of the income (including guaranteed payments) is subject to SE tax; limited partner's share is not unless the partner performs services for the partnership. Other items, i.e., interest and dividends, retain their character; are passed through to the partner's individual income tax return.

- **Losses**

Flow to partners. Is limited by the partner's basis, at-risk rules and passive activity rules. Subject to "hobby loss" rules.

- **Personal Liability**

General partner personally liable for all debt. Limited partner's liability usually limited to investment.

- **Tax Year/Tax Form**

Normally calendar (December 31)/ fiscal, Form 1065

- **Return Due**

15<sup>th</sup> day of 4<sup>th</sup> month following close of tax year

- **First Extension**

Form 7004 extends deadline



# Limited Liability Corporation

- **Organization & Administration**

An existing partnership can generally register for LLC status in the state in which it conducts business. Registration is generally less complicated than forming a corporation.

- **Entity Description**

Formed under state law. Treated as a disregarded entity, partnership or corporation. Single-member LLCs are usually treated as disregarded entities taxed directly to their owner.

- **Taxation (same as Partnerships)**

Income/expenses flow through to partners. Income taxed to the partner whether or not distributed. Pass-through items retain the same character to the partner as they had in the partnership.

# Limited Liability Corporation (Continued)

- **Wages & Self-Employment (SE) Tax**

Profits subject to income tax (as in partnership). Members' business income (including guaranteed payments) may be subject to SE tax.

- **Losses**

Flow through to members. Recognition of loss is limited by the member's basis, at-risk rules and passive activity rules.

- **Personal Liability**

Degree of liability protection varies from state to state.

- **Tax Year/Tax Form**

Normally calendar (December 31)/Form follows taxes  
(Could be Form 1040, 1120, 112S, or 1065, depending on set-up)



# Tax Planning

## S Corporation vs C Corporation

### Factors to Consider

S Corporation	C Corporation
<ol style="list-style-type: none"><li>1. <b>Tax: Income:</b> passes directly to shareholders</li><li>2. <b>Top tax rate:</b> 35%</li><li>3. <b>Bottom tax rate:</b> Graduated rates for individuals begin at 10%</li><li>4. <b>Undistributed earnings:</b> Generally are not taxable, up to share-holder's basis</li><li>5. <b>Fringe benefits:</b> Restrictions for shareholders who own 2%+ of stock</li></ol>	<ol style="list-style-type: none"><li>1. <b>Tax: Income:</b> taxed at corporate level <u>and</u> at individual level</li><li>2. <b>Top tax rate:</b> 35%</li><li>3. <b>Bottom tax rate:</b> 15% for first \$50K regardless of shareholder's income</li><li>4. <b>Undistributed earnings:</b> May be eligible for capital gains tax when business is sold</li><li>5. <b>Fringe benefits:</b> Few restrictions</li></ol>

Thank you for your attention and  
participation.  
Any additional questions?