Business Startup Guide

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Table of Contents

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I. INTRODUCTION

Starting and maintaining a business is a very exciting, rewarding, and demanding job. The financial and tax aspects of running a business are highly technical and unique to each different business. This guide provides a brief outline of certain topics as a starting point for further discussion. Guidance in this document is not meant to be all-inclusive, as there are many exceptions to the basic rules that are summarized here.

Professional guidance from your accountant, attorney, banker and insurance person is key to the success of the business. The CPA firm of Porter & Sack, CPAs, S.C. works with small businesses of all sizes on different levels of need in the following areas:

Business:

- Corporate, partnership, and LLC tax preparation and planning.
- Training and technical support for QuickBooks accounting software.
- Business start-up consulting and guidance.
- Payroll support services.
- Review and compilation of personal and business financial statements and forecasts.
- Assistance in the sale and acquisition of businesses.
- Valuations of closely held businesses.
- Preparation of Forms 990 and related WI forms for non-profit organizations.

Personal:

- Individual tax preparation and advice.
- Estate planning.
- Estate and trust tax preparation.
- Resolving disputes with the IRS and Wisconsin Department of Revenue.

Litigation:

- Valuation of pensions to assist in determination of divorce asset allocation.
- Determination of economic loss and forensic accounting.
- Expert witness testimonial to support our calculations when in litigation.

II) FORMS OF BUSINESS ORGANIZATIONS

1) Choose the Entity Appropriate for Your Business

One of the first business decisions you will need to make is to select the legal entity for your business. Choosing the proper entity format is an important decision that has functional and administrative ramifications. The various options must be reviewed with respect to the specific facts of the business under consideration. The short and long-term goals of the business, along with the various other factors must be considered in order to make the determination of the business structure to use.

Different owners often base the final entity decision on different factors. Limited liability is often a key requirement and thus narrows down the entity choice decision. Some owners want the least paper intensive and least burdensome structure (sole-proprietorship). Loss deductibility is restricted in some entities and not others. Some owners want an entity for which they can perform most/all administrative functions. Some owners want a separate entity that allows them to accumulate retained earnings to develop capital while utilizing lower tax brackets (C-Corporation).

The final decision of which entity is best for you can be a complicated decision that is best made via a collaborative effort that involves the business owner, the CPA and the legal counsel. Some of the other issues to consider when selecting your business structure are:

1. How the profits from the business will be taxed.
2. Type of business and number of owners.
3. Employee benefits available or required.
4. Simplicity and costs of formation / continuation / termination.
5. Record keeping requirements.
6. Payroll administration abilities and costs.
7. Ability / need to restructure in the future.
8. Income, loss and distribution sharing.
9. Amount, type and basis of assets and liabilities available to contribute to new business.
10. Year end preference.

Based on the entity that is chosen different tax deductibility results can occur for various items / benefits. The next two pages summarize the entity choices available.

2) Types of Entities

A business can generally be classified as any one of the following four structures, each with different legal, tax, and operational characteristics. A brief overview of the different kinds of operating entities follows:

Sole Proprietorships

A sole proprietorship is an unincorporated business that is owned by one individual. It is the simplest form of business organization to start and maintain. The owner of the business is personally liable for all debts of the business, and his/her own assets may be subject to the claims of business creditors as there is no insulation between the business and the individual. The income and expenses of the business are reported directly on the owner's personal tax return (Schedule C).

A sole proprietorship can be set up as a one-person Limited Liability Company. For legal purposes, the LLC status provides an insulating barrier between the assets used for the business and the personal assets of the owner. Thus, the sole proprietor is able to obtain a legal protection similar to that of a corporate entity.

An LLC is easy to establish and inexpensive in Wisconsin. The LLC can be established by accessing the Wisconsin Department of Financial Institutions web-site (www.wdfi.org). Once the LLC has been established, a $130 registration fee is due. A nominal yearly fee is then charged to maintain the LLC status.

From a tax perspective, forming an LLC does not cause any change. The company is still a sole proprietorship and completes a Schedule C as long as there is only one member.

Advantages	Disadvantages
*Easiest to organize.	*Unlimited liability (if LLC is not used).
***Tax return simplicity.**	*Can have only one owner.
*Single level of taxation (pass through).	*Owner must make quarterly tax payments based on earned income.
*Can employ spouse and gain 100% medical deductibility.	*All business income subject to self-employment tax.
*Business is easy to discontinue.	
*Single member LLC election easy to add.	

Partnerships

Two or more owners can join in a more formal relationship to conduct a business as a partnership. A partnership is a "pass through" entity. It is called a "pass through" entity because the net taxable income is passed through to and recorded on the tax return of each of the partners/members. The partnership is a separate entity that must satisfy certain administrative organizational requirements. For example, a partnership must file a year-end tax return for its operations. Generally, the year end is December 31st meaning a federal Form 1065 must be filed by April 15th.

A partnership may also elect to become an LLC. In addition, it may elect to organize as a Limited Liability Partnership. In an LLC or LLP, the partners are referred to as members. The LLC or LLP election provides legal benefits similar to that of a corporate entity. For tax purposes, the entity is still considered a partnership and completes Form 1065.

Advantages

*Can have two or more owners.
***Minimal formation requirements.**
*Partnership income is taxed on partners' individual return (pass through).
*LLC election available.

Disadvantages

*Unlimited liability (unless LLC used).
*Annual partnership tax return required.
*Must use owners' year-end.
*Authority for decisions is divided.
*Partner must make quarterly tax payments for income allocated to each partner.

C-Corporation

A corporation is a separate legal tax entity that must file a corporate tax return within two and one half months after the close of its fiscal year. It is formed when a shareholder transfers money/property for the corporate stock and by satisfying state statutes as to organizational documentation. A corporation may pay wages to its owner/employees. For tax purposes, there are two types of corporations: "C" and "S". C-Corporations retain the profits within and incur a corporate level tax. Profits are paid to the owners via wages or dividends. The owners of the corporation are not liable for the debts of the corporation unless they have personally made guarantees for the debt.

Advantages

*Limited liability to owners.
*May use any fiscal year end.
*Ownership transferred easily.
*Can have one or more owners.
*Full deduction for health insurance on owner-employees.

Disadvantages

***Corporation pays tax on income.**
*No pass through of tax losses or income.
***Payroll tax filings and costs.**
*Annual corp. tax return required.
*Audit risk-dividend re-characterization.
*Corporate formalities to follow causing setup to be more expensive.

S-Corporation

An S corporation is a C corporation that has elected to be treated as a "pass through" entity for tax purposes. The pass through feature allows income to avoid the double taxation of income that occurs with the "C" corporation. The shareholders then include their share of the corporation's income and deductions on their tax returns. Wages will normally be paid to the owner. LLC's can generally elect to be taxed as an S corporation.

Advantages

***Limited liability to owners.**
***Single level of taxation (pass through).**
*Can have one or more owners.
*Ownership transferred easily.
*Opportunity of saving FICA taxes to owners.
*LLC election available

Disadvantages

*Very strict shareholder allocations.
***Payroll tax filings and costs.**
*Annual S-Corporation tax return required.
*Must use owners' calendar year end.
*Loss deductibility limited to basis.
*Excess distribution problem.
*Corporate formalities to follow.

III) ACCOUNTING

1) <u>A Functional Accounting System</u>

Having a functional accounting system is an essential element to successful companies. At a minimum, the system must be able provide a record of historical activity. This information is needed for completing tax returns and fulfilling other data requests. More organized accounting systems become a management tool and are able to provide useful information for management decisions.

Useful accounting systems have the following characteristics:

- Simple to use
- Easy to understand
- Reliable
- Accurate
- Consistent
- Timely
- Tailored to your business

2) <u>Record Keeping Options</u>

There are various methods that can be used to maintain the accounting records for your business. Based upon the need for timely information and the amount of time the owner has to commit to the accounting function, some method of bookkeeping must be put in place. An accounting system can be updated annually, quarterly, monthly, or daily. Your CPA or bookkeeper can perform the accounting function internally or externally. The three basic levels of commitment to the bookkeeping function that a business owner should consider:

1) <u>Checkbook:</u> At the minimum a separate business checkbook should be maintained to record all business transactions. All revenues must be deposited into this account and all business expenses must be paid from this account. The check stubs (or the check register) will provide the operating results that you, your accountant, or bookkeeper can then summarize for you periodically or at year end.

2) <u>Cash Receipt and Disbursement Registers:</u> Some business owners prefer to perform a portion of the accounting function by listing and summarizing the monthly checkbook activity onto columnar spreadsheets (paper or computer driven). These monthly sheets can provide management information, tied into the monthly cash reconciliation process and used for year-end tax work.

3) <u>Accounting Software:</u> The ideal level of accounting service is to maintain a computerized accounting system on a daily basis. A general ledger system such as QuickBooks posts each transaction to specific accounts as they are entered and provides income statements and balance sheets at any point in time.

Recommendation: An accounting system can be very simple and performed on 13-column spreadsheets or it can be a computerized system producing daily information. Each business owner should devise a system that blends the owner's desires in the following three areas:

1) The owner's desired level of participation in the daily, weekly, monthly process,
2) The owner's need for timely information about the results of operations, and
3) The financial commitment available to the accounting process.

As your business grows, you need to evaluate whether your accounting system is appropriate and providing timely information to manage and control your business. Work closely with your CPA to ensure your accounting system grows along with your business.

3) Is QuickBooks Software Right for You?

QuickBooks is the number one business software in the nation. It is very flexible, easy to use, allows customization for your business needs, and modestly priced (approximately $250). But is QuickBooks right for your business demands? The following questions play a key role in deciding whether to use QuickBooks for your business:

- Do you have a desire to computerize your accounting system?
- Are you computer literate or do you have some bookkeeping experience?
- Do you need a way to invoice your customers and track accounts receivable?
- Would you like to have a "tool" that can help you manage your business?
- Are you interested in timely profit and loss reports that are available within seconds?

If you answered yes to several of the above questions, you should investigate the costs and benefits of this business management tool. QuickBooks can be tailored to meet your unique business needs at a technical level that is right for you.

Our very successful implementation plan includes the following recommendations:

1. Identify the duties and the information that you need the system to accomplish.
2. Record all business assets, liabilities and expenditures that you are entitled to record.
3. Gain an understanding of the two basic financial statements.
4. Use an experienced QuickBooks consultant to maximize benefits and minimize costs.

We strongly recommend that you utilize a few hours of upfront QuickBooks consulting to save you time, realize benefits applicable to your business and avoid creating problems that will be more costly to fix at year end.

Software Highlights:

*Simplify year-end tax return preparation work
*Record revenue and expenses
*Invoice your customers
*Enter and pay bills
*Pay your employees (payroll)
*Track time and costs
*Record your checkbook activity and reconcile your checking account
*Print checks on pre-printed forms
*Record credit card activity
*Track project or job costs
*Create estimates or proposals
*Manage your inventory

4) Choose Your Accounting Method to Minimize Your Tax Bite

An "accounting method" is the consistent method under which the business recognizes and records its income and expenses. The method must clearly reflect taxable income. The IRS deems an accounting method to clearly reflect taxable income if all items of gross income and all expenses are treated consistently from year to year. The accounting method is established when the business files its first tax return. Changing your accounting method is a complicated process that should only be done when absolutely necessary.

There are two basic methods of accounting although there are numerous variations. Once an accounting method is selected, it must be consistently applied in future years so consider this election carefully. The two basic methods are as follows:

Cash Method of Accounting

This method of accounting is the simplest. Revenues are recorded as income when *received* and expenses are recorded and deductible when *paid.* Taxable income is determined effectively by the cash flow. A simplistic view to this method of accounting is that the businesses check book is the summary that reflects taxable revenues and expenses.

Most taxpayers with average gross annual receipts of $25 million or less can use the cash basis of accounting (and thus avoid accounts receivable income recognition) although inventory amounts cannot be deducted until sold.

Accrual Method of Accounting

Under the accrual method, a business records revenues when *earned* regardless of when they are received. Expenses are recorded when *incurred* although they may not necessarily be paid. This method best matches income with expenses although it is more complicated to maintain as accounts receivable and accounts payable must be recorded in the accounting records.

Recommendation: Usually businesses try to use the cash basis method of accounting as it can minimize your tax liability since only revenues collected are treated as taxable income. This avoids paying tax on accounts receivable, which have not been collected yet.

Recommendation: Existing accrual basis businesses can automatically change accounting methods under Revenue Procedure 2000-22 by filing Form 3115 if they qualify.

5) Accounting 101

Accounting systems are hinged on the basic premise of categorizing information into understandable categories. Five different categories commonly used are as follows:

Assets – Things we buy or contribute to the business that have value. This includes bank accounts, accounts receivable, and fixed assets such as computer equipment and furniture.

Liabilities: Money we borrow to run the business. This includes credit cards, accounts payable, and long-term liabilities such as bank loans.

Equity: This section represents assets minus liabilities. It is a combination of transactions that occur between the owners and the company and a running balance of the company's operating results. It includes such accounts as Owner's Contributions, Owner's Draws and Retained Earnings.

Revenues: Sales made by the company for its product or services This group can include accounts such as "Sales," "Gross Revenue," or something more specific such as "Consulting Income."

Expenses: Expenditures made by the company to support operations and sales. This is where you find all of your different categories of expenses such as Supplies, Rent or Wages.

6) Financial Statements 101

Financial statements are the reports that provide the end result of a company's activity. They are made up of three distinct reports: Balance Sheet, Income Statement and Cash Flow Statement.

- **Balance Sheet –** A balance sheet states the assets, liabilities and equity on a specific date (i.e. – December 31, 20XX). This "snap-shot in-time" report satisfies the following equation: Asset = Liabilities + Equity.

- **Income Statement –** An income statement shows the revenues less expense over a period of time (i.e. – January 1, 20XX to December 31, 20XX). The income statement shows how well the business faired for that period by the resulting profit or loss.

- **Cash Flow Statement –** A reconciliation of cash for a given period of time. Cash flow statements reconcile the uses and receipt of cash from the beginning of a period to the end of a period.

IV) INCOME TAX REPORTING

Business owners must be aware of how taxable profits (or losses) will be taxed. No matter what your entity choice, profits will be subject to two taxes: **income tax and social security tax**. The type of entity will determine how and when these taxes are due and paid.

Income Taxes

Income taxes are imposed on the profit (revenue less expenses) generated by a business operation. Please note payments from the company to the owner (i.e. – draws or dividends) are not deductible expenses. When a draw or dividend is taken, the owner is transferring the company profits out of the company for personal use. The entity choice dictates how complicated your income tax reporting will be:

Sole proprietors report income and expenses of the business directly on the owner's personal tax return by completing an extra form (Schedule C).

C-corporations prepare a separate tax return (Form 1120) and pay taxes on profits as a separate legal tax entity.

Partnerships or S-Corporations prepare a separate return (Form 1065 or Form 1120S), but "pass through" the profit or loss to it owner(s). The owner(s) then report the profit or loss and pay the tax on their personal return.

Remember Social Security and Self-employment Tax

It is intuitive when we think of taxes to focus on income taxes. Another tax to keep in mind is the 15.3% social security or self-employment tax. Social security and self-employment tax are essentially the same thing. Social security is imposed on wages and self-employment is imposed sole proprietors and general partners.

Social security (including Medicare) is deducted from wages immediately at the time of payment. The tax (15.3%) is evenly divided between the employer and the employee.

Self-employment tax is a 15.3% tax based on the taxable income generated by the partnership or sole-proprietor. The tax is calculated at the end of the year on the owner's personal tax return. It is a tax imposed strictly on business profits. Itemized deductions, personal exemptions and other adjustments will **not** reduce self-employment tax due. Thus, it is not uncommon for new businesses owners to pay no income tax, yet owe a substantial amount of self-employment tax.

Requirement to Pay in Taxes during the Year

Generally, taxpayers are required to pay in the appropriate amount of taxes equally throughout the year. Two methods are available to make payments: withholding and estimated payments.

Withholding payments are a function of payroll. The employee instructs the employer to withhold a certain amount of their gross payroll check for taxes. The employer then submits the withholding tax to the appropriate government agency as required.

Estimated payments (ES) are another method used to submit taxes. ES payments are used by sole proprietors and partners. ES payments are made quarterly based on an estimated amount of tax (both income and self-employment) that is anticipated for the year. Safe harbor estimates do exist to avoid penalties.

V) PAYROLL TAX PROCEDURES AND FILINGS

Payroll accounting and the necessary procedures, records and deadlines are very detailed and technical. Assistance from a professional in this area is recommended. Payroll services are available to produce timely paychecks and the required tax filings for a nominal fee.

1) Summary of Payroll Tax Records

A summary list of many of the required forms follows:

Form Name	Form Name	Purpose	Due Date
EMPLOYEE RECORDS			
Payroll records		Summarizes employee paycheck data.	
Withholding Allowance Certificate	W-4	Employee identifies number of exemptions	Immediately upon new hire.
Employment Eligibility Verification	I-9	Department of Immigration requirement.	
WI Withholding Exemption Certificate	WT-4	New hire reporting requirement.	
FEDERAL WITHHOLDING			
Federal tax deposit via EFTPS	On-line	Method for depositing taxes online.	Mo./Qtr.
Employers Quarterly Federal Tax Return.	941	Summarizes wage and withholding data to IRS.	Quarterly
Wage Statements	W-2	Summarizes employee wages and withholdings	Jan 31
WISCONSIN WITHHOLDING			
Wisconsin Tax Deposit Report	On-line	Transmittal for submitting withholding to WDOR, needs to be filed/paid electronically.	Mo./Qtr.
Employer's Annual Reconciliation	On-line	Summarizes annual withholding, needs to be filed electronically.	Jan 31
STATE UNEMPLOYMENT			
Quarterly Contribution Report	UC-101 On-line	Computes Wisconsin unemployment taxes.	Quarterly
FEDERAL UNEMPLOYMENT			
Employer's Annual Federal Unemployment Return	940	Computes federal unemployment tax.	Jan 31

The IRS and Wisconsin Department of Revenue each have a publication that describes the requirements in more detail than what we have here, along with providing the withholding tables needed to do your own payroll (if you do not subscribe to a service). The Federal Guide to Payroll Requirements is Publication 15, also called Circular E 'Employer's Tax Guide.' Wisconsin publishes their requirements in Publication W-166.

Note: Preparing wage checks and satisfying payroll tax requirements is a technical matter and not all issues are addressed in this summary.

2) <u>Forms Required of Employees</u>

Every time a new employee is hired, the new employee is required to complete and deliver to the employer the following three forms. These forms must be maintained in the employee's personnel files at all times.

i) <u>Form I-9</u>: Employment Eligibility Verification

The U.S. Department of Justice requires every employer to have a new employee fill this form (employment eligibility verification). The employer is required to review and verify the information provided by the employee and retain this form. This form does not need to be filed with any governmental agency.

ii) <u>Form W-4</u>: Employee's Withholding Allowance Certificate

Every employee is required to complete this withholding allowance certificate so the employer knows how much federal tax to withhold from his or her paycheck. If the employee fails to provide this information the employer is required to withhold federal taxes as though the employee is a single person who claims no withholding allowances.

iii) <u>Form WT-4</u>: Employee's Wisconsin Withholding Exemption Certificate / New Hire Reporting

Effective Jan 1, 1998 the employer has to file/fax this form with the Department of Workforce Development for reporting new hires within 20 days of the date of hire.

3) <u>Independent Contractor or Employee</u>

As your business grows, you will most likely find it necessary to find help. At this point you will need to determine if you are hiring an independent contractor or an employee. For workers who are employees, a business must withhold federal income tax, social security taxes and federal unemployment taxes on wages it pays workers. State obligations, fringe benefits and retirement plan coverage generally exist as well. By contrast, these responsibilities don't apply for workers who are independent contractors. The business simply pays the contractors for their services. The contractor is then responsible for their own taxes, insurance and benefits

The amount of control one party has over another party is a key element in determining the proper classification. In addition, keep these items in mind that an independent contractor:

1) Uses his/her own tools,
2) Has numerous customers,
3) Controls his/her own work hours and job completion,
4) Generally advertises in the yellow pages, and
5) Submits an invoice for piecemeal projects as completed.

If you have any variance from this generality, you probably have an employee relationship and you are exposing yourself to extensive penalties.

Always have your independent contractor complete and return a Form W-9 -Request for Taxpayer Identification Number and Certification.

VI) DEDUCTIBLE EXPENSES

1) ‘Ordinary and Necessary’ Requirement

A valid business expense must be “ordinary and necessary” in the course of legitimate and normal business operations. In addition, the expense must meet the “primary purpose” test (see five W’s discussed later). The facts and circumstances of your business determine if these two tests are met for valid business deductions.

Certain costs attributable to inventory may not be immediately deductible but should be expensed when the item is sold or consumed. Capital expenditures such as furniture, equipment and vehicles must be depreciated over their assigned tax lives. Capital expenditures may be expensed subject to various limitations in the year of purchase.

2) Business Use of Home

Non-incorporated businesses can deduct a percentage of home expenses if certain criteria are met. The office must be used “regularly and exclusively” by the taxpayer for one of the following:

1) As the principal place of business (including administrative use), and
2) As a place to meet or deal with clients in the normal course of the business, or
3) In connection with the business if it is a separate structure not attached to the taxpayers personal residence.

If the home office deduction hinges on administrative use, there cannot be any other fixed location for the business to conduct its administrative or management activities.

Upon meeting the above requirements, a proportion of the utilities, homeowner’s insurance, real estate taxes and interest (or rent) are deductible.

3) Business Use of Auto

Taxpayers using an automobile in a trade or business can account for business expenses of the automobile by using either:

1) Standard mileage method. In 2018, the rate is 54.5 cents per mile effective January, 1 2018. In 2017 the rate was 53.5 cents per mile.

2) Actual expense method (gas, insurance, depreciation, repairs etc.).

Regardless of the method used, automobiles are “listed property” subject to depreciation restrictions and mileage records must be maintained to identify:

1) Total miles driven in the year, and
2) Total business miles driven in the year.

4) Depreciation

Depreciation is the annual deduction allowed to recover the cost basis of business or income producing property with a determinable useful life of more than 1 year. Depreciation starts when you first use the property in the business. If certain elections are made, the tax law does provide a cost threshold indicating when the capitalization of longer lived assets is required. Currently, the de minimis capitalization threshold is $2,500.

Common depreciation life categories are as follows:

MACRS Life	Types of Assets	Annual Depreciation rates	AMT Life
3 Years	Tractor units for use on road, race horses over 2 years old, any other horse over 12 years old.	33.33% / 44.45% / 14.81% / 7.41%	4 12 10
5 Years	Taxis, autos, light trucks, computers, typewriters, calculators, copiers, buses	20 / 32 / 19.2 / 11.52 / 11.52 / 5.76	5 6 9
7 Years	Office furniture, fixtures, equipment, any item not in any other category.	14.29 / 24.49 / 17.49 / 8.93 / 8.92 / 8.93 / 4.46	10
10 Years	Vessels, barges, water transportation equipment, any single-purpose agricultural or horticultural structure.	See IRS tables	18
15 Years	Land improvements such as parking lot, sidewalk, road, fence, landscaping, patio, driveway, and qualified improvement property	See IRS tables	20
20 Years	Farm buildings	See IRS tables	25
27.5 Years	Residential rental property	Straight line, mid-month convention	40
39 Years	Commercial real estate (office buildings, warehouses)	Straight line, mid-month convention	40

Software is depreciated over 36 months using a straight-line method and a monthly convention.

5) Section 179 Deduction

Rather than depreciating the cost of business property over several years, Section 179 of the Internal Revenue Code allows tangible depreciable property used in an active conduct of a trade or business to be expensed in the year of purchase. For 2018, the Section 179 limit is $1,000,000.

Generally only personal property (equipment, furniture, machines, etc.) qualifies as Section 179 property. Buildings and their structural components do not qualify. The deduction is limited to the aggregate taxable income derived from the active conduct of the business. Sole-proprietors can include wages in the computation to maximize the Section 179 deduction.

6) Amortization

Amortization is the annual deduction allowed to recover the cost of certain "intangible" assets used in a business or an income producing activity. Amortizable assets include:

Life	Type of Asset	Description
60 months or immediate write-off up to $5,000 for each type (Total $10,000)	Organization Costs (election required) Startup costs (election required)	Amounts spent for legal and accounting fees to draft legal documents and for filing fees. Expenses incurred prior to commencement of operations
15 Years	Purchased goodwill Covenant not to compete payments Copyrights and patents Franchise, trademarks, trade names	Excess purchase price over tangible property value. Payments to seller to restrict reentry into competition. Legal and filing fees. Fees paid to acquire operating rights or reserve a name.

7) Travel and Entertainment Deductions

Travel, transportation and entertainment deductions are defined as follows:

Travel deductions are the expenses incurred while traveling "away from home overnight" for business and/or employment purposes. Deductible expenses include meals, lodging on the way and at the destination, airfare, auto expenses, taxi fare, tips, etc.

Transportation deductions are the expenses of transportation directly attributable to the conduct of a business and/or employment, even though not "away from home overnight." Deductible expenses include airfare, taxi fare, auto expenses, etc.

Meal expenses that are directly related or associated with an active trade or business may be deducted. A specific business and/or employment purpose must be established.

Entertainment expenses are not deductible as of January 1, 2018. This includes entertaining guests at nightclubs, theaters, sporting events, etc.

An important aspect of all deductions is documenting the primary business purpose. This is especially important when documenting travel and meal deductions. Documentation must clearly show that the "primary purpose" was business related rather than personal. In addition to the amount of the deduction, the "five W's" must be documented:

Who	traveled or was entertained?
What	was the nature of the trip or entertainment?
Where	was the travel destination or place of entertainment?
Why	was the trip taken or that person entertained?
When	was the trip or entertainment?

8) Summary of Documentation Rules

Documenting expenses is a tedious chore generally not enjoyed by the business owner. Thus, getting into a systematic routine of properly supporting your income and deductions is critical. In the event you are challenged on the amounts reported, you will be glad you spent the extra effort.

In general you are required to keep adequate contemporaneous records. This includes an account book, log, diary, journal, expense statement or some other similar record. With respect to automobile expenses, the log must detail the mileage driven for business and investment purposes and the total mileage driven. It is extremely important that these records are kept to substantiate the business percentage of automobile use.

Travel, transportation or entertainment deductions must be documented on a "timely basis" which means at or near the time of expenditure. Otherwise, you will not be able to claim deductions with respect to these items on your income tax return. If any expenditure is $75 or more a receipt is necessary to support the deduction. For expenses below $75 no receipt is necessary, but the "five W's" must be documented for all deductions whether above or below $75. We recommend keeping receipts for as many transactions as possible.

VII) OTHER ITEMS TO BE AWARE OF

While the focus of the start-up guide is on income and self-employment tax, the new business owner needs to be aware of other business related items.

Sales and Use Tax

The sales tax system in Wisconsin charges a 5% tax on all sales of tangible property. It also requires the business owner to self-assess use tax of 5% when sales tax is not charged and should have been. Each county then has the authority to add an additional .5% tax to the levy.

The sales tax system in Wisconsin can be fairly complicated. It is also the tax most likely to come up for audit. A full discussion of sales tax is beyond the scope of this guide, but the business owners should understand:

- Sales tax standards for the industry being operated in (taxable vs non-taxable sales)
- In-state verses out-of-state sourcing rules (i.e. – Nexus)
- How exemption certificates work
- Record keeping requirements
- When sales tax returns (Form ST-12) should be filed online

Personal Property Tax

Cities and towns have the authority to tax personal property used by a business. This is similar to a real estate tax assessment. Generally, the personal property tax return is due on March 1. No tax is due with the return, but it does provide the information necessary to levy the tax. The personal property tax bill is then received later in the year.

Please note, qualifying manufactures file a special return and are eligible for a credit.

Workman's Compensation Insurance

Businesses with employees are required to carry worker's compensation insurance. Workers compensation insurance coverage provides standardized insurance coverage that provides compensation in the event of a job-related injury.

Business owners can elect to forgo this coverage for themselves (an election must be made to do this). Please consult your insurance agent on this.

Worker's compensation insurance is obtained through a private insurance company. However, the rates are dictated by the State of Wisconsin. Thus, the payment is the same no matter which carrier is used. Rates do vary by the risk involved with the profession. For example, the premium for a construction worker will be more than the premium for a receptionist. You should consult an insurance professional to discuss this matter in more detail.

VIII) TAX TIPS FOR THE BUSINESS OWNER

- Choose the Most Advantageous Accounting Method

Generally, taxpayers can choose between the cash and accrual methods of accounting for reporting income and deductions. The cash basis method of accounting should not be overlooked for new businesses.

- Accelerate Deductions and Defer Income

With the cash method of accounting you may be able to defer certain revenues by planning properly toward the end of the tax year. By paying off all of the outstanding bills at the end of the year the business will reap the tax saving benefit in the earliest possible year.

- Maximize Business Vehicle Deductions

Consider the business related travel trips as potential deduction opportunities. Business owners can deduct either actual expenses or the standard mileage rate. A certain amount of record keeping must be kept. Devise a plan that meets both your specific travel characteristics with your ability to keep records and yet will stand up the IRS scrutiny. Be sure to consider all aspects of business related travel including trips to:

Continuing education	Customer meetings and deliveries
Business lunches	Pick up mail
Business meetings	Bank for business
Purchase of supplies	Competition shopping

- Retirement Plan Contributions

Take advantage of the benefits associated with qualified retirement plans for yourself and your employees. There are numerous low cost plans to consider depending on your desired level of contribution participation for both the owner and the employees. See the “Retirement Plan Summary” in the Appendix for further details.

- Self-employment Tax Reductions

Since income distributions to an S-Corporation shareholder are not subject to employment taxes, you can pay yourself a reasonable salary and withdraw the excess from the company free of the self-employment taxes.

- Business Property Depreciation

Generally, businesses can elect to deduct immediately up to $1,000,000 for 2018 of qualifying business property in the year it is placed in service. The deduction is taken all in the first year in lieu of claiming depreciation over the prescribed five or seven years. Taxpayers generally prefer this election to save taxes “now” rather than saving taxes over the extended depreciable life.

Expense Report

Name ________________________________

Expense Report for the Period Ended

____________, 2018

Receipts/invoices <u>must</u> be attached for all amounts. Business meals, entertainment and gift receipts must also include who, what, when, where, and why (five W's) on the documentation (amounts under $75 do not require a receipt if the "five W's" are listed with the amount).

<u>AUTO EXPENSE</u>

Mileage – Business miles __________ x $ .545 $ ____________________

(Attach detailed listing of trips, mileage and dates)

<u>SUPPLIES</u>

Stamps	$	____________________
Supplies		____________________
Other	__________	____________________

Total $ ________________

<u>TRAVEL</u>

Lodging	$	____________________
Flights		____________________
Gifts		____________________
Other	__________	____________________

Total $ ____________

<u>OTHER</u>

Meals and Entertainment	$	____________________
Telephone		____________________
Prof. Dues		____________________
Other	__________	____________________

Total $____________________

TOTAL FOR MONTH $__________________

Employee signature ______________________

Approved by ______________________

Checklist for Starting a Business

Feasibility and Entity Choice

1) Consult an accountant. Compare the tax aspects of various business entities.

2) Consult an attorney regarding federal and state laws governing creation, ownership and operation of the entity.

3) Consult with an insurance professional to ensure understanding of business liability and worker's compensation coverage.

4) Choose a business entity.

5) Draft and execute agreement among principals. Target the business start date.

6) File with state for certificate of assumed name (DBA).

7) Hold all necessary corporate or other organizational meetings. Elect Board of Directors.

Complete Filings

8) Obtain a Federal Employer Identification Number (EIN), form SS-4.

9) File for incorporation, or file necessary LLC or partnership documents with the state. For a corporation that wants to elect 'Subchapter S' status, file IRS Form 2553 by the 15^{th} day of the third month of the tax year to which the election applies.

10) Obtain state tax ID numbers. Also file required documents with state unemployment tax department. Obtain state sales tax certificates.

11) Obtain any required city, county, or local business licenses and permits.

Accounting and Operations

12) Open a business checking account. Establish banking advisor relationship.

13) Fund the entity. Corporations issue stock certificates.

14) Set up books for the new entity. Close books on previous entity or sole proprietor if changing the form of business.

15) Send appropriate notification of the business name and business start date to customers, vendors, bankers, etc.

16) Hire employees.

17) Start business operations.

18) Review wills and estate plans of the owners.

Accounting Terms

ACCOUNTING: an information system that measures, processes, and communicates financial information about an identifiable economic entity to permit users of the system to make informed judgments and decisions.

ACCOUNTING CYCLE: all steps in the accounting process including analyzing and recording transactions, posting entries, adjusting and closing the accounts and preparing financial statements.

ACCOUNTS: individual records affecting a particular asset, liability, equity, revenue, cost or expense item.

ACCOUNTS PAYABLE: amounts owed to suppliers/vendors for goods/services sold.

ACCOUNTS RECEIVABLE: amounts due to business from customers for goods/services sold.

ACCUMULATED DEPRECIATION: depreciation from fixed asset purchase date to most recent balance sheet date.

ACCRUAL BASIS: the reporting of revenues from sales in the period of which they are sold, regardless of when the cash is received, and the reporting of expenses in the period incurred regardless of when payment is made. Recording accounts receivable and payable accomplishes this method of accounting.

ASSETS: resources the company owns.

BAD DEBTS EXPENSE: amounts determined to be uncollectable from customers on past credit sales.

BALANCE SHEET: a financial statement that shows the financial position of a business at a particular date.

CASH BASIS OF ACCOUNTING: a basis of accounting under which revenues and expenses are recognized when cash is received and when cash is paid (no receivables or payables).

CASH FLOW FORECAST: a forecast or budget that shows the firm's projected ending cash balance for each month of the year so that periods of high or low cash availability can be anticipated; also called a cash budget.

CHART OF ACCOUNTS: the specific list of all accounts used to record activity and summarize transactions.

CONSISTENCY: an accounting convention that requires that a particular accounting procedure, once adopted, will not be changed from period to period.

COST OF GOODS SOLD: amounts paid or to be paid for inventory sold.

CREDIT: the right side of an account.

DEBIT: the left side of an account.

DEFERRAL: the postponement of the recognition of an expense already paid or of a revenue already received.

DEPRECIATION (depreciation expense): the periodic allocation of the cost of a tangible long-lived asset over its estimated useful life.

EXPENSES: amounts paid or to be paid for business operating expenditures.

FIXED ASSET: cost of business resources having a long life (generally greater than one year).

GAAP: Generally Accepted Accounting Principles.

GENERAL LEDGER: a book or computer file listing all business accounts, the transaction/journals posted in the accounts, and the balances in the accounts.

INCOME STATEMENT: a financial statement that shows the amount of income/loss earned by a business over a period of time.

INTERNAL CONTROLS: policies, procedures and practices to protect business resources from loss, promote operational efficiently and to provide reasonable assurance of the accuracy of accounting data.

JOURNAL: a summary of all transactions for a period of time.

LIABILITIES: amounts owed by the company.

LONG-TERM LIABILITIES: debts of a business that fall due more than one year ahead, beyond the normal operating cycle, or are to be paid out of noncurrent assets.

NET INCOME (LOSS): equals gross profit minus expenses.

OWNERS EQUITY: the resources invested by the owner of the business; assets – liabilities = owner’s equity; also called residual equity.

REVENUE (OR SALES): goods or services sold for a period of a time.

TRIAL BALANCE: list of accounts in the general ledger with their respective balance at a point in time.

WORKING CAPITAL: the amount by which total current assets exceed total current liabilities. Current assets minus current liabilities equals working capital.

J J M and B SERVICES
BALANCE SHEET – ACCRUAL BASIS
As of December 31, 2xxx

<u>ASSETS</u>	
Current Assets	
Cash	$ 5,700
Accounts Receivable	35,900
Inventory	15,000
Prepaid Insurance	4,300
Total Current Assets	60,900
Fixed Assets	
Vehicles and Equipment	75,000
Furniture and Fixtures	25,000
Total Fixed Assets	100,000
Less: Accumulated Depreciation	(60,900)
Total Net Fixed Assets	39,100
TOTAL ASSETS	**$ 100,000**
<u>LIABILITIES AND EQUITY</u>	
Current Liabilities	
Accounts Payable	$ 8,600
Accrued Liabilities	3,700
Current Portion of Long-Term Notes Payable	21,500
Total Current Liabilities	33,800
Long-Term Liabilities	
Equipment Notes Payable	45,100
Less: Current Portion of Long-Term Notes Payable	(21,500)
Total Long-Term Liabilities	23,600
Total Liabilities	57,400
Equity	
Capital/Common Stock	10,000
Retained Earnings	32,600
Total Equity	42,600
TOTAL LIABILITIES & EQUITY	**$ 100,000**

J J M and B SERVICES
INCOME STATEMENT – ACCRUAL BASIS
For the Year Ended December 31, 2xxx

Sales	$ 550,000
Cost of Goods Sold	
Materials	183,150
Labor	121,000
Payroll Taxes	14,850
Subcontractors	26,950
Other Direct Costs	4,950
Total Cost of Goods Sold	**350,900**
Gross Profit	**199,100**
Selling, General & Administrative Expenses	
Advertising	11,650
Depreciation	17,600
Entertainment and Meals	2,200
Insurance	8,600
Interest	9,900
Miscellaneous	15,400
Office Expense	4,400
Rent	13,750
Salaries	85,900
Payroll Taxes	9,900
Telephone and Utilities	7,150
Total Selling, General & Administrative Expenses	**186,450**
NET INCOME	**12,650**
Retained Earnings, Beginning	**19,950**
Retained Earnings, Ending	**$ 32,600**

Comparison of Types of Entities

	Sole Proprietorship	Partnership (Form 1065)	S-Corporation (Form 1120S)	Corporation (Form 1120)
Entity Description	**One individual** who carries on an unincorporated trade or business. (A husband and wife who own a business jointly and contribute to the business as owners must file Form 1065 as a partnership. Exception exist in marital property states.)	An association of **two or more individuals** who make up a legal contract to carry on a trade or business. Each partner contributes cash, property, and/or services. A joint undertaking merely to share expenses or share ownership of property, does not necessarily constitute a partnership. A partnership has its own legal status.	A corporation can elect to be taxed as an S-Corporation by filing Form 2553. Only domestic corporations with one class of stock are eligible. Limited to 100 shareholders, and may not have another corporation as a shareholder. (Exception for qualified subchapter S subsidiary). Other restrictions apply.	A business entity that carries its own legal status, separate and distinct from its owners.
Taxation	Net profit is computed on Schedule C and is **reported as income on the owner's form 1040.**	Partnership income and expenses **pass through** to the individual partners. Income is taxed to the partner whether or not it is actually distributed. Pass-through items retain the same character in the hands of the partner as they had in the hands of the partnership.	Taxed in the same manner as a partnership. Income and expenses **pass through** to shareholders. Pass-through items retain the same character in the hands of the shareholder as they had in the hands of the corporation.	**A C-Corporation pays tax on its profits**. When the owners (shareholders) take profits from the corporation, the **distributions take the form of taxable dividends (double taxation)**.
Wages & Self Employment Income	Owner is subject to self-employment tax of 15.3% of net earnings. Self-employment tax is computed on Schedule SE and is reported as "Other Taxes" on Form 1040.	A general partner's share of business income (including guaranteed payments) is subject to self-employment tax. A limited partner's share of business income is not subject to SE tax unless the partner performs services for the partnership. Other items, such as interest and dividends, retain their character and are passed through to the partner's individual income tax return.	An employee / shareholder of an S-Corporation receives wages for services rendered. **Wages paid to employee / shareholders must be "reasonable."** Additional profits are passed through to the shareholder and are taxable for income tax purpose but **not for SE tax purposes. Double taxation of profits is avoided.**	Shareholders who perform services for a corporation, including officers, are treated as employees. Wages of corporate employees are subject to payroll tax and withholding. Wages paid to employee-shareholders must be "reasonable".
Tax Deductibility of Losses	Business losses can offset other income such as interest, capital gains, or a spouse's wages if filing a joint return. Subject to "Hobby Loss" rules under IRC §183.	**Losses pass through to partners**. Recognition of a loss by a partner is limited by the partner's basis, at-risk rules, and passive activity rules. Subject to "Hobby Losses" under IRC §183.	**Losses pass through to shareholders.** Recognition of loss is limited by the partner's basis, at-risk rules, and passive activity rules. Subject to "Hobby Losses" under IRC §183.	Capital losses are allowed only to the extent of capital gains. Net operating loss of a corporation may be carried over against corporate income, but is not directly passed through to shareholders.
Personal Liability	**Sole proprietor is liable** for all business debts and actions. The LLC format is available and **can limit liability**.	**A general partner is personally liable** for all partnership debt. A limited partner's liability is usually limited to the partner's investment in the partnership. **LLC protection is available.**	**Shareholders are not liable for debts** incurred by the corporation. Liability is generally limited to the amount invested.	**Shareholders have limited liability**, just as with an S-Corporation.
Organization and Administration	**Easiest business to organize.** Allows complete intermingling of business and personal funds (although this is not recommended). Partnerships and corporations cannot intermingle business with personal funds. Business results are filed along with the owner's individual income tax return.	**Easy to organize.** A written partnership agreement is recommended, but not required. Can allocate earnings in any proportion you agree on. In the absence of a written agreement, partnership items pass through based on the partner's ownership interest.	Set up as a C-Corporation. **Must make tax election** prior to 15th day of 3rd month of tax year to be treated as an S-Corporation for that year. Certain events will cause automatic termination of S status.	**More difficult and expensive to organize.** Must hold periodic board meetings and keep minutes. Must comply with federal and state regulations.

Retirement Plan Options

After a business satisfies basic operational cash needs, the owners should look to the benefits of maximizing retirement plan contributions. The IRA is the most basic method. As cash flow permits, larger contributions can be achieved using either a SEP, SIMPLE or Owner-only 401(k).

A key differentiating concept between plans is if the employer matching contribution that is required for qualified employees. In addition each plan has a different matching percentage. A SIMPLE plan is a popular option with small business owners. It is low maintenance, allows a nice elective deferral for the employee and has a low required employer match (3%).

	IRA	SEP	SIMPLE	OWNER-ONLY 401 k
Who Qualifies	Anyone under age 70½ with earned income can contribute to an IRA. Full deduction if taxpayer is not active participant in an employer maintained retirement plan. Phase-out rules apply if an active participant.	Anyone with self-employment income; including freelance fees, earnings from childcare or a hobby, and earnings as a general partner in a partnership. Contributions are treated the same as an IRA.	Employers with 100 or fewer employees and self-employed individuals can set up a SIMPLE plan. Eligible employees must have received $5,000 in compensation in participation year. Can require that the two preceding years also satisfy the $5,000 minimum	Anyone with an owner-only business operation. This includes spouses. Must be 21 years of age with one year of service (1,000 hours).
Maximum Contributions Allowed in 2014 (before catch-up)	Each spouse can contribute up to $5,500 OR their earned income amount, whichever is less. A non-working spouse can also put up to $5,500 in a spousal IRA. The tax deduction allowed is subject to phase-out rules	20% of self-employment income or 25% of wages up to a maximum contribution of $55,000. NOTE: Self-employment net income must first be reduced by ½ of SE tax taken as an adjustment to income on Form 1040.	Employee elective deferrals limited to $12,500	Employee elective deferrals limited to $18,500. Employer match of up to 25% of earned income.
Penalty for Withdrawal Before Age 59½	10% of distribution. (Some exceptions allowed)	10% of distribution. (Some exceptions allowed)	10% of distribution or 25% if withdrawn less than 2 years from the date first participated in plan. (Some exceptions allowed)	10% of distribution. (Some exceptions allowed)
Annual Contributions Required?	No	No. If elective contribution is made, contribution must be same percentage for all employees.	Participant – No Company Match – Yes. Employer is required to make matching contributions of up to 3% of employee wages or employee contributions; whichever is less.	Participant – No Company Match – No Note, only owners participate in the plan.
Deadline for Establishing and Funding the Plan	Establish: April 15th of following tax year. Funding: Same	Establish: Tax filing date (usually April 15th), including extensions. Funding: Same	Establish: October 1 of current tax year. Funding: Elective deferral due by end of tax year (12/31). Match due by tax filing deadline including extensions	Establish: December 31 Funding: Elective deferral due by end of tax year (12/31). Match due by tax filing deadline including extensions.
Catch-up Contribution when over 50 years of age	Additional $1,000 if earned income is available.	Not applicable	Additional $3,000 if earned income is available.	Additional $6,000 if earned income is available.