

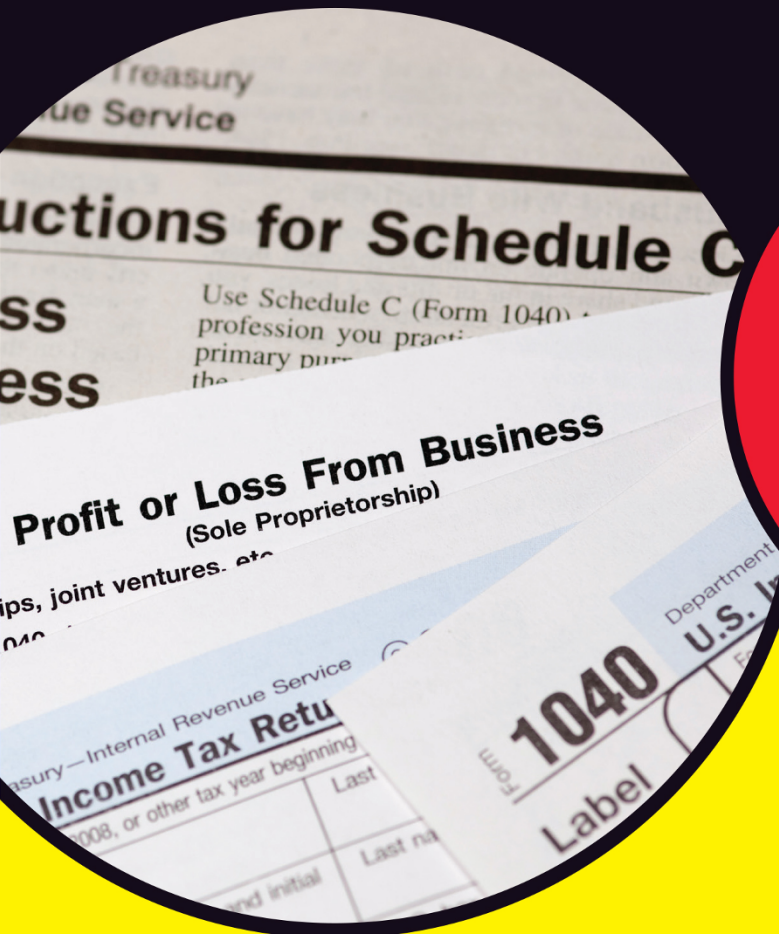
LEARNING MADE EASY



3rd Edition

# Small Business Taxes

for  
**dummies**<sup>®</sup>  
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on the new tax rules

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# Small Business Taxes

3rd Edition

**by Eric Tyson, MBA**

Financial consultant and bestselling author

for  
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# Introduction

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**W**elcome to the third edition of *Small Business Taxes For Dummies!*

Starting and operating a small business involves many moving parts and issues. Money is the lifeblood of any business. You need money to start a business, and you need money to keep a business going.

As you earn and spend money in your business, taxes permeate just about everything that you do. Taxes are too often maddeningly complicated. But they need not be so. Enter this book! And the Tax Cuts and Jobs Act federal income tax bill, which took effect in 2018, produced many changes that reduced and positively impacted small-business taxes. There have been additional and important tax law changes since, which are included in this latest edition.

I've owned and operated numerous small businesses in my life. I love the freedom and opportunity to pursue what I believe in and what interests me. And I generally detest dealing with tax issues. But I also know how important tax issues are in terms of the financial success or lack thereof for a small business.

Handled in the best possible way, you can save yourself tens of thousands — if not hundreds of thousands — of dollars by making informed tax moves. And you can comply with the tax rules and regulations and stay out of trouble with the Internal Revenue Service and your state and local tax authorities.

But if you stick your head in the sand or give in to the complexities of the tax laws, you may end up in trouble both financially and with the law.

## About This Book

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For most folks, their single biggest “expense” is their tax bill. And for tens of millions of small-business owners, the nation's tax laws are a complex and constantly changing web ready to trip them up and siphon off their most precious and valuable business resource — their money.

*Small Business Taxes For Dummies*, 3rd edition, assists both current and aspiring small-business owners with important tax planning issues, filing issues, dealing with IRS audits and notices, getting help, and more.

This book provides you with a crash course on taxes and your small business. Specifically, the goal is to ensure your understanding of the myriad tax rules and incentives so you can legally minimize your tax bill, stay in compliance with the law, and maximize your company's success. You need not read this book in the order it's presented. You can use the book as a reference and selectively read material currently relevant and of greatest interest to you.

Here are the biggest changes and updates in this edition:

- » Impact of COVID-19 and tax breaks associated with it
- » Expanded discussion of newer retirement account options
- » Additional discussion of the 20 percent qualified business income deduction
- » Expanded coverage of issues affecting incorporated small businesses, partnerships, and LLCs
- » Additional coverage of websites, apps, and other online tax resources
- » Pending/likely changes coming from new Congress

I've written this book so you can efficiently find information and easily understand what you find. And although I'd like to believe that you want to pore over every last word I've written, I actually make it easy for you to identify "skippable" material. This information is the stuff that, although interesting, isn't essential for you to know. Text in sidebars: The sidebars are the shaded boxes that appear here and there. They include helpful information and observations but aren't necessary reading.

## Foolish Assumptions

In writing this book, I made some assumptions about you, dear reader:

- » You want expert advice about important small-business tax and financial topics — such as the best way to purchase and write off equipment and other business expenses, establish and fund retirement accounts, and correctly complete common business tax forms — and you want answers efficiently.

- » Perhaps you want a crash course in small-business tax and financial issues and are looking for a book to help solidify major financial concepts and get you thinking about your small-business taxes in a more comprehensive way.

This book is basic enough to help novices get their arms around thorny tax issues. But advanced readers will be challenged, as well, to think about their small-business taxes in a new way and identify areas for improvement.

## Icons Used in This Book

The icons in this book help you find particular kinds of information that may be of use to you.



TIP

This target flags strategy recommendations for making the most of your small-business tax decisions.



ERIC'S  
PICKS

This icon highlights the best products and services I've come across in the small business tax arena.



REMEMBER

This icon points out information that you'll definitely want to take away from this book.



WARNING

This icon marks things to avoid and points out common mistakes people make when making small-business and tax decisions.



INVESTIGATE

This icon tells you when you should consider doing some additional research. Don't worry — I explain what to look for and what to look out for.

## Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with some access-anywhere goodies on the web. Go to [www.dummies.com](http://www.dummies.com) and type in "Small Business Taxes For Dummies Cheat Sheet" in the search box to discover a list of pointers that can help you think about the role of money in your life and start achieving your financial goals.

# Where to Go from Here

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This book is organized so you can go wherever you want to find complete information. You can check out the table of contents to find broad categories of information and a chapter-by-chapter rundown of what this book offers, or you can look up a specific topic in the index.

If you're not sure where you want to go, you may want to turn a few pages and start at the beginning with Part 1. It gives you all the basic information you need to assess your small-business tax situation and points to places where you can find more detailed information for improving it.

# 1 Understanding Small Business Taxes

## IN THIS PART . . .

Minimize your tax bill through year-round tax planning and understand the tax law changes. Be sure to factor taxes into your small business decisions, check out common tax mistakes, and understand tax terms and rates.

Decide what business entity (corporation, LLC, sole proprietorship, and so on) to use, and consider what benefits to offer to your employees.

Investigate your small-business retirement account options — such as SEP-IRAs, SIMPLE plans, 403(b) plans, and 401(k) plans — and select top-notch investments.

Handle small-business real estate decisions, such as deciding whether to work out of your home, lease space, or buy property.

Plan your estate, including your small business. Determine your estate's tax concerns and reduce your expected estate taxes.



## IN THIS CHAPTER

- » Appreciating the value of year-round tax planning
- » Understanding recent important tax law changes affecting small businesses
- » Checking on changes made by the SECURE Act of 2019 and COVID-19 relief bills
- » Looking ahead to possible upcoming tax law changes
- » Noting the various taxes you and your business pay

## Chapter **1**

# Small Business Taxes 101

**E**ven though I write about personal finances, including tax issues, I don't particularly enjoy dealing with taxes. I would rather cut my lawn, take care of my neighbor's dog, or even visit my dentist (for a routine cleaning). At least in all these cases, I know my time commitment is reasonably limited, and when I'm done, I'm satisfied that the job has been done well and I can move on to something else.

Filling out state and federal tax forms is often complicated and confusing. Because I write about taxes, I feel that it's essential for me to complete my own income tax forms and returns, which forces me to wallow in the details as much as possible so that I can more fully appreciate the challenges taxpayers face. (By contrast, prior surveys have found that the representatives in Congress who sit on committees that draft the nation's tax laws generally use paid tax preparers themselves.) Not surprisingly, a report from the National Taxpayer Advocate cited "the complexity of the tax code as the No. 1 most serious problem facing taxpayers."

Though some of this book deals with the drudgery of completing required tax forms, much of it deals with the more interesting — and dare I say, fun — part of small business taxes, which is planning ahead and strategizing so as to reduce and minimize your taxes. You see, if you simply view your role with taxes and your small business as jumping through the many hoops that federal, state, and local authorities require, you're missing out on something potentially really big — saving and keeping more of your hard-earned money.

This chapter introduces the basics of small business taxes. Here, I discuss the value of tax planning all year long. I also explain recent tax law changes along with those you may see in the future. Finally, I define some important tax-related terms regarding the taxes you pay or may come across.

## Valuing Year-Round Tax Planning

Taxes are a large, vital piece of your small-business and personal financial puzzle. You're required by law to complete your income tax forms each year and pay the taxes you owe. You do this because you have deadlines and don't want contact initiated by local or state authorities or the IRS to result in fines, penalties, or worse, jail time!

Nothing really forces you to plan ahead regarding your tax situation and small business. That's why the vast majority of small-business owners don't take steps year-round to plan and reduce their taxes. However, tax planning all year is valuable because it enables you to stay on top of your tax and business financial situation and minimize the taxes you legally owe. In this section, I explain typical ways in which taxes enter small-business decisions and some common tax mistakes folks make in this realm.

### Factoring taxes into small business decisions



REMEMBER

Taxes infiltrate many areas of your small business and your personal finances. Some people make important financial decisions without considering taxes (and other important variables). Conversely, in an obsession to minimize or avoid taxes, other people make decisions that are counterproductive to achieving their long-term business and personal financial goals. Although taxes are an important component to factor into your major business and financial decisions, taxes shouldn't drive or dictate the decisions you make.

The following list shows some of the ways that tax issues are involved in making sound financial decisions throughout the year.

- » **Type of business and benefits offered:** The type of business entity you select for your business — sole proprietorship, limited liability company (LLC), S corporation, and so on — can have significant tax and other consequences. The benefits you're able to utilize and offer to your employees, if you have them, also have tax ramifications (see Chapter 2).
- » **Retirement accounts:** Taking advantage of retirement accounts can mean tens, perhaps even hundreds, of thousands more dollars in your pocket come retirement time. Offering retirement account access to your employees can also be a valuable employee benefit for recruiting and retaining good employees if they understand what they have. Refer to Chapter 3 for more on retirement accounts.
- » **Spending:** Throughout this book, I discuss myriad spending decisions you may face in your small business, such as buying equipment (Chapter 8), spending on employee benefits (Chapter 2), and so on. These decisions will often affect your taxes both now and in the future.
- » **Protecting your assets:** Some of your insurance decisions also affect the taxes you pay. You'd think that after a lifetime of tax payments, your heirs would be left alone when you pass on to the great beyond — but that's wishful thinking. Estate planning can reduce the taxes that are siphoned off from your estate. See Chapter 5 to find out more about estate planning.
- » **Tracking your business financials:** Throughout the year, you should stay on top of your business's income and expenses so that you can see your business's financial health and record the numbers you need come tax time. Chapter 6 covers these important issues.

## Checking out common tax mistakes

Even if some parts of the tax system are hopelessly and unreasonably complicated, there's no reason why you can't learn from the mistakes of others to save yourself some money, no matter the time of year. With this goal in mind, this section details common tax blunders that people make when it comes to managing their money.

## Seeking advice after an important decision

Too many people seek out information and hire help *after* making a decision, even though seeking preventive help ahead of time generally is wiser and more financially beneficial.



TIP

Before making major small business and financial decisions, educate yourself. This book can help answer many of your questions. You may also want to do further research on your own (see Chapter 12) and/or hire a tax advisor (refer to Chapter 13) for some advice before making your decision(s).

## Failing to withhold or submit enough taxes

If you're self-employed (or earn significant taxable income from investments outside retirement accounts), you need to make estimated quarterly tax payments. You also need to withhold taxes for your employees and send those taxes along to the appropriate tax agencies. Some small-business owners don't have a human resources department to withhold taxes and dig themselves into a perpetual tax hole by failing to submit estimated quarterly tax payments.

To make quarterly tax payments, complete IRS Form 1040-ES, "Estimated Tax for Individuals." This form (discussed in Chapter 10) and its accompanying instructions (and payment coupons) explain how to calculate quarterly tax payments. You can submit payments by mail or electronically through creating/using an online account on the IRS website (<https://www.irs.gov/>). For more information on the requirement for employee tax withholding, see Chapter 6.

## Missing legal deductions



REMEMBER

Some taxpayers miss out on legitimate tax write-offs because they just don't know about them. If you aren't going to take the time to discover the legal deductions that are available to you and that I discuss throughout this book, then you should pay for the cost of a competent tax advisor at least once. Fearing an audit, some taxpayers (and even some tax preparers) avoid taking deductions that they have every right to take. Unless you have something to hide, such behavior is foolish and costly. Note that a certain number of returns are randomly audited every year, so even when you don't take every allowable deduction, you may nevertheless get audited! And, if you read Chapter 11, you can find out how to deal with an audit like a pro.

## Forsaking retirement accounts

All the tax deductions and tax deferrals that come with accounts such as 401(k)s, SEP-IRA plans, and individual retirement accounts (IRAs) were put in the tax code to encourage you to save for retirement. That's something that you as a small-business owner should be doing for yourself as well as encouraging your employees to do.

Most excuses for missing out on these accounts just don't make good financial sense. Some folks underfund retirement accounts because they spend too much

and because retirement seems so far away. Others mistakenly believe that retirement account money is totally inaccessible until they're old enough to qualify for senior discounts. (See Chapter 3 to find out all about your small-business retirement account options.)

## Not owning real estate

In the long run, owning a home should cost you less than renting. And because mortgage interest (on up to \$750,000 of mortgage debt) and property taxes (up to \$10,000 when combined with your state income tax payments) are deductible, the government, in effect, subsidizes the cost of homeownership. (Stay tuned as the state and local tax limit — aka SALT — may be increased higher than \$10,000 in 2022.)

If you have a home office, you may be able to take additional expenses on your tax return. If you need a retail or commercial space for your small business, you should compare leasing to buying and be sure to factor in the tax benefits of owning. See Chapter 4 for more about real estate and taxes.

## Neglecting the timing of events you can control



TIP

As a small-business owner, you should pay attention to how your net income for the year is shaping up for the current year and how things are looking for next year. For example, if you're in the early stages of your business and you can see that you'll have more income next year, then it may be in your best interest tax-wise to delay paying some expenses from late in the current year into early next year. (This works when using cash basis accounting.)

Or suppose that you operate on a cash accounting basis and think that you'll be in a lower tax bracket next year. Perhaps business has slowed or you plan to take time off to be with a newborn or take an extended trip. You can send out some invoices later in the year so that your customers won't pay you until January, which falls in the next tax year.

## Not using tax advisors effectively



REMEMBER

If your financial situation is complicated, going it alone and relying only on the IRS publications to figure your taxes usually is a mistake. Many people find the IRS instructions tedious and not geared toward highlighting opportunities for tax reductions. Instead, you can start by reading the relevant sections of this book. When you're overwhelmed by the complexity of particular small-business and tax decisions, get advice from tax and financial advisors who sell their time and nothing else. (Chapter 13 has tips on hiring help.)

As a small business owner, ask yourself how much you're worth running your business versus how much you're worth as a bookkeeper. Then ask yourself which task you enjoy more and consider hiring a bookkeeper.

Note that using a tax advisor is most beneficial when you face new tax questions or problems. If your tax situation remains complicated or if you know that you'd do a worse job on your own, by all means keep using a tax preparer. If your situation is unchanging or isn't that complicated, consider hiring and paying someone to figure out your taxes one time. After that, go ahead and try completing your own tax returns.

## Noting How Corporate and Individual Tax Reform Impacts Small Business

Corporate tax reform in the United States was long, long overdue. For too many years, corporations in the United States faced a much higher corporate income tax rate than did companies based in most overseas economies. As a result, increasing numbers of U.S. companies had chosen to expand more overseas rather than in the United States and to be headquartered outside of the United States, which wasn't good for the long-term health of the U.S. economy and labor market.

Congress passed the Tax Cuts and Jobs Act in late 2017, which took effect with tax year 2018. It was the most significant tax reform package passed since the Tax Reform Act of 1986. What follows are the highlights of the most significant provisions that affect (and mostly benefit) small business.

### Checking out corporate income tax rate reduction and simplification

At 35 percent, the United States had had one of the highest corporate income tax rates in the world before 2018. The Tax Cuts and Jobs Act slashed the corporate income tax rate to 21 percent, which represented a 40 percent reduction.

The corporate tax rules and deductions were simplified, including eliminating the corporate alternative minimum tax and closing some loopholes. The United States also moved to a *territorial* tax structure whereby U.S. companies would no longer pay a penalty to bring their overseas profits back home. The immediate impact of this change was to enable U.S. corporations to bring back to the United States more than \$2 trillion being kept overseas to avoid excessive taxation.