Internal Revenue Service

New Business Workshop

Volunteer Workshop Presenter

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Before You Go

Please submit your comments about this workshop on my website

www.LarryHesscpa.com
Topics

- Taxpayer Identification Number
- Recordkeeping
- Retaining Tax Records
- Self-employment tax
- Estimated Taxes
- Employee or Independent Contractor?
Taxpayer Identification Number
Taxpayer Identification Number

Social Security Number from Social Security Administration

Format 000-00-0000

Employer Identification Number (EIN) from IRS

Format 00-00000000
To Obtain New EIN

IRS.gov
- Search for “EIN”
- Receive EIN immediately
- Tip: Print onscreen confirmation

Fax Form SS-4 1-215-516-3990
- Receive by fax within about 6 weeks
What Form Must Be Filed?

Taxes paid with return
- Sole Proprietorship  \textit{Schedules C & SE}
- Corporation  \textit{Form 1120}

Taxes paid by owners (aka pass-thru entities)
- Partnership  \textit{Form 1065}
- S Corporation  \textit{Form 1120S}
- Limited Liability Company  \textit{It depends}

\textit{Tip}: Obtain advice from a competent tax professional and attorney when considering the appropriate type of entity for your business.
Recordkeeping & Bookkeeping
What’s the Difference?

**Recordkeeping**
Documentation required to prove entries on tax return

**Bookkeeping**
System used to compile category totals
Why Keep Records?

**Good records are required to …**

- Prepare tax returns and support items reported on tax returns
What Must Be Proven?

- All income is taxable unless you prove otherwise

- Expenses are the opposite. You must prove you are entitled to deductions
  - You spent money
  - Payments were connected to your business
Supporting Documents
(Examples)

Income
- Deposit records
- Bank transfers
- Loan agreements
- Investments

Expenses
- Itemized receipts
- Paid bills
- Bank & credit card statements
- Cancelled checks
Information Needed for Every Payment

- Date
- Check # or other reference
- Who you paid
- What for
- Category of the expense
- Amount
Why Bookkeeping?

A good bookkeeping system can help you …

- Prepare financial statements
- Monitor progress toward business goals
- Identify productive & unproductive income sources & expenditures
You May Use
Any Bookkeeping System

- **Pile of Receipts** (ok, but ...)
- **Handwritten Ledgers** (good)
- **Software** (best)
  - Spreadsheet
  - Checkbook app
  - Business app
Pile System

IRS New Business Workshop
<table>
<thead>
<tr>
<th>DATE</th>
<th>PAID TO</th>
<th>CASH</th>
<th>CHECKS</th>
<th>TOTAL PAID</th>
<th>TOTAL CASH</th>
<th>TOTAL CHECKS</th>
<th>TOTAL OTHERS</th>
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<td>TOTALS</td>
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<td></td>
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<td>3000</td>
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</table>

IRS New Business Workshop
Some Best Practices

- Don’t mix personal and business income and expenses
- Open separate bank and credit card accounts for your business
- Always deposit cash received
- Never take cash back from deposits
- ATM withdrawals and checks payable to “cash” are not deductible until the cash is spent
Saving Your Tax Records
How Long To Save Tax Records

Save documentation supporting entries on tax returns for *as long as the returns can be audited.*

**IRS:** 3 years after filing deadline or actual filing date, whichever is later.
- N.M.: Dec. 31 of third year after return is *due*

**Exceptions**
- 6-years under certain circumstances
- Tax returns - forever
- Capital assets - almost forever
Capital Assets

- Asset expected to have a useful life longer than a year and is not intended for sale in the regular course of the business's operation.

- Amount of deduction and timing is determined by rules for depreciation.

- Documentation of purchase must be retained until 3 (or 6) years after last year subject to depreciation rules.
Taxes Affecting Businesses

Income Tax
(Everyone knows about this one)
Taxes Affecting Businesses

Payroll Tax

(IRS New Employer Workshop)
Taxes Affecting Businesses

Self-Employment Tax
(Social Security and Medicare)
Important For Self-Employed People

Be prepared to pay tax owed

• Self-employment tax can be considerably more than income tax
• Direct payments to the IRS include income tax
• No withholdings to help pay
Calculating Self-Employment Taxes

Paid on net earnings from self-employment

- Sole proprietors
  - Net profit shown on Schedule C
- Partnerships & multi-member LLCs
  - Income on Schedule K-1 given to owners
- Use Schedule SE to calculate
**Self-Employment Tax vs. Income Tax**
(Example using 2020 rules)

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
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<tbody>
<tr>
<td>Business net profit</td>
<td>$44,200</td>
</tr>
<tr>
<td>Standard deduction (2 \times $12,400)</td>
<td>-24,800</td>
</tr>
<tr>
<td>Exemptions (4 \times $0)</td>
<td>0</td>
</tr>
<tr>
<td>Total deductions</td>
<td>-24,800</td>
</tr>
<tr>
<td>Taxable income</td>
<td>19,400</td>
</tr>
<tr>
<td>Income tax</td>
<td>10.0% \times 19,400</td>
</tr>
<tr>
<td><strong>Self-employment tax</strong></td>
<td>15.3% \times 44,200</td>
</tr>
<tr>
<td><strong>Combined tax</strong></td>
<td><strong>8,526</strong></td>
</tr>
</tbody>
</table>
Pay on Time

Pay by April 15
• Not affected by extension

If you pay late
• Penalty 1/2% per month on any amount paid after April 15  (maximum of 25%)

Consequence
• You may need payment plan
  – Challenging to pay current year taxes & back taxes at same time
Taxes Affecting Businesses

Estimated Tax
(Quarterly Payments)
Estimated Tax Is Not A Tax

- Prepayments of current year tax
- Paid with direct payments to IRS
- Each payment is combination of income and self-employment taxes
  - Amount of each tax is not specified
Prepayment Requirement

General rule

- Prepay 90% of current year tax in 4 equal payments due
  
  April 15 - June 15 - September 15 - January 15

- Federal tax withheld from paychecks treated as if paid equally throughout the year
Minimizing Penalty for Underpayment Estimated Tax

- No penalty if 100% of prior year total tax is paid in current year *(with limitations)*
- Payments can be matched to fluctuations in sales during the year
When Estimated Tax Payments Are Not Required

**Individuals**
- Expect to owe less than $1,000 when you file your return.

**Corporations**
- Expect to owe less than $500 when corporate return filed.
### One Way to Determine Approximate Tax If Income Is Variable or Unpredictable

**Based on Business Gross Receipts**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax (From self-employment tax example)</td>
<td>$8,526</td>
</tr>
<tr>
<td>Divided by</td>
<td></td>
</tr>
<tr>
<td>Business gross receipts (From Schedule C, line 1 or CRS-1s)</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Federal tax cost related to sales</strong></td>
<td>8.5%</td>
</tr>
</tbody>
</table>

**Tip**: Using gross receipts reported monthly to N.M. Taxation & Revenue Dept. is a good reminder of when to calculate federal estimated tax payments.
Consequence of Not Prepaying Required Amount on Time

Penalty for underpayment of estimated tax

- Currently 3% of required payment amount for number of days not paid
  - 1.7% effective maximum if no ES payments are made
3 Ways To Pay

Online (best)
- Go to www.IRS.gov
- Click “Make A Payment”

Check
- Mail with Form 1040-ES
  (1040-V after April 15)

Electronic Federal Tax Payment System
- EFTPS.gov
New Mexico also has estimated tax payment requirements similar to the federal rules.
Employee - or - Independent Contractor?
Making The Decision

- Not a voluntary choice
- Must be made using facts and circumstances surrounding the work relationship of each worker
- Sometimes misunderstood
  - “I’m the only person in my business”
- There can be temptations to ...
  - "1099" workers to save costs and simplify administration
  - Go along with a worker's request to avoid withholdings
Worker Status Types

**Employees**
- Under your direct control

**Independent Contractors**
- Not under your direct control
- People who are *in business* for themselves are not considered employees
- Perform services for your business
Cost of Having Employees

Cost of employer taxes

- As much as about 14% of wages

Payroll taxes

- Employer must match withheld Social Security and Medicare taxes (7.65%)
- Unemployment tax (up to 5.4% in N.M.)

Workers’ compensation insurance (may be required)

Discretionary costs

- Employee benefits (examples)
  - Health insurance
  - Retirement
  - Paid vacation
Cost of Misclassifying Workers

- Employee withholding taxes: 7.65%
- Employer payroll taxes: 7.65%
- Late filing penalty (per month): 5%
- Late payment penalty (per month): ½%
- Failure to deposit penalty: 10%
- Interest (per annum): 3%

Total approximately: 34%
Worker Recourse

Workers who believe they have been misclassified as independent contractors have recourse

- Report to IRS using Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*

- File unemployment or workers compensation claim
Making the Decision

Three general categories of factors to consider:

- Behavioral control
- Financial control
- Type of relationship
### 20 Factors IRS Considers When Evaluating Worker Status

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<thead>
<tr>
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<tbody>
<tr>
<td>Type of instruction</td>
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<tr>
<td>Amount of training</td>
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<td></td>
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<tr>
<td>Degree of business integration</td>
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<td></td>
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<tr>
<td>Extent of personal services</td>
<td></td>
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<tr>
<td>Control of assistants</td>
<td></td>
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<tr>
<td>Continuity of relationship</td>
<td></td>
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<tr>
<td>Flexibility of schedule</td>
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<tr>
<td>Demands for full-time work</td>
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<tr>
<td>Need for onsite services</td>
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<tr>
<td>Sequence of work</td>
<td></td>
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<tr>
<td>Requirements for reports</td>
<td></td>
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<tr>
<td>Method of payment</td>
<td></td>
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<tr>
<td>Payment of business or travel expenses</td>
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<tr>
<td>Provision of tools and materials</td>
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<tr>
<td>Investment in facilities</td>
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<tr>
<td>Realization of profit or loss</td>
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<tr>
<td>Work for multiple companies</td>
<td></td>
<td></td>
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<tr>
<td>Availability of public</td>
<td></td>
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<tr>
<td>Control over discharge</td>
<td></td>
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<tr>
<td>Right of termination</td>
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</table>
Behavioral Control Factors

Facts that illustrate whether there is a right to direct or control how the worker performs the specific task for which he or she is hired:

- Degree of instruction
- Training
Behavioral Control Factors

Types of instructions given

P When and where to do the work.
P What tools or equipment to use.
P What workers to hire or to assist with the work.
P Where to purchase supplies and services.
P What work must be performed by a specified individual.
P What order or sequence to follow when performing the work.
**Financial Control Factors**

- Unreimbursed expenses
- Opportunity for profit or loss
- Significant investment by worker
- Services available to the market
- Method of payment
Relationship of the Parties

- Employee benefits
- Intent of the parties/Written contracts
- Permanency of the relationship
- Discharge/Termination
- Regular business activity
IRS Resources

- Search IRS.gov for “small business”
  - Select link for Small Business and Self-Employed Tax Center
- Publication 334, Tax Guide for Small Business (For Individuals Who Use Schedule C)
- Publication 535, Business Expenses
- Publication 583, Starting a Business and Keeping Records
Where to Find Us

Online
www.irs.gov

Business and Specialty Tax Line
1-800-829-4933

TELE-TAX
1-800-829-4477

TTY/TDD
1-800-829-4059

Albuquerque Office
7200 Jefferson St. NE

Note: Appointments are required for individuals needing face-to-face service at the Taxpayer Assistance Center for all matters except for making payments. Make appointments by calling 844-545-5640.

IRS New Business Workshop
There’s more on my website

www.LarryHesscpa.com

- Share your feedback about this workshop
- Register for my other workshops
  - Essential N.M. Gross Receipts Tax
  - Basic (very basic) Bookkeeping
Your Questions?

What more would you like to know?