STOP OVERPAYING YOUR TAXES

11 Ways Entrepreneurs Overpay and How To Stop It Now!

BY: DIANE GARDNER, EA, CTC

Praise for *Stop Overpaying Your Taxes!*

As an entrepreneur and business coach, I am always seeking effective, efficient strategies to help myself and my clients accelerate profit and income growth. After reading Diane's book *Stop Overpaying Your Taxes!*, it is clear that tax planning is a must for entrepreneurs who are serious about impacting their bottom lines. This book provides clear and specific strategies that small business owners can use right away to start earning more (without spending more or working longer hours). A fantastic read that definitely got the wheels turning.

—Kelly Roach
Business Growth Strategist
www.KellyRoachCoaching.com

As a thirty-year entrepreneur, I love Diane Gardner's new book, *Stop Overpaying Your Taxes! 11 Ways Entrepreneurs Overpay and How to Stop It Now!*

I picked up tips from every single chapter. For example, do you know the five questions the IRS uses to determine if a meal is tax deductible?

Did you know as a sole proprietor you are not required to pay Social Security and Medicare tax on your child working for you until they are eighteen, or that you may avoid paying unemployment tax on your child working for you until they are twenty-one? These two tips, right here, would have saved me a boatload of cash, as my daughter worked for me from the time she was twelve to twenty-two.

This book is an easy read, chock-full of excellent tax-saving tips. Anyone who is self-employed should read it and keep it on their bookshelf as a valuable resource.

—Jean Kuhn
Author, *F-Ups: Franchisee Screw-Ups That Can Cost You Thousands*
www.JeanKuhn.com

Most tax books just tell you how to fill out tax forms. Diane Gardner's *Stop Overpaying Your Taxes!* gives you the savings you REALLY want. It's full of valuable strategies that will pay dividends every day. And if you're an entrepreneur or business owner like I am, it's information you NEED.

—Edward A. Lyon, JD

Author, *How to Beat Obamacare*

Stop Overpaying Your Taxes! shares real stories about real business professionals to give tangible, illustrative examples for each of the eleven ways entrepreneurs overpay their taxes.

Each chapter is devoted to one of the eleven ways. The book is written in plain language that is relatable in ways that other books or conversations with my own CPA haven't been for me. When my CPA mentioned some of these same topics a few years back, I know I had the deer-in-the-headlights look on my face and left her office nothing but confused. Perhaps my business wasn't mature enough. Perhaps the illustration used just didn't click for me. But this book pulled everything together.

Then the wheels in my mind started turning and the conversations with my spouse took place. He, too, has his own business (his an S Corp, mine an LLC), so there are many strategies that we can leverage for our respective businesses. We found ourselves making notes and preparing for some conversations with our CPA. I plan to bring this book along as a conversation starter for saving tax money in my own business as well as my spouse's business.

Entrepreneurs owe it to their businesses to read this book and then have the "talk" with their tax advisor. This book takes the scary out of taxes and makes the planning something to look forward to.

—Ruth Martin
Maplewood Virtual Assistance
www.MaplewoodVA.com

In a world seemingly filled with more hype and "quick-fix" books than ever, Diane's book, *Stop Overpaying Your Taxes!,* is not only easy to read and understand, but it is clearly written from a genuine place of serving and wanting to help other entrepreneurs and small business owners.

All too often small business owners throw their arms in the air when it comes to understanding their taxes and how to pay their fair share—but not a penny more! Diane is not only one of the most genuine people I've met, her book and all of her teachings are down-to-earth and just what is needed today in an ever-growing, complex business world.

I highly recommend reading this book and implementing what she recommends.

—Jim Palmer
Your Dream Business Coach
www.GetJimPalmer.com

Diane Gardner has written a clear and easy-to-understand tax guide for entrepreneurs. It's a must-read if you want to make sure you are taking advantage of all the legal tax deductions.

—Kathy Tagenel
President, Go-Givers International

I was very impressed with this book! I can see that the book as a whole will be valuable year-round.

I felt especially comfortable knowing that Diane goes the extra mile to keep up on all things IRS, and continues taking classes that keep her up-to-date so we know our taxes are being handled by the best in the business.

If something is there to save money for us, she will catch it.

—Kris Storey
Rathdrum, Idaho

Stop Overpaying Your Taxes!

11 Ways Entrepreneurs Overpay
and How to Stop It Now!

by Diane Gardner
EA, ATP, CTC

Biz Success Publishing
www.TaxCoach4You.com

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Diane Gardner / Biz Success Publishing
PO Box 1132
Rathdrum, Idaho 83858
(208) 687-0508
(800) 841-0212

Printed in the United States of America

ISBN: 978-0-9861008-0-2

Cover designed by Cynthia Kroetch of Express Graphics.
Interior graphic designed by Reece Montgomery.

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Foreword

The American Dream—Once You Grow It, This Is How to Keep It

I've spent many years as a practicing CPA honing my skills, working with businesses of all sizes, seeking out the top tax strategies, and coaching others to achieve maximum results. One thing I've noticed is no matter the size of the business, everyone is actively trying to get ahead. Young or old, experienced or just starting out, each person strives for a piece of the American Dream. Somewhere within each of us lies the belief that if we work hard, our wealth will grow and our results will pay off in the end.

Yet it takes more than working hard to grow your wealth. You must also know how to *keep* it. That's why I'm so excited about *Stop Overpaying Your Taxes!*

Diane Gardner, EA, CTC, is one of a select few tax professionals across the United States certified in the expertise of tax planning. In fact, there are fewer than 400 Certified Tax Coaches. Like her CTC peers, Diane has scoured the tax code, and she thoroughly examines her clients' income and business options to rescue every deduction, tax advantage, and credit possible.

In the pages of this book, you'll notice the emphasis on year-round proactive planning to ensure that business owners can utilize every available legal loophole and savings opportunity. You'll be guided through some of the most impactful ways to keep more of what you earn.

Did you know there's a way to do that? You'll understand more when you read the first chapter so you can learn the improvements a good plan can leave on your bank account.

Not all business advisors are the same! Be sure to thoroughly read Chapter 3, where you'll learn how to convert your tax advisor fees from a *cost of doing business* to an *investment*, complete with increased profits for your business.

Finally, Diane shares concise steps to build your own road map of what you should be doing in the next ninety days to gain control over your taxes and make a huge difference in your bottom line. And, along the way, she shares stories of how she's helped business owners keep as much as hundreds of thousands of dollars each year more!

Some readers of the book's early manuscript found it helpful to skip chapters and focus on the topics most meaningful to their businesses. Others enjoyed reading the book in its entirety because it stimulated their thinking about how they might apply what they'd learned to their own situation.

In any case, I hope each time you reread *Stop Overpaying Your Taxes!* you'll find something new and useful to help you work proactively to minimize your greatest expense and grow your wealth. As Diane and I like to say, "It's not how much you make that really matters, but how much you keep that brings you success."

—Dominique Molina,
CPA CTC
President, American Institute of Certified Tax Planners
San Diego, California

A Note from Diane

Dear Reader,

I’ve spent many years working with business owners and entrepreneurs as their accountant and trusted advisor. In my early years of being an accountant, I thought I was helping my clients by making sure they had good, solid financial records and accurate tax returns. I didn’t yet know about the tax-planning and -saving strategies that I’ve outlined for you in the following chapters.

Sadly I had been under the impression that income tax was paid on the net profit of a business, and that there wasn’t much that could be done about it. Tax-planning classes weren’t offered during my college career, nor was the subject even discussed—then or afterward in any of the continuing education classes I invested in each year.

As a young accountant, I often heard people make comments about tax planning being wrong somehow, or even bordering on illegal. I was confused myself as I didn’t know about legal tax-saving strategies.

That changed the day I saw an ad for proactive tax planning that guaranteed all strategies were IRS approved and court tested. That really caught my attention, since I had many clients who paid large amounts of income tax each year

I invested in the training program. This specialized training allowed me to become a Certified Tax Coach. Since then I’ve become part of the Certified Tax Coach community, which consists of about 400 Certified Tax Coaches across the United States.

The accountants who belong to this community are an elite group of accountants, in that *their primary focus is to reduce taxes* for each of their clients. Every month, they invest time in continuing education to learn more about legal tax-saving strategies.

Many of these accountants operate regular accounting practices where they prepare tax returns and offer bookkeeping and other accounting services. Some of them represent various financial services.

Certified Tax Coaches are located in most states. To my knowledge, I am the only Certified Tax Coach in Idaho. I offer tax-planning services to local business owners, plus technology has enabled me to assist business owners across the United States with their tax-planning needs.

When I'm able to work with a business owner and develop a customized plan to save them thousands of dollars in tax each year, I feel a genuine sense of accomplishment. More of a thrill, actually. I get excited helping families have greater means to invest in themselves.

Congratulations on taking the first step toward reducing your tax liability! I hope you enjoy reading about the tax strategies I've outlined on the upcoming pages. The stories are real, but names have been changed to protect people's confidentiality. I know you will benefit from their stories.

Please contact me if you have any questions or would like additional information. I'm always willing to chat for a few minutes with my readers. I look forward to hearing from you.

You can call me at (208) 687-0508 or (800) 841-0212. You can also e-mail me at Diane@TaxCoach4You.com if that is more convenient. Be sure to check out my Web site www.TaxCoach4You.com for weekly tax tips, blogs, videos, and other great information.

When you contact me, please request your free copy of my survey, “How Much Do You Know about Your Taxes?” Your answers may surprise you!

Now it’s time to buckle up and enjoy the ride! Happy reading!

Yours truly,

Diane Gardner

—Diane Gardner
EA, ATP, CTC

P.S. I would like to take a moment to thank a few people for their part in this book. First of all, I would like to thank my loving husband for his complete and total support throughout this project. Next I would like to say a special “thanks” to my business coaches: Dominique Molina, Ed Lyon, and Jim Palmer for their input and support over the last few years. I can’t forget to say a big “thank you” to Tammy Barley, editor, who has taken my manuscript and made it even better. You make me look good! I would be remiss if I didn’t mention my good friend and fellow author, Jeanne Hardt and all her wonderful support. Last, but not least, I would like to say “thank you” to God for blessing me with skills and talents that I would have never dreamed possible. The glory goes completely to Him!

Chapter 1

Tax Preparation, Tax Projections, or Tax Planning: Who's Really in Charge of Your Checkbook?

Recently I met with a new client. I'll call him Ron. Ron is a self-employed chiropractor. He was looking for an accountant who could help him with his income tax needs. He'd been working with a tax professional over the past couple of years but was struggling with the large amount of tax he seemed to owe each year.

In the course of our discussion, I looked at his last two years' tax returns. I saw the usual stuff—wages for his spouse, interest income, and business income. I also saw that he was itemizing his deductions, which means he was able to write off expenses such as property taxes, mortgage interest, and charitable contributions.

Ron has two children, so I saw some Child Care Credit and Child Tax Credit. All in all, this was a very normal looking tax return. But in my perusal of his tax return, I noticed something quite alarming. (More on that in just a moment.)

I continued to visit with Ron, and he told me he wasn't happy with his tax preparer because he always owed so much money at the end of the year. His business was growing consistently, and his profits were increasing as well. Ron had an in-house employee who handled all of his business bookkeeping needs, including payroll processing and the preparation of compliance items, such as payroll tax returns and sales tax returns.

After asking a few questions, I discovered that the only contact Ron had with his tax preparer was when he brought his tax information into the tax preparer's office at tax time each year. He was wondering why his tax preparer wasn't doing a better job of saving him money on his tax return.

I found myself thinking of dozens of similar conversations I've had with prospects and new clients. For some reason, the popular belief is that tax preparers have some sort of "magic wand" which they can simply wave over the pile of papers and tax forms, and have these forms miraculously align themselves into proper order and record themselves in the appropriate areas so as to give the taxpayer the best possible tax outcome.

In reality, there isn't much a tax professional can do at tax time with a stack of receipts or other financial documents, except to record them in the correct places of the tax return.

In the tax profession, we call this "looking in the rearview mirror." You are looking at the past (history), and your only choice is to record it correctly.

Now, back to Ron. It seems that Ron's prior tax preparer had offered to meet with him each fall, and had even offered to prepare a tax projection. Ron didn't think this was necessary. Plus he was concerned that he would be billed for some consultation time, and possibly even for additional hours to work up a tax projection.

I knew I had my work cut out to educate Ron. It was going to be a challenge to convince him of the importance of being proactive with his accounting records and tax information. It was going to be important for me to show him how tax planning can minimize the amount of tax paid each year.

So, I set out to educate Ron on the differences between tax preparation, tax projections, and tax planning.

Ron seemed surprised to learn that the **tax preparation** engagement only includes the actual recording of various financial numbers on the appropriate forms and lines of the tax return. It does not include cleaning up his QuickBooks file, identifying changes and corrections to be made in his QuickBooks, or even searching for missing deductions (though most tax professional do make it a habit to inquire as to common deductions that appear to be missing).

As we continued to work, I noticed that it appeared there were some potentially missing deductions on his prior tax returns.

I questioned him about the lack of auto and truck expenses. Ron explained that over the course of the year, he probably drove his vehicle about 10,000 miles, since he had two offices in neighboring towns. When asked if he kept a mileage log, I received a blank look and a side-to-side shake of the head.

I began to see the seriousness of Ron’s tax situation.

After we finished discussing the tax preparation items, I went on to explain how the preparation of a tax projection works and what it’s supposed to accomplish.

A **tax projection** is simply the analysis of two or three different tax scenarios.

Oftentimes, tax projections are prepared in the autumn as a means to estimate what the net profit of the business may be and the subsequent income tax liability that may be owed. The client can then make an informed decision as to the possible purchase of a piece of equipment, additional contributions to a retirement plan, or even additional deductions for things such as year-end bonuses for their staff or year-end charitable contributions. An adjustment may need to be made to the last estimated tax payment or two.

In addition, tax projections can be used to determine other possible scenarios, such as opening a second business location, adding additional product lines or staff, looking at a potentially different niche market, bringing in a business partner, and so on.

There are many valuable uses for tax projections, but mainly they look at particular scenarios and determine what would be the expected outcome if certain factors change.

I could see the light start to go on in Ron’s head. He began to grasp the importance of looking at his financial information from a tax standpoint and not just from a management or compliance viewpoint.

He then asked me to prepare a tax projection for his business so he could have a good estimate of how much tax he might owe for the current year. I agreed to assist him and wrapped up our meeting.

Immediately I sat down with his QuickBooks backup and began to print off some financial reports. I delved into the gross income, cost of sales, and overhead expenses for his business over the past three years.

Then I began the process of preparing a tax projection. Since it was already September, I only had to estimate the sales, cost of sales, and overhead expenses for four months—September to December. This was accomplished by referring to the prior years' financial reports and the information I'd gleaned from our conversation. I could see a pattern to the income and expenses in the last four months of each year.

Next, I prepared a "mock" or pretend tax return. This mock tax return utilized the information from his prior two years' tax returns, his current year estimated business income and expenses, and other information.

Armed with this information, I was able to calculate an estimated amount of tax that would be owed for both the federal tax return and the state tax return.

Estimated tax payments are commonly made by self-employed individuals. Business owners who don't receive payroll from their businesses don't have withholding paid in on their behalf like employees do. Therefore, they may need to pay their estimated tax liability in four payments throughout the year:

1. April 15
2. June 15
3. September 15
4. January 15

Estimated payments may also be required for business owners who have pass-through income from their businesses that is reported on a K-1 form, either from a Partnership or from an S Corporation.

The actual calculation of the payments is too technical for this discussion. For more information about this topic, be sure to contact your tax professional.

I then prepared adjusted estimated tax payments for the September 15 and January 15 payments and packaged up the information.

Do you remember earlier I'd noticed something alarming? The area that was the biggest concern to me was that it appeared Ron was utilizing an incorrect business entity type for his business, and it was costing him about $23,000 in income tax each year.

I knew something had to be done, and quickly!

So I did what any good tax coach would do. I called Ron and explained the need for a second consultation.

I was ready with my tax projections and had completed a tax analysis, which identified several areas in his business where it appeared he was overpaying his income tax.

Ron came into my office, and we spent the next hour going over his numbers. My goal was to make sure he really understood where the numbers were coming from and how much tax liability I had estimated he would owe for the current year.

Then I went on to explain the difference between tax preparation, tax projections (such as the ones I had just prepared), and true **tax planning**.

Business owners have two ways to put cash in their pockets: 1) a financial defense—the ability to spend less money, or 2) a financial offense—the ability to generate more sales and make more money.

For most people, spending less is easier than making more money.

The Government Accountability Office estimates that business owners overpay their taxes by $50 billion each year. This is shocking news! So, if taxes are your biggest expense, then it makes sense to concentrate your efforts where you spend the most.

Tax planning guarantees results. You can spend all sorts of time, energy, and money on promoting your business, but there are no guaranteed results. Or you can set up a retirement account and immediately see tax savings from this strategy.

These guaranteed results start with planning. You can't expect results if you don't invest in tax planning to begin with. Tax planning is an investment in the future of your business growth. (What would you do with an extra $5,000, $8,000, or even $10,000 each year? What about $30,000 or $50,000 each year? How could this money benefit your business or your family?)

Ron stated that he would like to use his tax savings each year to open a retirement account of some sort and start saving for his retirement, even though he still had quite a few years before retirement would become a reality.

Now that he was more knowledgeable about his finances and his tax situation, he agreed with the need to go to the next step. It was time to prepare a customized tax plan that would minimize his taxes legally—by using IRS-approved, court-tested strategies.

At this point it was time for me to dig in and go to work once again. At our next meeting, I presented Ron's customized tax plan to him. The tax savings identified in the plan were substantial. Ron was momentarily speechless! He then asked me why his prior tax preparer hadn't told him about these tax savings.

I reminded him of the differences of the three different engagements: tax preparation, tax projections, and tax planning.

Find a Certified Tax Coach to assist you with tax planning to help stop any overpayment of taxes on your tax returns. Don’t be an over-payer statistic!

Summary

- There isn’t much a tax-preparation professional can do with a stack of receipts at tax time except record them in the correct places of the tax return.
- **Tax preparation** records history—various financial numbers are recorded on the appropriate forms.
- A **tax projection** is the analysis of one or more tax scenarios.
- Tax projections are often used to calculate and/or adjust estimated tax payments.
- **Tax planning** is an investment in the future of your business growth.
- A tax analysis is the first step in the tax-planning process.
- Tax planning guarantees results year after year.
- Find a Certified Tax Coach to assist you with your tax-planning needs.

Chapter 2

Choosing the Wrong Business Structure Can Crumble Your Dreams and Cost You Money

I received a phone call from a potential new client. My staff set up an initial consultation so I could visit with Darlene and her husband, Jim, who were getting ready to start up a new business. I really like to meet with new business owners prior to them actually starting their businesses, because it gives me the opportunity to gather information and help them make the best decisions possible, which ultimately affects the future of their business success.

Darlene and Jim were starting a trucking company. They were in the middle of negotiations to purchase a truck, they had already set up all their Department of Transportation (DOT) identification numbers, and they had their insurance all lined up.

It was now time to meet with an accountant to determine what type of entity they should become. They wanted to know which entity type was best for them.

I was thankful they'd made the effort to get their information from a knowledgeable source. Too often people listen to rumors and other misconceptions from less-than-informed sources and ultimately make decisions that aren't based on complete and accurate information.

We spent a little time discussing the ramifications of the five choices for entity types.

1. Sole Proprietorship
2. Partnership
3. S Corporation
4. C Corporation
5. Limited Liability Company

(These terms will be capitalized throughout the book in order to clearly specify each entity type being discussed.)

Each entity type has legal, liability, and financial ramifications, in addition to the advantages and disadvantages of each type.

Business and/or personal liability protection can be provided by certain entity types. There may also be significant tax savings, and costs, depending on the industry type.

Prior to making this very important decision, all factors should be weighed carefully. I told Darlene and Jim to keep in mind the following.

- The wrong entity can cost you thousands of dollars in wasted tax.
- Without careful planning, your business may outgrow your entity type, leaving you with an entity that isn't working on your behalf.

It's very important to plan for the future when choosing your business entity type.

Next I began to describe each of the five entity types to Darlene and Jim.

1. Sole Proprietorship

This is probably the most common type of entity due to the fact that if you don't legally pursue one of the other entity types, you will operate as a sole proprietor.

Business Structure

A Sole Proprietorship is generally you doing business in your own name *or* using a trade name/DBA (doing business as).

It's quite common to see real estate agents, hair stylists, and people who work in the multi-level marketing world utilizing this type of entity and doing business in their own names.

With a Sole Proprietorship, you deposit your business income into a business bank account and pay your expenses from this same account.

One advantage of a Sole Proprietorship is the ease with which it can be formed. It's also the least expensive of the five entity types during the formation process.

A disadvantage of a Sole Proprietorship is the lack of business continuity. If something happens to you, the business is gone. There's no way for it to continue to operate in your absence.

Liability

A Sole Proprietorship doesn't have the benefits of liability protection. Therefore, you are personally liable for any claims against your business. If there is a lawsuit, personal assets may be used as a means to settle the lawsuit.

The only way to reduce your liability exposure is through the purchase of insurance, such as general liability insurance, an umbrella package, or even errors and omissions insurance coverage.

(Insurance is generally an inexpensive way to lessen the risk in any type of business entity, and is highly recommended.)

Taxes

At tax time, you will file a Schedule C—Profit or Loss from Business—which is a schedule that is attached to your personal tax return.

Another disadvantage of a Sole Proprietorship is in the area of taxes.

- **Income tax** is calculated on the net profit of the business. (Gross business income – business expenses = net profit.) If your net profit is $30,000 and you're in the 15% tax bracket, your federal income tax would be $4,500.
- Don't forget about state tax, if you live in a state that has income-tax rates.
- Net profit is also subject to **self-employment tax**, which is currently 15.3%. (Example: Net profit of $30,000 x 15.3% = $4,590 in self-employment tax.) So, if you are a sole proprietor, you would pay $4,500 in income tax plus $4,590 in self-employment tax, for a total of $9,090 in tax.
    - What is self-employment tax? As a sole proprietor, you are acting as both the employer and the employee for purposes of Social Security and Medicare taxes. When you're an employee, you have 7.65% withheld from your gross pay for Social Security and Medicare tax. Your employer matches this amount, which results in a total of 15.3%. This tax is remitted to the IRS on a regular basis and is reported on your W-2 form. The

employer receives a deduction for the 7.65% employer's share of the tax that is paid on your behalf.

- When you operate as a sole proprietor, you pay both parts of the Social Security and Medicare tax—15.3%—and it's reported on your personal tax return.

Audit Warning: The IRS really likes to audit active Sole Proprietorships netting over $100,000 in profit. This category of business is one of the most heavily audited groups.

Best Candidate(s)

The best candidate for operating as a Sole Proprietorship would be a small start-up business with low liability exposure. The reduced costs of start-up and administration make this an attractive type of business entity.

It's quite common for businesses to begin with this entity type and later find they've outgrown their entity. They realize their exposure to liability has increased and they're paying higher taxes. They also see an increase in their audit risk. Generally businesses will move away from this business structure once the business is established and profitable.

Darlene and Jim looked at each other and shook their heads. They'd had no idea about the risk of liability exposure they could be facing. Truck drivers carry a significant amount of potential liability exposure due to driving many miles each day and coming into contact with other drivers, bad weather, and other unforeseen scenarios.

2. Partnership

This entity type operates as an unincorporated entity in which multiple individuals manage the business. There are General Partnerships and Limited Partnerships.

Business Structure

In a **General Partnership**, partners equally share the work, responsibilities, and control of the business.

In a **Limited Partnership**, there is always at least one general partner and at least one limited partner. General partners equally share the work, responsibilities, and control of the business. The big difference is that the limited partners are not active participants but are chiefly investors.

Liability

Like Sole Proprietorships, Partnerships do not have any liability protection, and all general partners are liable for each partner's actions. Creditors usually go after the strongest partner to satisfy a debt, but they may pursue the partners individually as well.

In **Limited Partnerships**, the general partner(s) are responsible for any liabilities of the entity, but limited partners receive liability protection limited to their investment in the entity.

Taxes

Partnerships file an annual tax return, Form 1065, U.S. Return of Partnership Income. The business doesn't pay any tax because the income is passed through to the partners via a K-1 form. This form reports each partner's share of the income or loss, basis in the business, and allocation of Partnership debt. The figures from the K-1 form are reported on each partner's personal income tax return.

Each partner's basis consists of the amount of money or other assets contributed to the business plus the partner's share of profits less the partner's draws that have been taken. A partner's basis may also be increased by their share of debt owed by the partnership.

General partners are subject to self-employment tax on their share of the active business income. The net effect is very similar to that of a Sole Proprietorship as far as the amount of tax that is paid.

Limited partners typically are not subject to self-employment tax because they're not active participants in the business.

Darlene and Jim thought for a moment and decided to pass on this entity type as well, due to the unlimited liability exposure they would have and the amount of self-employment tax they could potentially pay.

Corporations (S Corporation and C Corporation)

Business Structure

Corporations are separate legal entities from their owners (shareholders) and must be treated as such.

The Corporation has the ability to continue in operation even if the main shareholder(s) leave the business. This allows the Corporation to have the ability to exist almost infinitely.

Individuals, Partnerships, Limited Liability Companies (LLCs), trusts, and so on can own shares in a Corporation. Most large businesses that need to attract investors are almost always Corporations.

Corporations require some additional paperwork in the formation process. I highly recommend meeting with an attorney to discuss and implement the appropriate paperwork. There are online corporate document filing services, but I usually see the best success when there has been a face-to-face meeting with an attorney. The owners develop a better understanding of the corporate record-keeping and tax-filing requirements when they’ve met with an attorney and have had the opportunity to get questions answered.

Liability

Corporations provide limited liability to their owners. If the Corporation is operated correctly, creditors generally can’t get beyond the corporate shield to get to the personal assets of the owners. This means the creditors would be limited to only the corporate assets.

An exception to this would be when corporate debt is required to be guaranteed personally. This is common when the Corporation is seeking financing of some sort. The bank or mortgage company may require the owners to guarantee the liability personally. This would allow the financing agency the ability to go after personal assets in the event the Corporation defaults on the loan.

An example of this is the purchase of a large piece of equipment, such as a truck. The financing company may require the officers to sign the loan documents and, in addition, then require the owners to guarantee the loan personally. If the Corporation defaults on the loan, the financing company may go after the personal assets of the owners to satisfy the obligation.

Taxes

Corporations file a Form 1120 or 1120S, U.S. Corporation Income Tax Return, depending on which type of Corporation is chosen.

Dividends issued to the owners are not deductible at the corporate level but are considered income to the owners. This is what is referred to as *double taxation*.

There are ways to generally get around the dividend issue by utilizing bonuses to the shareholders, increasing salaries, and the like. This allows some control of the net profit amount, and thereby the dividend amount, that may need to be reported.

Current corporate rates range from 15% to 39%. Corporations do not get the benefit of reduced capital gains rates like individuals receive. All gains are considered ordinary income and are taxed at the regular corporate tax rate. Generally, you don’t want to hold appreciating assets in a C Corporation since the potential tax rate is significantly higher than individual tax rates.

3. Corporations: S Corporation

Business Structure

S Corporations are limited to one hundred owners (shareholders) and have other important ownership restrictions. The owners must be U.S. persons.

Additionally, you must elect to be treated as an S Corporation, and there are deadlines for this election.

Not all states recognize the S Corporation classification, so be sure to check with a local professional.

Since S Corporation shareholders must be U.S. persons, typically Partnerships, Corporations, other S Corporations, Limited Liability Companies (LLCs), and most trusts are excluded as owners of an S Corporation.

Liability

Owners of S Corporations experience the same limited liability protection as the owners of C Corporations or Limited Liability Companies (LLCs).

Taxes

S Corporations file a Form 1120S U.S. Income Tax Return of an S Corporation. Much like a Partnership, the profits and losses flow through to the shareholders and are reported on a Form K-1 for each shareholder. The owners then report the profits and losses on their individual income tax returns, and the tax is then paid on the individual tax returns.

There is one major difference between a Partnership and an S Corporation when defining basis. In a Partnership, basis may include the debt of the Partnership. This isn’t true for S Corporations. Only the amounts loaned by the shareholders to the entity are included in basis. Loans from third parties, such as banks, are not included.

Shareholder basis affects the deductibility of losses. A shareholder must have sufficient basis to deduct the losses on their individual tax return. If they don’t have sufficient basis, the losses become suspended until such time as basis is restored.

One of the major advantages to an S Corporation is that corporate profits and distributions to the owners are not subject to self-employment taxes. This can result in significant tax savings on the owners' individual income tax returns.

To benefit from this tax savings, the IRS requires the owners to pay themselves a "reasonable" salary, which is subject to payroll taxes. The challenge is to determine what portion of the profits should be paid out as salary subject to the appropriate payroll taxes and what portion can be paid as a distribution, which is not subject to payroll taxes.

Remember our previous example of a business with a net profit of $30,000? Let's change our previous example to be an S Corporation with a net profit of $100,000. A reasonable salary must be paid to the owners, and payroll taxes must be withheld and paid. If that reasonable salary was in the $50,000 range, then there would be significant tax savings. Reasonable salary may vary depending on the industry type, hours worked, skill level of the owners, and so on.

By utilizing the S Corporation entity type, you can potentially save $7,650 ($50,000 x 15.3% = $7,650) in tax simply because the net profit of the Corporation is not subject to self-employment tax. This is a substantial tax savings, and this money can now be used for business growth, to pay down debt, or even to invest in retirement planning, among other things.

4. Corporations: C Corporation

Business Structure

C Corporations often have more than one hundred owners (shareholders). C Corporations are also separate legal entities from their owners.

Liability

Owners, or shareholders, of C Corporations experience the same limited liability protection as the owners, or shareholders, of S Corporations. This is one of the perks that make corporations attractive as an entity type.

Taxes

There is a primary difference between an S Corporation and a C Corporation in the areas of filing and paying taxes.

A C Corporation files its tax return and the tax is paid on that tax return at the corporate level.

Sometimes shareholders take additional money out of the corporation over and above their salaries. This transaction is considered to be a dividend to the shareholders. Each shareholder is required to pay tax on the dividends they receive.

The end result is the double taxation that you hear so much about: the corporation has paid tax on the business profits and the individual shareholders must pay tax on dividends.

Also, some businesses like to deduct fringe benefits, such as health insurance, long-term-care insurance, and medical expenses. C Corporations are generally the best entity for these types of write-offs.

Darlene and Jim weren’t sure if this was the best entity type for them or not. I quickly informed them that we still had one final entity type to discuss.

5. Limited Liability Company (LLC)

Business Structure

An LLC is the most flexible entity type of all the entity types.

You have a few choices when deciding to utilize an LLC. A business can be a single-member LLC or a multi-member LLC.

By default, a multi-member LLC is a General Partnership.

LLCs are formed under state law similar to S Corporations and are not available in every state.

They generally require upkeep and maintenance much like a Corporation, which varies from state to state.

Liability

A single-member LLC typically provides less liability protection than a multi-member LLC, as it is considered to be a disregarded entity. The courts generally have recognized a lower level of liability protection than with a multi-member LLC.

Taxes

A single-member LLC will file a Schedule C, Profit or Loss from Business, which is reported on the owner’s individual income tax return. It is a disregarded entity, which means it will be treated as a sole proprietor for tax purposes.

A multi-member LLC is required to file a separate tax return, apart from the tax returns of its owners. The default tax return will be a Partnership Tax Return, Form 1065.

The IRS allows a multi-member LLC to elect to be treated as an S Corporation or a C Corporation for income tax purposes. This may provide some tax savings and/or allow for the deduction of various types of fringe benefits.

Therefore, an LLC may be taxed and treated like a Sole Proprietorship (Schedule C), a Partnership (Form 1065), an S Corporation (Form 1120S), or a C Corporation (Form 1120). This often makes an LLC the entity of choice due to this flexibility. (Please check the rules in your state.)

If a business starts out as an LLC, later on it may elect to be taxed as an S Corporation or even a C Corporation. All changes can be done while keeping the same business name, tax identification number, bank accounts, and so on. The only thing that changes is the type of tax forms that are filed.

Darlene and Jim thought for a few minutes. A lot of information had been shared over the course of our consultation. After asking a few final questions, they made the decision to start their business as a multi-member LLC.

I thought their decision was a wise one, since we live in a very “LLC-friendly” state. The formation costs and the annual filing costs are minimal. This entity type will allow them the opportunity for growth as their business evolves over the years.

Choosing an entity type is a complex matter that should not be taken lightly. You should consult a qualified tax professional to make sure your business purpose fits with the entity type you choose. Making the mistake of a wrong entity type may cost you thousands of dollars in wasted tax. Therefore it's worth the investment in the future of your business to consult a tax professional.

Entity Comparison Guide				
Entity Type	**Limited Liability**	**How Taxed**	**Subject to Self-Employment Tax?**	**Fringe Benefits**
Sole Proprietor	No	Individual	Yes	Limited
Partnership	No	Individual	Yes	No
S Corp	Yes	Individual	On payroll	Limited
C Corp	Yes	Corp & Individual	On payroll	Yes
LLC	Yes	Corp or Individual	Depends on how taxed	May be limited

Summary

- The five entity types are Sole Proprietorship, Partnership, S Corporation, C Corporation, and Limited Liability Company (LLC).
- The wrong entity type can cost you thousands of dollars in wasted tax each year.
- **Sole Proprietorship** is the most common entity type due to the ease of formation.
- There is no liability protection outside of insurance for a business operating as a Sole Proprietorship or as a Partnership.
- Net profit is subject to the self-employment tax rate of 15.3% for Sole Proprietors and Partnerships.

- **Partnerships** allow multiple individuals to own and operate a business.
- Partnership income tax is paid at the partner level and is subject to self-employment tax.
- **Corporations** are separate legal entities from their owners (shareholders).
- Limited liability protection is provided by the corporate entity type.
- There are two types of Corporations: S Corporation and C Corporation.
- Additional paperwork is required during the formation of a Corporation, and additional record keeping is required during the life of the Corporation.
- Income tax for an **S Corporation** is paid at the shareholder level, while income tax for a **C Corporation** is paid at the corporate level.
- **Limited Liability Company (LLC)** offers several choices of entity types and tax filing.
- Choosing an entity type is a complex matter and should not be taken lightly.

About the Author

Diane Gardner, Your Tax Coach, is a Quilly Award recipient and the best-selling author of *Stand Apart* and *Why Didn't My CPA Tell Me That?* She's been working in the accounting field with small businesses since 1982. Diane is the founder of Adept Business Solutions and Tax Pro Solutions, which meet the needs of her clients by providing accounting and proactive tax-planning services.

Diane is a graduate of San Jose University where she majored in accounting. She is a licensed Enrolled Agent (EA), which allows her to prepare income tax returns and to represent taxpayers in all fifty states.

Diane is also a QuickBooks Pro advisor, an Accredited Tax Preparer (ATP), and a Certified Tax Coach (CTC). Certified Tax Coaches are an elite group of professionals who focus on helping businesses and individuals pay the least amount of tax that is legally possible.

Diane has worked hard to make her businesses stand apart from other accounting and tax professionals by specializing as a tax coach. Her personal goal is to make sure business owners are *not* overpaying their taxes, by utilizing proactive tax planning. Her clients generally realize an average tax savings between $5,000 and $50,000 per year.

Her clients also benefit from her knowledge of marketing, which she shares freely. She writes articles, presents seminars, and offers coaching services to her clients. In addition, she is the leader of the Business Breakthrough Mastermind Group, which meets in her hometown of Rathdrum, Idaho.

When Diane isn't busy working with business owners, she is a devoted wife, mother, and grandmother. Her toddler grandson, Braden, is a very important part of her life, and she is fortunate to be able to spend quite a bit of time with him.

This grandma has now learned more than she ever thought she would know about important things such as backhoes, excavators, front end loaders, and other pieces of heavy equipment. Much of her downtime is spent with a little boy digging in the dirt and making roads.

Diane is quite active in her church and serves on the board of the Twin Lakes Friends Camp, which offers summer camping programs for kids. She is also active in her community and in several local Chambers of Commerce.

For more information about any of the information Diane has presented, you may reach her by calling

(800) 841-0212

or

(208) 687-0508

or by going to her Web sites:

www.AdeptBusiness.biz

www.TaxCoach4You.com

You may also e-mail her at Diane@AdeptBusiness.biz or Diane@TaxCoach4You.com.

Diane receiving her Quilly award.

Diane at a book-signing event.

TAX COACH 4 YOU

Go to www.TaxCoach4You.com to claim your FREE "Stop Overpaying Your Taxes" bundle.

While you're there, you can sign up for "Tax Tip Tuesday" to get my weekly short tax tip e-mailed directly to you. You'll also receive my weekly tax-planning blog, which is filled with entertaining tax-planning articles.

Here's what a couple of my satisfied clients are saying about me:

"Diane Gardner helped position my company so that I will be saving about $45,000 in income taxes over the next three years! I didn't know how much tax I was overpaying until I had a tax plan prepared. Diane was wonderful in the way she laid out the various tax strategies, and her firm has been great throughout the implementation process. I will definitely recommend other pro-anglers and business owners to take the time to meet with Diane and her team. I'm confident she can save them money too!"

—Brandon Palaniuk
BMP Fishing
Hayden, Idaho

"My wife and I met with Diane to talk about our need for tax planning. She prepared a customized, written tax plan for our business. As a result of this plan, we anticipate saving about $40,000 a year in taxes. This is a huge savings for us. We can now take that money and invest it back into our business.

Diane suggested ideas that we had previously explored but we hadn't implemented them due to a lack of knowledge of how to do it. Thanks to Diane and her team, the implementation process has been quite simple and effortless on our part.

We would highly recommend tax planning with Diane and her team to small business owners everywhere!"

—Scot & Mary McCauley
R & S Machine Consultants
Hayden, Idaho

How Much Do You Know About Your Taxes?

Are You Confident You Are Getting Every Available Tax Break?

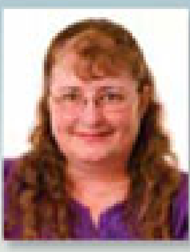
Is Your Tax Advisor Giving You Proactive Advice To Save You Tax?

Find the hidden business deductions within your business such as:

- Utilizing the correct entity type
- Industry specific write-offs
- Maximizing meals and entertainment write-offs
- Write off healthcare costs through your business
- Save for college and take a tax deduction
- Maximizing auto and truck deductions

The Government Accountability Office estimates that business owners overpay their taxes by <u>$50 billion</u> each year. This is shocking news! Most entrepreneurs overpay their taxes simply because they don't know all the various deductions that are available.

Finally, an easy to read book that will guide you through the maze of self-employed tax deductions.



Diane Gardner, Your Tax Coach, is a Quilly award recipient and a best-selling author who specializes in proactive tax planning for small businesses.

$14.95 Biz Success Publishing

STOP OVERPAYING YOUR TAXES

DIANE GARDNER, EA, CTC