



Transcript for Podcast Episode: 015

Small Businesses and Personal Taxes: Requirements and FAQs

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Michelle: We are Modern CPA. Our purpose is to provide valuable information to small business owners on our podcast, Profit Points. We discuss business how tos, give tax tips and dig into real life experiences in the crazy world of running your own business. If you find this podcast helpful, then like subscribe and follow us on social media.

Michelle: Hey, everyone, welcome to this episode of Profit Points. We are going to talk today about taxes and we've gotten questions from clients about will my small business affect my personal taxes? And we're going to go through what some of those requirements are for, you know, the different types of entities so that we can properly answer that for you on the podcast. And we would love it if you could like and subscribe to our YouTube channel and you can also find us on the web at ModernCPAOnline.com. And we have Shawn Cahill today with us. Hi, Shawn.

Shawn: Hi, Michelle. How are you doin'?

Michelle: Good, good. So we're going to talk about how small businesses affect personal taxes. One of the biggest things that I think people need to identify is what kind of entity they are; to determine what kind of taxes are going to be affecting their personal taxes.

Shawn: Yeah. Yeah. So yeah. The entity structure, the way your business is operating for tax purposes is really it's going to dictate how and what taxes you have on your personal tax return. So let's start with the pass through entities. So your, your, your company could be organized as an S-Corporation or partnership or an LLC, that is taxes, an s corporation or partnership. And for tax purposes, it's those entities that do not pay taxes at their level that the income and losses are passed out to you on a schedule you want to report on your personal income tax return. So that structure, it's as it says, it's passed through the income pass through, and you pay taxes on your personal tax return.

Michelle: So let's just really quickly kind of dove into the past and part of that just so people are kind of clear on what that means. If you're set up as a partnership or an S corporation, that entity does report a tax return. The income and all the expenses related to that business activity is reported on a tax return. The form will be dependent on what type of entity you are, but for this purpose, we can just simply say, you know, if a return is prepared, it's really an informational return. It goes to the IRS. That information is provided by the owners. Excuse me, I'm we're c today

the owners and that information goes to the IRS. And the net effect of that business activity is then reported on what this is called the Schedule K-1. And that information goes to the owners of the entity. So whether you have one owner or if you have multiple owners. Again, sorry, you know, the K-1 is then distributed out to report your portion of the activity. Right. Yeah. And then that's where the personal taxes come into play.

Shawn: Exactly. Exactly. And then, you know, wherever the company is organized or where it operates, well, you will have state and potentially city tax returns that also need to be prepared for those entities. And in most cases, the states and cities will follow the federal and it'll pass out. It will be a pass through as well. They will pay state or city taxes. There are some state and city taxes that are paid at the entity level like franchise taxes, certain net profits taxes in different cities. So you have to kind of understand or get some information on those particular states to identify how they're going to affect either business and then your personal taxes as well.

Michelle: Right. And so when we say taxes, we really mean income taxes that are being paid. Those would get paid. On the personal side, the entity still could have payroll taxes if there's employees. And again, the types of taxes that you had mentioned about franchise taxes, state taxes, net profit taxes, business privilege taxes.

Shawn: Yeah. In addition to that, your company may have sales tax that you may have to charge your customers and remit to the states and localities that you operate in, as well as potential use taxes on anything that you use within your business that could be subject to use tax. So those are, you know, those other types of taxes would be reportable to the entity itself and not to the owners. So, you know.

Michelle: Yeah.

Shawn: As far as personal taxes, then you're looking at basically your income taxes.

Michelle: Right. So if a S Corporate Partnership, net income is \$20,000 and there's two owners, then you're anticipating to receive K-1 that would be each \$10,000 and then that would be the income that is reportable to the personal on their personal taxes. We've had multiple conversations about the types of taxes that those K ones can produce, whether it's income taxes or self-employment taxes, depending on the structure of your business. You know, if you're operational, whether or not you are in a rental business, you know, something to that effect. So, you know, the types of taxes that that this income is subject to really is dependent upon that a couple factors.

Shawn: Right, exactly. So you have once you bring that income onto your personal tax return, that, you know, can be different buckets of income that are reported. And, you know, then you would analyze, see what what taxes you would be subject to. Generally, most of it's going to be income taxes. But, you know, if there's if there's capital gains that are passing out, you could be subject to a lower capital gains rate or, you know, other types of rates. And that's more rate differential than actual, you know, type of tax rate.

Michelle: So, you know, outside of an S Corp. or partnership that's considered the pass through, you also can be a sole proprietor or an LLC that's considered to be a type of sole proprietor. In the case of a sole proprietor or an LLC, that's a sole proprietor called Single Member LLC. Those would be directly reported on the person's personal income tax return on the appropriate schedule. Correct. I mean, you wouldn't have a K-1 in those instances. You would just have a sub schedule within your own personal tax return. You don't have to understand all of the intricacies of that, but I definitely want small business owners to be aware that what things are required of them, especially if they're talking to their tax professional. You know, are they expecting a second tax return, you know, an escort return or are they expecting a partnership return or is everything built into their personal return? And a really good example of a story that I have is an individual created an LLC single member reported this income on their personal tax return. They were a mental health therapist running their practice for the first time and were trying to make payments for business taxes with the IRS. But this was before they came to see me and we had a consultation with them and basically went through the process of what does it mean to be a single member LLC and how were they getting taxed? And then it made sense that she's not she wasn't paying business taxes, although she was paying taxes on her business operations. When she's reaching out to the IRS and saying, I got to pay these business taxes, they're going, I don't know what you're talking about even, do you have payroll that you need to be, you know, paying? You know, it was very confusing because the language is so important when it comes to this kind of stuff.

Shawn: Yeah. And it's all the more reason not to do it on your own. You have definitely to consult with your CPA to understand, you know, what has to be done and how it I mean, it's it's it's it's all different people. And people should understand. Yes, I have taxes. I have to pay on the income. That is my business first and then from there. Then we take it to the next step. How and where.

Michelle: Right.

Shawn: How we get those taxes paid and in what manner and form.

Michelle: Yeah, yeah, yeah. But it really was eye opening that she really wanted to do the right thing by making the payments or whatever, you know, amounts that she thought she had to pay. But the fact that she was very confused as to what to do. Right. What things would be required of her. And that made her really nervous. It made her nervous that either she was missing something or that she wasn't paying in enough based on the type of income that she had. And maybe she was afraid that she also wasn't paying the right tax. So it was sitting in an account, a business account, let's say, or a personal account that it shouldn't have been. And now the IRS is going, Well, where's my money? And she says, Well, I sent it to you, but I, you know, it went to the wrong place or it was applied to the wrong account, that kind of stuff.

Shawn: Yeah. And you know, if you start sending money to the IRS without.

Michelle: Without direction.

Shawn: Yeah. It could, did, could take a while to untangle and to get it right. And all the while, you know, penalties and interest could be adding up. And it just makes for a bad situation. So.

Michelle: Yeah, a very difficult time.

Shawn: Yeah. It's really and they're dealing with the IRS and their backlogs and that this time that we're dealing with it's it takes a long time to get anything done with them when there's issues. So yeah trying to avoid those issues can save you your time, money and definitely aggravation, stress and aggravation.

Michelle: I mean, most people are afraid of the IRS or I mean, states probably as well. But, you know, we get a lot with the IRS. They just do not want confrontation with the IRS. Now, that being said, when you're in business and you have multiple things going on, there's a chance that you are going to have issues with the IRS. Does not mean that they're bad. It does not mean that life is going to end as you know it. It just means that things have to be sorted out. And to be honest with you, you know, there are instances where something wasn't done properly, but there's instances where the IRS didn't do something on their end properly. So it's good to kind of take a step back, figure out the situation and realize that there are going to be instances where you're going to have communication with the IRS, that you're going to have to have you know, you're going to have to either respond to or have a professional response for you.

Shawn: Yeah, exactly. And that's it's you know, the first thing we always say, okay, don't don't don't freak out. Let's take one step at a time and identify what's happening. And, you know, we'll make up a plan of how to attack it and get it resolved. So. Right.

Michelle: So when you have activity, let's say operational activity coming through from the business S-Corp or pass through partnerships, the types of taxes that people can incur are, like you had said, are ordinary income taxes as well as potential capital gains taxes. And then there's also self-employment taxes that could be assessed on some of those types of income. When you are a sole proprietor and you are reporting operations like on a Schedule C, not a Schedule E, which is a rental, but Schedule C, which is business operations. That income is going to be subject to self-employment taxes as well. And those are pretty hefty. I mean, yeah, you're paying both pieces, the employer and the employee piece, because you're self-employed and you know, that's over 15%.

Shawn: Yeah. I mean, if it goes up to the Social Security wage limit or whatever that is, every year.

Michelle: It changes every year. Yeah, but.

Shawn: But you know. The first 140,000 plus could be subject to 15.3% in taxes right off the bat. And then on top of that, it's your ordinary income taxes that are added to that based on whatever your tax bracket is. So, you know, those taxes add up very quickly. Being a sole proprietor or if you're in a partnership that has, you know,

operational income and you're subject to self-employment income from that operation. So. Basically. So understanding these types of taxes and what it's going to look like for you personally, then you can plan as to how much you need to save to pay in estimates. Because as being self-employed or having self-employment income, you're not all on payroll. So you're not having those taxes withheld from your paycheck every week or.

Michelle: Two weeks, bi weekly or month. Yeah.

Shawn: So you have to pay those taxes on your own. So you have to be really diligent in putting money aside for those quarterly estimates for, you know, for feds, state and local or city.

Michelle: If that applies to you.

Shawn: So that's where, you know, proper planning ahead of time comes into play. And like I said, having that diligence to put that money aside really, really comes in becomes important because those penalties start adding up pretty quickly.

Michelle: Yeah. And it's really easy to get behind the eight ball on those and find yourself kind of digging a hole every year if you're not careful.

Shawn: Yeah, I mean, we see it. We see it all the time, you know, especially with new business owners getting behind in year one with taxes that they can't afford to pay the estimates for year two. And all of a sudden you're two, three years behind taxes. And, you know, it's a nightmare.

Michelle: It does. It does. I've seen it many times. And then you're kind of playing catch up with all the payments, you know, whether it's in an installment agreement or some sort of, you know, trying to pay down. So you have a year of heavy tax payments because you're trying to catch up from all the old years. So it's really important to have an understanding as to what these taxes are, to be aware that they're out there, first of all, and to know that, you know, it's not going to be as easy to calculate and it is going to require some diligence on your end to to save appropriately for those taxes. So Modern CPA Online has a Uplevel your Small Business IQ course that goes into detail about these taxes, how they affect your personal tax return depending on the type of entity you are. We give really good tutorials on what entities are what, you know, what kind of entity you want to be. And you know, after speaking with your attorney and then, you know, what kind of taxes are you looking at incurring with having that kind of structure? So, you know, we're suggesting people go to the course because it really does give a lot more details on what taxes are, how to calculate them. And, you know, the starting basis of what could be potential taxes for you. We suggest going to modernCPAonline.com and you will see under courses, Uplevel your Small Business IQ. Well Shawn, thank you for joining us today. Joining me today. I love seeing your face.

Shawn: Thanks Michelle.

Michelle: Yeah. And, you know, we hope that if people have some questions that they comment in our comment section below and follow and like us on YouTube. Take care, guys.

Shawn: Bye everyone.

Michelle: If you find this podcast helpful then like subscribe and follow us on social media.