

How to get ready for filing Sole Proprietorship and Sole Member LLC taxes

2021 Tax Year

How do you know what form to file or what to do?

- You must have received compensation or money for a service or product you have sold. Expenses are written off only if you received payment for services or products in the same year. If not, then you do nothing till next year or when you receive compensation for this new business.
- You file with your 1040 individual income tax return as a Schedule C business and list all income and expenses listed in this memo.
- Money withdrawn or transferred to personal use is not a taxable event and not a paycheck this is only a draw out of cash or bank account it does not affect your profit.

Sole Proprietorship or Sole Member LLC

Businesses often start out as a sole proprietorship simply because it is easier at the beginning. Unlike other business structures, no formal set up is involved. Sole proprietorships are viewed as pass-through entities because all business income and losses are reported on the business owner's personal tax return rather than on a separate business return.

Profits and losses are reported on Schedule C, which is submitted with Form 1040.

Following are specific rules that affect the taxation of sole proprietorships:

- All business profits are taxed, even if they are not withdrawn or have taken a draw from the business.
- There is no distinction between the personal assets of the owner and the business, so the business owner is personally liable for all business debts and liabilities.
- Subject to certain income and other restrictions, sole proprietors may be able to qualify for the 20% pass-through tax deduction mandated by the Tax Cut and Jobs Act of 2017 (the TCJA). This deduction is set to expire in 2025, however, unless it is extended by Congress.
- Unlike other business models, which are taxed at the company rate, sole proprietors are taxed at their individual rate.
- Business records must be kept separately from personal expenses. This is generally by a separate checking account away from personal checking account.
- Quarterly estimated taxes must be paid in lieu of income tax withholding. These are paid April 15th, June 15th, Sept 15th, and Jan 15 of the next year. Any payments after Jan 15th they will put into another year, and it will not count toward the current year tax estimates. These also would not be due the first year in business as you do not have a track record with the IRS with filing of a 1040 schedule C return. But you can put 20% of your profit into a bank savings to anticipate upcoming taxes.

- Self-employment taxes must be reported on Schedule SE, which is submitted with Form 1040 and paid when income taxes are paid.
- Sole proprietorships business may hire employees, but the sole proprietor is responsible for filing taxes and properly administering those employees on required forms for example 941, and state applicable forms.
- Sole proprietors may use independent contractors but must file 1099-NEC before Jan 31st of the following year for anyone paid more than \$600 in anyone year.

Once the business reaches a certain level of profitability, the business owner may choose to restructure the business. Doing so allows the owner to protect they're some of the personal assets. Usually, it also results in lower taxes.

Information you need to be prepared to provide/questions to answer when you file current year taxes.

- Did you start this business in 2021? When was your first sale for a service or a product?
- If a sole member LLC, you need to have and provide a copy of your operating agreement.
- If you had helpers, sub-contractors, or persons that provided a service for your business in 2021 that you paid more than \$600, you are required to send a 1099-NEC to them by 1-31-2022, and the fines are very large if you do not do this before the deadline.
- Did you have a separate bank account that all income and expenses were processed through?
- Does your business accept credit card for payments to you? Then you will receive a 1099-K that will show income received.

Note: Form 1099-K is issued by payment card processors and other third parties to their payees—and to the IRS. When a small firm or self-employed accepts credit cards, it uses a card processor to deposit the money, less its fees, in the business's financial account. The processor is responsible for collecting payment from the customer.

Starting in 2022, payment processors must issue 1099-Ks to anyone paid more than \$600 during the year (currently required only when 200 transactions totaling over \$20,000 are processed for anyone by the processor)—and to the IRS.

The new rule applies to gig economy firms such as Uber and Airbnb and to processors such as PayPal, VISA, and MasterCard.

The IRS estimates that about 80% of gig economy workers did not receive 1099-Ks under the old rules and so probably did not report those earnings to the IRS.

Many states have their own 1099-K requirements. Most match the federal ones and use copies of the federal 1099-K. But a few have their own filing thresholds and forms.

- What do your bookkeeping records look like? If you are waiting till the end of the year to have bookkeeping done, it may cost you a lot more than you can afford. As a small business you need to have a system in place to keep track of income and allowed expenses.



Please let us know if you would like our assistance with keeping track of this for you.

The only reason we are pushing these rules is because, if you do not do all the above items, then the IRS can deem you a hobby and your deductible expenses would be very limited.

Note: Also, if you have no income for your service or products you will not be able to deduct any of your expenses.

TIP: The best defense in case of an audit is a business checking account with all income consistently tracked. If you do not have one, make sure the method you use is substantiated beyond doubt. Using a bank account to track income is cheap, efficient, and essential if you want your business to grow.

What expenses can you deduct

Business expenses:

- Advertising
- Contracted Labor (if you send out 1099s)
- Health Insurance (you pay for)
- Legal/professional fees (if you send out 1099s)
- Rent and utilities on a separate office space
- Business licenses and permits
- Personal property taxes paid for business equipment
- Wages paid to employees that you filed 941s, 940, W-3, and W-2s for this current year
- Travel expenses for out-of-town work (lodging, airfare, car rental, or other).
- Small tools or equipment **under** \$2500 each item
- Larger tools or equipment **over** \$2500 each item (we need purchase receipt or contract) as these is depreciated over 5-7 years.
- Job material or supplies used in business
- Job waste material removal
- Purchases of items for resale
- Commissions paid (if you send out 1099s)
- Equipment lease or rental fees
- Liability or Workers' Comp. insurance
- Interest paid
- Equipment repairs and maintenance
- Sales taxes paid to city or state gov.
- Job permits and fees
- Other job cost(s)

Office expenses:

- Bank service fees
- Computer expenses
- Dues & subscriptions
- Gifts to clients (limited to \$25 each person per year)
- Gifts over \$25 a year may be promotional items
- Merchant fees or PayPal fees
- Internet expenses
- Uniforms or gear (**if job requires**)
- Telephone or Cellphone expense (not a family plan-only business phone). You do need separate telephone for your home line.
- Office supplies
- Dry cleaning or laundry (for uniforms)
- Postage expenses
- Printing or copy expenses
- Software
- Training, seminar, or education cost
- Website cost and hosting fees

We have a very good list of expenses for your specific business expenses, if you call and request it, that is more detailed.



- Meals are now only for business travel over 50 miles away or with a client in which you can document the who, what, when and why of the meeting. But require certain proof before you can deduct.

PayPal and credit card statement receipts insufficient as proof of expenses.

To prove your business meals, follow the two easy steps below:

1. Keep the receipt that shows the name of the restaurant, the number of people at the table, and an itemized list of food and drinks consumed. Take a picture and store it with your notes into your journal of expenses.
2. On the receipt, record the name or names of the person or persons with whom you had the meal and record the business reason for the meal.

If you charge a business meal to a credit card, the credit card statement provides your proof of payment. When possible, always pay by credit card or write a check so that you have clear proof of payment.

***Key point. Proof of payment is not proof of what you purchased, so in addition to proof of payment, keep the receipt with the notations as described earlier. With this combination of proof of payment and receipt with notations, you have what we call audit-proof documentation.

Make sure to document the meal deductions as we explained above. Without the right documentation, you not only lose the meal deductions, but you also become suspect to the IRS— and that can lead to a full-blown audit (often known also as misery).

Business Meal Rules

Rule 1. Your deductible business meals must be tax code Section 162 ordinary and necessary business expenses, and they must not be subject to disallowance under tax code Section 274.3 (Not to worry—we'll make this easy.)

Rule 2. Per IRS regulations, you may not deduct lavish or extravagant business meals. You are not likely to have this problem, regardless of what you spend. Here's why: • In its publication on entertainment expenses, the IRS states: "Meal expenses won't be disallowed merely because they are more than a fixed dollar amount or because the meals take place at deluxe restaurants, hotels, or resorts

Rule 3. You must be present at the business meal, and you must provide the business meal to a person with whom you could reasonably expect to engage or deal with in the active conduct of your business, such as a customer, client, supplier, employee, agent, partner, or professional advisor, whether established or prospective.

Remember, to qualify for the 100 percent deduction, you need a restaurant. The IRS recently provided definitions and examples of what is and is not a restaurant. A restaurant is "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises.

A restaurant that is **not "a business"** that primarily sells pre-packaged food or beverages not for immediate consumption," including, but not limited to, the following:

- Grocery stores
- Specialty food stores
- Beer, wine, or liquor stores
- Drug stores
- Convenience stores
- Newsstands
- Vending machines or kiosks

In general, the 50 percent limitation applies to business meals from the sources listed above.

For 2021 and 2022, Congress gave businesses large and small an incentive to buy business-meal food and beverages from restaurants, because such purchases are 100 percent deductible. Be sure every business meal you buy is from an IRS-approved restaurant location, which is a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether you consume the food or beverages on the business's premises.

This new rule is another reason to move away from deducting a per diem for your business travel meals. You'll almost always get larger tax deductions by deducting 100 percent of your actual restaurant expenses versus 50 percent of the per diem amount.

Eating facilities located on the employer's business premises are not "restaurants!"



Home office information we need

- We will need the square footage of the whole home and then just the square footage of your office. Can you provide a picture of your office space to make sure it is a qualified office space?
- We will need utilities for the year, any repairs or maintenance for the home, HOA fees paid, rent paid for the year, or your mortgage interest and property tax statements for the year. We will not use the figure if you give us an average of a monthly cost. We only can use actual expenses that you can document with receipts.



Questions to be answered

- Do you use your office regularly and exclusively for business use?
- Is this your principal place of business?
- Do you meet with clients or customers here in the normal course of business?

TIP: *If you have an office in your home that qualifies for a home office deduction, all your business-related mileage is deductible. But, if you have an office or regular place of business outside your home, you may not deduct commuting miles to and from work or to your first and from your last stop home.*

Vehicle Expenses



Your vehicle expenses are the greater of **mileage** or **actual** cost to run your vehicle; you can take one or the other, but not both. We will also need the make, model, and year of the vehicle and when you put it into service for your business.

Mileage must show total miles on vehicle and total business use miles this is needing daily odometer readings in a hand written log or an app you can get and use that shows personal and business miles.

Actual expenses:

- Fuel
- Insurance
- Oil changes
- Repairs and maintenance
- Other cost(s)
- Parking and tolls
- License and registration
- Interest on this vehicle
- Tires
- Cost of vehicle if purchased this year

TIP: *If you take depreciation for a vehicle, actual expenses are required for the life of the depreciation (5 years).*

Other ways to keep track of miles to show usage is your oil changes, repairs, or new tires. As they keep your odometer readings so you can use that for the beginning and a picture of your odometer reading last day of the year. Always remember proof is your ace to taking a business deduction.

What to do with your receipts for this year of 2021

Get a box of manila folders and mark them A-Z with one letter per folder. File all receipts in alphabetical order by vendor so, if needed, you can find them.

Label one folder "statements" for each bank account and each credit card. Place statements into them accordingly.

Make another set of manila folders marked A-Z, with one letter per folder, and file all invoices, contracts, or payment copies into these by customer name.

Your bookkeeping can be either on Excel, QuickBooks, or we can do it, but someone **must** do it as you do not want to be in business all year long and not be able to write off expenses or qualify for the business credit of 20%. Remember proof keeps you out of problem with IRS.

When you come in for taxes to be done, we do not want your box of receipts, because we will have to send it to the bookkeeping department first.



We are giving you an opportunity to get set up, so you can be free to do what you do best and leave the bookkeeping to us.

Until **February 28, 2022**, we will accept your 2021 box of receipts and bank statements for as low as \$95 a month (if you did not have this business all year it will be prorated). Or with a contract it is \$175.00 a Quarter.

Checklist of things to do:

Here is a short checklist of some tax-planning ideas. Review these ideas so you can identify anything you forgot for a business deductions for your tax return. You want business deductions because business deductions reduce both your income and your self-employment taxes.

- Eliminate the word “friend” from your vocabulary. From now on, these people are sources of business, so start talking business and asking for referrals over meals and beverages.
- Hire your children. This creates tax deductions for you, and it creates non-taxable or very low taxed income for the children. Also, wages paid by parents to children are exempt from payroll taxes, but they must be filed on a 941 and issue them W2’s at end of the year.
- Properly classify business expansion expenses as immediate tax deductions rather than depreciable, amortizable, or (ouch!) non-deductible capital costs.
- Correctly document and classify business meals that qualify for the 100 percent deduction rather than the 50 percent deduction.
- Correctly identify your maximum business miles, so you deduct the largest possible percentage of your vehicles. Apps are great tools if used.
- Qualify your office in your home as an administrative office.

Call 719-548-4924 now!

Annual bookkeeping during tax season starts at \$1200. However, when you have a signed, current engagement contract, to have us process bookkeeping on a monthly or quarterly basis, the fees can go down. So, consider hiring us for 2022 and staying current all year long.

Sincerely,



Kathy Bylkas, EA