

# TAX PREPARATION ESSENTIALS

FOR SMALL BUSINESSES

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FACILITATOR:

**Jason Raak, CPA**  
Tax Manager,  
Stockman Kast Ryan + Company



**719-667-3803**

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## ***About the facilitator...***

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### **Jason Raak, CPA**

**Tax Manager – Stockman Kast Ryan + Company**

Jason started his career in public accounting at Stockman Kast Ryan + CO in 2012. He provides tax consultation to clients from a variety of industries. He also specializes in the unique tax needs of the construction industry. Jason received a B.S. in Accounting from the University of Colorado Colorado Springs and is pursuing an M.S. in Taxation from Northeastern University.



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# Tax Prep Essentials for Small Businesses



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## Small Business Taxes

## What New Business Owners Need to Know About Federal Taxes

- Is it a Business or a Hobby?
- Selecting a Business Structure
- Employer Identification Number (EIN)
- Business Taxes
- Recordkeeping
- Small Business Publications



## Income Tax

Annual charge levied on both earned income (wages, salaries, commission) and unearned income (dividends, interest, rents).

- All businesses except partnerships must file an annual income tax return. Partnerships file an information return.
- The form you use depends on how your business is organized



## Income Tax - Deductions

Business expenses are the cost of carrying on a trade or business. These expenses are usually deductible if the business operates to make a profit.

### What Can I Deduct?

To be deductible, a business expense must be both ordinary and necessary.

- An **ordinary expense** is one that is common and accepted in your trade or business.
- A **necessary expense** is one that is helpful and appropriate for your trade or business. An expense does not have to be indispensable to be considered necessary.



## Income Tax - Deductions

It is important to separate business expenses from the following expenses:

- Cost of Goods Sold
- Capital Expenses
- Personal versus Business Expenses
- Business Use of Your Home
- Business Use of Your Car
- Other Types of Business Expenses



## Income Tax - Deductions

### Cost of Goods Sold

If your business manufactures products or purchases them for resale, you generally must value inventory at the beginning and end of each tax year to determine your cost of goods sold.

The cost of goods sold is deducted from your gross receipts to figure your gross profit for the year. If you include an expense in the cost of goods sold, you cannot deduct it again as a business expense.

Types of expenses to consider:

- The cost of products or raw materials, including freight
- Storage
- Direct labor costs (including contributions to pensions or annuity plans) for workers who produce the products
- Factory overhead



## Income Tax - Deductions

Under the uniform capitalization rules, you must capitalize the direct costs and part of the indirect costs for certain production or resale activities.

- Indirect costs include rent, interest, taxes, storage, purchasing, processing, repackaging, handling, and administrative costs.

This rule does not apply to personal property you acquire for resale if your average annual gross receipts (or those of your predecessor) for the preceding 3 tax years are not more than \$25 million.



## Income Tax -Deductions

### Capital Expenses

- You must capitalize, rather than deduct, some costs. These costs are a part of your investment in your business and are called capital expenses.
- Capital expenses are considered assets in your business. In general, there are three types of costs you capitalize:
  - Business start-up costs
  - Business assets
  - Improvements



## Income Tax - Deductions

- Employees' Pay**
  - You can generally deduct the pay you give your employees for the services they perform for your business.
- Retirement Plans**
  - Retirement plans are savings plans that offer you tax advantages to set aside money for your own, and your employees' retirement.
- Rent Expense**
  - Rent is any amount you pay for the use of property you do not own. In general, you can deduct rent as an expense only if the rent is for property you use in your trade or business. If you have or will receive equity in or title to the property, the rent is not deductible.
- Interest**
  - Business interest expense is an amount charged for the use of money you borrowed for business activities.
- Taxes**
  - You can deduct various federal, state, local, and foreign taxes directly attributable to your trade or business as business expenses.
- Insurance**
  - Generally, you can deduct the ordinary and necessary cost of insurance as a business expense, if it is for your trade, business, or profession.

## Income Tax

### When

2018 Filing Due Date (Tax Year 2017)	Form
January 31st	Form W-2 (electronic or mail)
March 15th	Form 1065 – Partnerships Form 1120S – S Corporations
April 17th	Form 1040 – Individuals Form 1041 – Trusts and Estates Form 1120 – C Corporations

### How

- Schedule C
- Schedule E
- Schedule F
- Form 1120S
- Form 1120C

## State Income/Franchise Tax

### What

#### Income Taxes

- Applied on a percentage basis to an organization's income in a state.

#### Franchise Taxes

- Applied based on revenue, income, or can be a flat fee.

### Who

#### Organization's doing "business" in a state

- Nexus and P.L. 86-272
- Economic Presence
- Registered Business

## State Income/Franchise Tax

### Why

Special rules apply to state income taxes to avoid people taking (too much) advantage of low-income tax states

### Where

Individual states have their own filing requirements. Most states require an annual form that includes much of the same information submitted for Federal purposes.

## State Income/Franchise Tax

### When

#### Typically annually

- Different states have varying due dates, and vary with the length of the extension permitted and whether or not Federal extensions are accepted

### How

Most states allow electronic filing for state income/franchise tax returns

## Sales Tax

### What

Taxes assessed and collected on the sales price

### Who

If your business will be selling, renting or leasing tangible personal property, you must get a Sales Tax Account / License and file sales tax returns.

- Colorado generally does not impose a state sales tax on services. Some Colorado home-rule cities (that collect their own local sales tax) charge a sales tax on certain services.

## Sales Tax

Filing frequency is determined by the amount of sales tax collected monthly.

### When

#### \$15 or less per month

- Sales tax returns may be filed *annually*.
- Annual returns are due January 20.

#### Under \$300 per month

- Sales tax returns may be filed *quarterly*.
- Jan - Mar: due Apr 20
- Apr - Jun: due Jul 20
- Jul - Sep: due Oct 20
- Oct - Dec: due Jan 20

#### \$300 or more per month

- sales tax returns must be filed *monthly*.
- Monthly returns are due the 20th day of month following reporting period.

## Sales Tax

### When

- Businesses that pay more than \$75,000 per year in state sales tax must pay by Electronic Funds Transfer (EFT).
  - EFT is due the 20th day of month following reporting period.
- Wholesale businesses with a sales tax liability of \$180 per year or less can file annually.

## Sales Tax - Deductions

Retail Sales Tax Return allows the following deductions from sales tax.

### How

- Service sales (sales that were exclusively for services, not tangible personal product)
- Sales to governmental agencies, religious or charitable organizations (these sales should be documented and records kept)
- Sales of gasoline
- Sales of drugs by prescription and prosthetic devices
- Trade-ins for taxable resale
- Bad debts charged-off, returned goods, trade discounts and allowances where tax as paid (cash discounts are not allowed)
- Cost of utilities, excluding tax (restaurants only)
- Sales of agricultural compounds and pesticides

Deductions taken on the "Other" line must include an explanation.

## Sales Tax - Exemptions

### How

- **Food, including food sold through vending machines** (See FYI Sales 4, Guidelines For Determining Sales Tax Rates For Taxable Food Items and FYI Sales 59, Vending Machines)
- **Machinery** (information available soon)
- **Farm Equipment** (See FYI Sales 75, Sales and Use Tax Exemption on Farm Equipment)
- **Sales of low-emitting vehicles** (See FYI Sales 91, State Sales and Use Tax Exemption for Low-Emitting Heavy Vehicles)
- **School related sales** (See FYI Sales 86, Sales Tax Exemption on School Related Items)

## Excise Tax

### What

Indirect tax on sale of particular good or service. Levied on the producer or merchant.

### Who

- Excise taxes you may have to pay if you do any of the following:
- Manufacture or sell certain products.
  - Operate certain kinds of businesses.
  - Use various kinds of equipment, facilities, or products.
  - Receive payment for certain services.

## Excise Tax

### How

**Form 720** - The federal excise taxes reported on Form 720, consist of several broad categories of taxes, including the following.

- Environmental taxes
- Communications and air transportation taxes
- Fuel taxes
- Tax on the first retail sale of heavy trucks, trailers, and tractors
- Manufacturers taxes on the sale or use of a variety of different articles

## Excise Tax

### When

### Summary Table of Due Dates for Excise Tax Payment & Filing of Form 720

Quarter	Due Date
1 <sup>st</sup> Quarter (Jan 1 – Mar 31)	April 30
2 <sup>nd</sup> Quarter (Apr 1 – Jun 30)	July 31
3 <sup>rd</sup> Quarter (July 1 – Sep 30)	Oct 31
4 <sup>th</sup> Quarter (Oct 1 – Dec 31)	Jan 31 (of the following year)

## Use Tax

### What

The Colorado use tax (same rate as state sales tax) should be collected by vendors who have no business location in the state but sell products in Colorado.

### Who

If you deliver into a special district that imposes a use tax, those special district taxes must be collected.



## Use Tax

### Why

The special district taxes for the Denver area Regional Transportation District (RTD), Cultural District (CD), and any Rural Transportation Authority (RTA) district taxes, as well as local taxes must also be collected, if applicable.

### Where

You will file the special district use taxes on the Retailer's Use Tax Return (DR 0173)

## Use Tax

### When

Filing frequency is determined by the amount of use tax collected monthly.

**\$15 or less per month:** use tax returns may be filed annually

**Under \$300 per month:** use tax returns may be filed quarterly

**\$300 or more per month:** use tax returns must be filed monthly

### How

The first time you file using the DR 0173, the Department of Revenue will set up a Retailer's Use Tax Account for you.

After the first filing, you may use Revenue Online to file all future retailer's use tax.

## Self -Employment Tax

### What

**Self-employment tax (SE tax)** is a social security and Medicare tax primarily for individuals who work for themselves. Your payments of SE tax contribute to your coverage under the social security system.

- Social security coverage provides you with retirement benefits, disability benefits, survivor benefits, and hospital insurance (Medicare) benefits.

### Who

Generally, you must pay SE tax and file Schedule SE (Form 1040) if the following applies.

- If your net earnings from self-employment were \$600 or more.

## Self -Employment Tax

### Why

Similar to the Social Security and Medicare taxes withheld from the pay of most wage earners.

### Where

Form 1040 - Schedule SE

## Self -Employment Tax

Figure your net profit or net loss from your business.

- You do this by subtracting your business expenses from your business income.
- If your expenses are less than your income, the difference is net profit and becomes part of your income on page 1 of Form 1040.
- If your expenses are more than your income, the difference is a net loss.

### How

Quarterly Estimates:

- April 15
- June 15
- September 15
- January 15

### When

## Payroll Tax

### Who

When you have employees, you as the employer have certain employment tax responsibilities that you must pay and forms you must file.

### What

Employment taxes include the following:

- Social security and Medicare taxes
- Federal income tax withholding
- Federal unemployment (FUTA) tax

## Payroll Tax

### Federal Income Tax

- Employers generally must withhold federal income tax from employees' wages.
  - To figure out how much tax to withhold, use the employee's Form W-4 and withholding tables described in Publication 15, Employer's Tax Guide.

### Social Security and Medicare Taxes

- Employers generally must withhold part of social security and Medicare taxes from employees' wages and you pay a matching amount yourself.
  - To figure out how much tax to withhold, use the employee's Form W-4 and the methods described in Publication 15, Employer's Tax Guide and Publication 15-A, Employer's Supplemental Tax Guide.

**You must deposit the wages you withhold.**

## Payroll Tax

### Federal Unemployment (FUTA) Tax

- Employers report and pay FUTA tax separately from Federal Income tax, and social security and Medicare taxes. You pay FUTA tax only from your own funds.
- Employees do not pay this tax or have it withheld from their pay.
  - Refer to Publication 15, Employer's Tax Guide and Publication 15-A, Employer's Supplemental Tax Guide for more information on FUTA tax.

## Payroll Tax

**Where**

Form 941  
Electronic Federal Tax Payment System (EFTPS)

**When**

Quarterly filing of Form 941.  
Deposits: Monthly or semi-weekly based on total tax liability reported on Form 941 for prior 4 quarters.

## Employer Responsibilities

The following list provides a brief summary of an employers' basic responsibilities. Because the individual circumstances for each employer can vary greatly, responsibilities for withholding, depositing and reporting employment taxes can differ.

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### Reporting to others

- 1099's
- K-1
- W-2

### Reporting from others

- 1099-K
- 1099 - MISC
- 1099- S
- Closing Statements

## 'Tis the Season!

**For Filing Taxes! Be prepared to provide you CPA with everything they need!**

- If you are a first time client, be ready to provide:
  - Copies of prior returns
  - Organizing documents
  - Employer ID Number
  - Financial statements
  - Detail for capital acquisitions
  - List of questions for your CPA
  - Follow-up questions





## Notices

### Read

- Each notice or letter contains a lot of valuable information, so it's very important that you read it carefully. If we changed your tax return, compare the information we provided in the notice or letter with the information in your original return.

### Respond

- If your notice or letter requires a response by a specific date, there are two main reasons you'll want to comply:
  - To minimize additional interest and penalty charges.
  - To preserve your appeal rights if you don't agree.

### Pay

- If you agree with the notice pay as much as you can, even if you can't pay the full amount you owe.

### Keep a copy of your notice or letter

- It's important to keep a copy of all notices or letters with your tax records. You may need these documents at a later date.

### Contact IRS

- Typically, you only need to contact the IRS if you don't agree with the information, if they requested additional information, or if you have a balance due.

## Unintended Tax Consequences

- Debt Financed Distributions
- Cancellation of Debt
- Passive Activity Losses
- Distributions in excess of basis
- At-Risk Limitations

## Additional Resources

IRS.GOV

Publication	Description
Publication 15	Publication 15, (Circular E), Employer's Tax Guide
Publication 334	Tax Guide for Small Business (For Individuals Who use Schedule C or C-EZ)
Publication 463	Travel, Entertainment, Gift and Car Expenses
Publication 505	Tax Withholding and Estimated Tax
Publication 531	Reporting Tip Income
Publication 535	Business Expenses
Publication 547	Casualties, Disasters and Thefts (Business and Nonbusiness)
Publication 560	Retirement Plans for Small Business (SEP, SIMPLE and Qualified Plans)
Publication 583	Starting a business and Keeping Records
Publication 587	Business Use of Your Home (Including Use by Day-Care Providers)
Publication 946	How to Depreciate Property
Publication 1635	Understanding Your Employer Identification Number (EIN)
Publication 1779	Independent Contractor or Employee

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**Danielle Gaffney**  
Tax Manager  
[dgaaffney@skrco.com](mailto:dgaaffney@skrco.com)

**Jason Raak**  
Tax Manager  
[jraak@skrco.com](mailto:jraak@skrco.com)





### Pikes Peak Small Business Development Center

559 E. Pikes Peak Ave., Suite 101, Colorado Springs, CO 80903

719-667-3803

[sbdc@elpasoco.com](mailto:sbdc@elpasoco.com)

[www.pikespeaksbdc.org](http://www.pikespeaksbdc.org)

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