Why Does Your Start-Up Need a CPA?

New Business Consulting

- Choosing the Right Business Entity
- Choosing the Right State of Formation
- Startup Expenses
- Accounting System Design/Implementation
- Business Tax Strategies

Choosing the Right Business Entity

Which is better, LLC or S-Corporation?

Is a regular C-Corporation a viable option because of tax-free fringe benefits to owners? What about future investors, the lower tax rate on qualified dividends, and making use of the graduated income tax rate schedule that taxes some corporate net income at only 15%?

Choosing the legal form of business involves consideration of many factors, including:

- Who the owners will be
- How each owner will contribute initially and as the business operates
- How items of taxable income, deduction, and tax credits are to be allocated among the owners
- Future owners – what type and when they will come on board
- Expected level of income
- Potential liabilities
- Type of income
- States in which the business will operate
- Self-Employment or FICA (Social Security / Medicare) taxes
- Business life cycle / time horizon, and exit strategy

State income taxes and other taxes, in many cases, can be a huge, even deciding, factor. An experienced new business tax consultant, such as San Diego CPA Michael Fitzsimmons, can help evaluate the choices to make the right decision.

The entity choice for a small business usually comes down to an LLC or S-Corporation because of tax benefits and liability protection. If liability protection is not a concern, a sole proprietorship or general partnership requires no formal creation and can avoid some taxes, such as California’s $800 minimum annual business income/franchise tax. Professional services businesses can use Limited Liability Partnerships (LLP) to protect one partner from another partner’s malpractice. Regular C-corporations can still be a good choice in the right circumstances.
The forms of business generally available in the United States are:

- **Unincorporated / No Liability Protection:**
  - Sole Proprietorship (Schedule C)
  - Partnership

- **Liability Protection, No Double-Tax:**
  - Limited Liability Company (LLC)
  - S-Corporation
  - Limited Partnership (LP)
  - Limited Liability Partnership (LLP)
  - Series Limited Partnership
  - Series LLC

- **Other Forms of "business":**
  - C-Corporation (regular corporation)
  - Trust – sometimes used as a business entity, but generally will be taxed as a corporation or partnership, not as a trust, if operating an ongoing business.
  - Joint Venture – this is not a business form or entity, but rather a term typically referring to a limited-term single-purpose business venture between two unrelated companies. These arrangements virtually always are taxed as partnerships.

### Choosing the Right State of Formation

In the United States of America, business entities are formed under the laws of one of the fifty states. Some states, such as Delaware and Nevada, are known for low taxes and otherwise business-friendly atmosphere. Some states have no personal income tax, and some have no business income tax. Some of those without business income tax, however, impose other business taxes instead, such as Washington’s Business & Occupations tax, Texas’ Margin Tax, Ohio’s Commercial Activity Tax, and the Michigan Business Tax.

While the choice of the state under whose laws a business entity is formed can impact tax savings, there is much misinformation on what tax savings can be achieved. An experienced new business tax consultant, such as San Diego CPA Michael Fitzsimmons, can help evaluate the choices to make the right decision.

### Startup Expenses

There is generally a misunderstanding of what expenditures are deductible before a business begins operations. For income tax purposes, most expenses are treated differently during the time before a business opens than during the time a business is operating. Most expenses that would ordinarily be deductible when paid are not deductible before the business begins offering products or services for sale. These expenses are called "start-up expenses" and are accumulated as an asset by the same name.

Once the business begins offering products or services for sale, the startup expenses asset is deducted as follows:

- Up to $5,000 of startup expenses are deducted upon starting business (unless total startup costs exceed $50,000)
The remaining expenses are deducted via amortization over 180 months (15 years) beginning in the first month products or services are offered for sale.

Startup expenses are all expenses paid or incurred before the business begins offering products or services for sale, except:

- Capital assets, such as equipment and real estate
- Interest
- Property and income taxes (except foreign personal property taxes)
- Research and experimental expenses deductible under Code Section 174

Capital assets are deducted over the time periods that vary from 5 years for computer equipment to 39 years for nonresidential real estate. The other expenses listed above are deductible in the year paid or incurred.

Two type of business startup expenses fall into their own categories and are accounted for separately from other startup expenses:

- The costs to form a legal entity, such as a new corporation or LLC, fall into a separate category called "Organizational Expenditures". These are subject to the same rules as startup expenses, and separate $5,000/$50,000 limits apply.
- The costs, such as commissions, to sell partnership interests, are a separate type of asset called "Partnership Syndication Expenses" and are not deductible until the partnership ceases business and is dissolved.

**Accounting System Design/Implementation**

Accounting is the language of business. It communicates to the owners and others the financial condition of the business and the results of operations. A well-designed accounting system can focus work on important activities, help reward exemplary performance, and tell an owner how well the business is performing, both overall and in specific areas.

The accounting system also plays a crucial role in saving income taxes because the way in which financial information is reported on tax returns starts with how it was recorded in the accounting system. Many tax strategies rely on accounting for transactions in a way that supports the tax position claimed. This not only helps save taxes up front, but also puts the company in a much stronger position if the IRS or other tax authorities choose to audit.

**Business Tax Strategies for Business Formation**

- Business
- S-Corporation
- Limited Liability Company (LLC)
- Corporation
- Partnerships
Let’s get started!