



LEGAL ASSISTANCE TO MICROENTERPRISES PROJECT (LAMP)

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It's Time to Pay the Piper! Tax Issues for Small Businesses

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Tax laws are vast and complicated; here are just the high points; you need to deepen your knowledge! Depending on how complicated your business is, you may need to hire a bookkeeper or an accountant.

I. Federal Tax Issues

1. What is an Employer Identification Number?

An Employer Identification Number (EIN) is a nine digit number issued by the Internal Revenue Service (IRS). It is needed by all employers, as well as partnerships, corporations, and some LLCs. If you are a sole proprietor or the sole member of an LLC which is not being taxed as a corporation **and** you have no employees, you can use your personal social security number (SSN) instead of an EIN.

2. How do I figure out the income or loss of my small business?:

You must file an annual federal tax return reporting your business income. The general formula for income tax is that you figure out your gross profit - all your receipts or sales, then you subtract your business expenses to find the net income or loss of your business.

3. What are deductible business expenses?

To be deductible, a business expense must be **ordinary and necessary** - something that is common in your type of business, trade or profession. If you have an expense that is partly for business and partly personal, you must separate the personal from the business part of the expense. Only the business part is deductible as a business expense

Some examples of expenses that may be deductible are: advertising, car and truck expenses, commissions and fees, conventions and trade shows, depreciation on property owned by the business, employee benefit programs, insurance, interest, legal, accounting

and other professional services, office expenses, rent, repairs to and maintenance of business premises and equipment, supplies, taxes and licenses, trade publications, travel, meals and entertainment, utilities and wages.

4. I have employees; does this have federal tax consequences?

Yes! You must withhold income taxes from your employees' paychecks; each employee should give you a signed form W-4 stating the withholding allowance. You must also withhold the employees' share of the social security tax and medicare tax from their pay.

As the employer, you are responsible for paying the employer's share of the social security tax and medicare tax. You must periodically deposit the withheld income tax and the employer's and employees' shares of the social security taxes at an authorized financial institution, usually a bank. If you have employees, it may be worthwhile to hire a payroll service to do this for you.

5. What is self-employment tax and how do I know if it applies to me?

Self-Employment tax must be paid on income you receive from actively working in your business - but not as an employee of that business. If you are a sole proprietor or partner, you must pay the federal self-employment tax in addition to regular income tax. The self-employment tax is equal to the employer's and employee's portion of the social security tax and the medicare taxes that you and your employer would pay on your compensation if you were paid as an employee. You may want to pay your taxes quarterly to avoid any penalties.

6. What about audits?

If the IRS feels your deductions are out of proportion to that normally seen for your type of business, you may be audited. To avoid any potential problems during an audit, you should be sure to keep good records of your expenses, and, it is advisable to separate your business from personal life through different bank accounts, record keeping, etc.

Auditors may try to determine whether: you failed to report all of your business sales or receipts; skimmed cash from the business; wrote off personal living costs - family travel, for example, as business expenses, failed to file payroll tax returns on time or make the required deposits, or improperly classified some workers as independent contractors rather than employees.

II. Texas State Taxes

1. What is the Texas Franchise Tax? Does it apply to me?

The Texas Franchise Tax is imposed on partnerships, corporations, limited liability companies, and some other business entities.

If the Texas Franchise Tax applies to your business, you must file an annual report, which is due every May 15. The tax rate is 4.5% on taxable earned surplus and .25% on taxable capital. If your revenues are over \$150,000, you should work with an accounting or tax professional to determine your tax due.

2. What about sales taxes? How do I know if I need to collect and remit sales tax?

Under Texas law, sales tax applies if you are selling or leasing tangible personal property. Some examples of tangible personal property are bicycles, clothing, shoes, toys, furniture, etc.

Under Texas law, sales tax applies if you are selling taxable services. Some examples of taxable services are: non-residential real property repair, restoration, or remodeling, shoe shining or repair, and dog grooming, appliance repair and furniture refurbishing or upholstering, laundry, dry cleaning, carpet cleaning, extermination and pest control, garbage and other waste collection or removal, janitorial and custodial services (including parking lot sweeping or cleaning), landscaping and lawn maintenance (including tree surgery and plant leasing), and surveying, developing photographs, producing artwork, printing, calligraphy, custom sewing or tailoring, catering, and assembling products such as toys, furniture, or equipment.

You should obtain a sales tax and use permit from the Texas Comptroller's Office and collect sales tax on applicable sales. The exceptions and rules regarding the collection and payment of sales tax and use tax are very complicated! You should check with the Texas Comptroller's Office to make sure you are complying with state law regarding the Texas Sales Tax.

The Comptroller's Office is generally responsive to requests for advice; be sure to get the advice in writing! You may be excused of tax, penalty, and interest charges that are due on a transaction if the Comptroller's office determines that you reasonably relied on written advice that was erroneous and were harmed by that reliance. For this relief to apply, a request for advice must be in writing, identify the taxpayer to whom the advice applies, and fully describe the facts and circumstances of the transaction.

3. I have employees; do I need to pay unemployment taxes?

The Texas Workforce Commission (TWC) Unemployment Tax must be paid if you pay \$1,500.00 in wages to an employee in a three month period, or have at least one part-time or full-time employee during twenty different weeks in a calendar year.

The TWC unemployment tax return must be filed by the end of the month each January, April, July, and October.

Employers must register with the TWC within 10 days of becoming subject to the Texas Unemployment Compensation Act, this can be done by contacting the TWC.

Employers subject to state unemployment tax are required to display a printed poster at each work site. This poster is provided by TWC and provides general information about filing a claim for unemployment benefits, Texas Payday Law requirements, and a schedule of the employer's paydays.

III. Local Taxes

1. What local taxes might affect my small business?

If your business owns tangible personal property (inventories, equipment, and machinery, such as copiers, computers, etc.) or real property, that is used to produce income, that property must be reported on a rendition form to your local county appraisal district between January 1 and March 31 each year.

For additional information, contact the local county appraisal district. See the government pages of your local telephone directory for telephone numbers.

Additional Resources:

Texas Comptroller's Office:

1-800-252-5555

http://window.state.tx.us/taxinfo/sales/new_business.html

Internal Revenue Service: information for small businesses

<http://www.irs.gov/businesses/small/index.html>

Texas Workforce Commission: information for employers

<http://www.twc.state.tx.us/customers/bemp/bemp.html>

Legal Assistance to Microenterprises Project (LAMP) provides free legal services for qualified low-income residents of the Texas RioGrande Legal Aid service area to start up or sustain a small business. LAMP provides useful legal advice and assistance on the laws that may affect proposed and existing businesses, including: formation, contracts, employment issues, tax, health and safety laws, commercial landlord/tenant leases, and lending laws. To complete an application, call toll-free: 1-888-988-9996 or 1-800-369-9270.