

BUSINESS TAX GUIDE

The issue of taxes is one of the most technical and heated issues in our society. Business owners face the challenges of understanding and complying with the variety of federal and state tax laws, many of which are not widely understood or understandable.

This guide should remove some of the mystery from this topic which is neither pleasant nor simple. However, it is important to note that these are only general guidelines. The tax law is highly technical and each individual situation has the potential to be different from the general rule. As a practical matter, there is no substitute for having a CPA or other competent tax adviser who is personally aware of your individual business situation.

REGISTRATION AND ID NUMBERS

Let us begin our discussion of your tax responsibilities with two simple rules:

1. **For tax purposes**, any owner of a non-incorporated business (proprietor, partner, or member is **not** considered an employee-whether the person worked in the business as an employee or not. These people are considered “self-employed.”
2. Do not forget rule one.

That sounds like a rather basic idea, but it (like much of the tax law) is difficult to grasp at first. It is vitally important to keep this in mind, because the rest of our discussion hinges on these two rules. That having been said, let’s talk about registering with the IRS and the Kansas tax authorities.

IRS

Every person and business subject to tax in the U.S. has at least one tax identification number. For individuals, this is your social security number. Sole proprietorships without employees also use the owner’s social security number, unless they are subject to federal pension or excise tax (such as the taxes on alcohol, tobacco, and firearms). These proprietorships and all other forms of business must obtain a separate tax identification number from the IRS. This is called an employer identification number or EIN. The EIN application is made on Form SS-4.

State of Kansas

The State of Kansas has a one-stop shopping approach to tax registration. Their “Business Tax Application” is really a set of registrations for every possible need: employer withholding, sales tax, excise taxes, etc. You may obtain one of these forms from the Department of Revenue’s web site or the KSBDC office and complete only the sections applicable to the taxes you will pay or collect. You will receive a tax number for each tax for which you have registered. To complete the application online go to: <https://www.accesskansas.org/businesscenter/index.html> and click on I’m a New User.

Enter an email address you would like to receive communications from and enter it under Non-Kansas.gov Subscribers and click Register. You will receive an email to continue the registration process to enter the website to complete your business tax registration.

INCOME TAXES

The decision on how the business is to be organized is probably the most important first decision you will make. It affects many things, including how you will report and pay taxes.

A sole proprietorship will report its activities and pay its tax on the personal tax return of the owner. This is done by attaching Schedule C to the owner's Form 1040. The owner includes all of the net profit from the business in his or her income, regardless of the amount taken from the business for personal use ("take-home pay"). This is because the business and the owner are the same "person" from a tax standpoint-the gains of the business are the gains of the owner.

A partnership is a tax reporting business form but not a tax paying one. The partnership reports, on Form 1065, a summary of its operations for the year. However, the partnership itself pays no income tax. The partnership's income and expense items are passed on to the partners according to the partnership agreement. Each partner includes his or her share of the income and expense items on the personal tax return and pays income tax according to his or her individual situation.

A corporation is a separate legal entity which both reports and pays income tax independent of its owners. Corporations report their activities and pay their tax on Form 1120. Generally, the only business-related items an individual stockholder would report on Form 1040 would be any salary or dividends paid to them by the corporation. Corporations which meet certain requirements may choose to be taxed similarly to a partnership under Subchapter S of the tax code ("S corporations"). S corporations file Form 1120S.

A newer form of business organization which is becoming popular is the limited liability company or LLC. Under new IRS regulations, LLC's may choose how they wish to be treated for income tax purposes-either as a partnership or a corporation. While LLC's generally choose to be taxed as partnerships, it may be better to be taxed as a corporation. Your CPA or tax adviser will be able to tell you which is best for you.

PAYROLL TAXES

Income Tax Withholding

You are required to obtain a Form W-4 for each employee to determine how much federal and state income tax to withhold from each paycheck. The amount of withholding will be different based on each employee's situation. IRS' Circular E has tables to help you figure the amount of federal withholding. The Kansas Department of Revenue publishes KW-100, a booklet which provides withholding tables for Kansas income taxes. Both the federal and state withholding tables are available on the Internet-the addresses are provided in the "Tax References" section.

Owners of non-incorporated businesses (and S corporation shareholders) make estimated tax payments throughout the year based on their expected income tax liability. Since the ultimate tax liability for these businesses is with the owner, it is his or her responsibility to make timely estimated tax deposits in sufficient amounts to avoid IRS penalties.

Social Security and Medicare Taxes (FICA)

Two more payroll taxes you will have to deal with if you have employees are the taxes to fund Social Security and Medicare. Sometimes these are referred to as FICA taxes (FICA stands for Federal Insurance Contributions Act, the law that established this tax). You may hear the Social Security portion referred to as OASDI tax (old-age, survivors, and disability insurance).

Social Security tax is collected on 12.4% of all wages to a maximum of \$102,000 (for 2008). Half of this amount, or 6.2%, is withheld from the employees pay and the other half is contributed out of pocket by the employer. Medicare tax is collected on 2.9% of all wages-again, half is paid by the employee and half by the employer. You are responsible for collecting all the tax due, reporting it on Form 941 and depositing it with the government.

Self-Employment (SE) Tax

The name of this tax is a little deceiving-to even think that the government would tax a person for being self-employed is unsettling to most people. In reality, this tax is the government's way of collecting FICA taxes from self-employed people. Remember, owners of non-incorporated businesses are not employees subject to withholding-as a result, no FICA taxes would be collected from them without the SE tax.

SE tax is collected on "net earnings from self-employment"-generally this is the net profit from the business. The tax is reported and collected on the owner's personal tax return. In fact, the SE tax is collected along with the income tax, which

means that you may need to provide for estimated SE tax payments as well as estimated income tax payments.

The tax is collected with the same percentages and income limits as the FICA taxes. The business owner pays both shares (the employee's and employer's share under FICA), or 12.4% (up to \$102,000, 2.9% above that). However, people subject to SE tax can deduct 1/2 of the SE tax paid on their Form 1040, which will reduce their federal income tax liability.

Unemployment Taxes

Federal (FUTA)

The federal unemployment tax is part of a federal/state partnership to provide unemployment compensation benefits. FUTA tax is different from FICA taxes in that employees do not pay any of the FUTA tax-the whole amount is paid by the employer.

FUTA tax is paid on the first \$7,000 of wages paid annually to each employee. The federal rate is 6.2%, but a credit of up to 5.4% is allowed for unemployment tax paid to the state. Therefore, most Kansas employers pay FUTA tax of 0.8%. FUTA tax is reported on Form 940.

State

The Kansas unemployment tax rate system is set up similarly to how a regular insurance company sets its premiums. Let's use the analogy of auto insurance. It is reasonable to say that the more accidents or traffic tickets a person has, the higher his or her premiums will be. Conversely, the fewer accidents or tickets, the lower the premiums.

For new businesses, the Kansas system charges 1% plus the average rate overall or 1% plus the average rate in the industry, whichever is more, of all wages up to \$8,000 per year per employee for the first three years. In the first three years, your rate will be at least 2%.

After the first three years, the rate fluctuates and depends on your "experience rating," which is directly affected by the number of unemployment claims the state has had to pay for your business. Here the analogy comes in: fewer claims mean a lower experience rating, more claims mean a higher experience rating. The maximum rate under law (the worst possible experience rating) is 5.4%.

TAX GLOSSARY

Employee-a person who works for a non-incorporated business who is not an owner of the business or any person who works for a corporation

Experience rating-the rate you pay in Kansas unemployment tax; based on the number of claims the system has paid on your behalf

FICA taxes-payroll taxes collected from employees and employers to support Social Security and Medicare

FUTA taxes-payroll taxes collected from employers to support federal unemployment compensation programs

Limited liability company-a newer business form which is a hybrid of a corporation and a partnership

Member-an owner of a limited liability company

Partner-an owner of a partnership

Proprietor-the owner of a sole proprietorship

S corporation-a corporation which meets certain requirements and has elected under Subchapter S of the tax code to be taxed as a partnership

Self-employed-a person who is an owner of any entity taxed as a proprietorship, partnership, or S corporation

Self-employment (SE) taxes-tax on self-employed people to support Social Security and Medicare

TAX REFERENCES

The Internet

The first step to working with either the IRS or the Kansas Department of Revenue on the Internet is to get Adobe Acrobat Reader. This is a free program which can be downloaded from the Internet. It is helpful to do this first because most of the forms and publications that you will want are posted in a format which can only be read by this software.

Adobe
Internal Revenue Service
Kansas Department of Revenue

<http://www.adobe.com>
<http://www.irs.ustreas.gov>
<http://www.ksrevenue.org/>

Forms and Publications

Can't keep all the forms and publications straight? Here's an easy one-stop list to all the forms and publications we talked about. These are all available on the IRS' or the KDOR's website.

Form SS-4	Application for Employer Identification Number
Form W-4	Employee's Withholding Allowance Certificate
Form 940	Employer's Annual Federal Unemployment (FUTA) Tax Return
Form 941	Employer's Quarterly Federal Tax Return
Form 1040	U.S. Individual Income Tax Return
Form 1040, Schedule C	Profit or Loss from Business (Sole Proprietorship)
Form 1065	U.S. Partnership Return of Income
Form 1120	U.S. Corporation Income Tax Return
Form 1120S	U.S. Income Tax Return for an S Corporation
Circular E	Employer's Tax Guide (also called Publication 15)
KW-100	Kansas version of Circular E
Business Tax Application	Kansas Withholding, Sales Tax, and Excise Tax Registration

More detailed information is contained in IRS Publication 334, "Tax Guide for Small Business."