What You Need to Know About Small Business Taxes

After many sleepless nights, months of planning, and years of hard work, you're finally ready ... it's time to take the leap and start your small business!

Now, we know tax payments are probably the last thing you want to think about right now but trust us — filing small business taxes for the first time doesn't have to be a nightmare. The sooner you start thinking about how to file small business taxes, the more time and money you'll be able to save.

Ready to learn how to file your taxes and maximize those small business tax deductions? Let's get started.

Step 1: Choose your small business structure.

One of the first decisions you need to make as a new small business owner is how you want to organize your business. Your legal business structure affects not only how your business operates, but also how you will pay your taxes.

Typically, small businesses fall under one of the following categories when filing taxes with the IRS.

Sole Proprietorship

A sole proprietorship is the most common business classification, and it consists of one owner who takes all the business's profits as personal income. As the owner of a sole proprietorship, you are personally responsible for any business debts because, in the eyes of the IRS, you and the company are the same entity.

The good news? This makes filing your taxes fairly straightforward! All you need to do is use Schedule C (Form 1040) to report your business expenses when filing your personal tax return.

Partnership

Partnerships are very similar to sole proprietorships. Essentially, the IRS taxes these businesses the same way; however, partnerships can have as many owners as necessary. All owners are still personally liable for any business debts.

A partnership is what is called a pass-through tax entity that reports profits and losses on Form 1065. The partnership does not pay income taxes but instead passes the tax liability to the partners. The partners receive a Schedule K-1 from the partnership to report their share of the profits and losses on their Form 1040 and pay the taxes.

C corporations (C corps)

A C corporation is a business with an unlimited number of owners called shareholders. Each shareholder owns a piece of the company and profits are distributed among them as dividends. If the owner of a corporation actively works for the corporation, the owner generally would receive a salary which would be reported on a W-2. The corporation would pay the employer's share of the social security and Medicare taxes as well as withhold taxes for the owner.

The IRS considers C corps and their shareholders as separate legal entities, which means the company is taxed on its profits and the shareholders are individually taxed when those profits are distributed. This is called a "double tax." While double taxation may sound unpleasant, a corporation does pose some benefits. For instance, a C corp isn't required to distribute all its profits to shareholders, and profits can be kept within the company to be used in other ways.

You may be thinking that C corps don't seem like a feasible option for a small business, and this can be especially true when you are first starting out. However, if you envision your business quickly outgrowing the startup stage and becoming a well-known company, this structure may be a solid choice for you down the road.

S corporations (S corps)

S corporations are similar to partnerships in terms of how they work. The S Corp profits and losses are reported on a Form 1120-S, but the S Corporation does not pay income taxes. The shareholders receive Schedule K-1 from the S Corp pay the income taxes on their personal Form 1040.

Limited liability companies (LLCs)

Your ability to structure your company as an LLC is dependent on what state you live in — each state has different LLC requirements and regulations. Unlike S corps, LLCs can have an unlimited number of members (shareholders), and each member owns a certain percentage of the company. The IRS also treats an LLC differently based on how many members it has. If you are the sole owner of a single-member LLC, you will be taxed the same way as a sole proprietorship. If you are part of a multiple-member LLC, you can choose if you want to be taxed as a partnership or a C corp.

Step 2: Understand your business taxes.

So, how much does a business pay in taxes? It's vital to understand what kind of taxes you will run into and how to adequately keep track of all your covered expenses to make sure you capitalize on those small business tax breaks. To help you out, we've listed some common taxes you might run into as a new small business owner.

1. Income Tax

We'll ease into things with income tax. In the business world, this is a tax on your business's profits. Unless your business is classified as a corporation, you file your business income tax with your personal tax return. Corporations pay income tax as well — remember that double tax we talked about — but the business files its own tax return in addition to the dividends that shareholders report on their personal tax returns.

2. Self-employment tax

If your business is classified as a sole proprietor, partnership, or LLC, you need to pay the self-employment tax. As a self-employed individual, your Medicare and Social Security contributions fall under this category. Since these taxes are not automatically withheld, it's crucial that you budget for this each year. To make things a little easier, the IRS generally requires you to make estimated tax payments every quarter, which we will cover in step 3.

3. Excise Tax

If your business deals with certain special products or services (some examples being tobacco, alcohol, or gambling) you may owe an excise tax. This tax is required regardless of your business structure. Excise tax is often built into the price of the goods or services you provide, but you still need to make sure to pass these taxes along to the IRS every quarter using Form 720.

4. Sales tax

Most states impose their own sales tax, so make sure you are familiar with your state and local tax laws. Like excise taxes, sales tax is often built into the price of the product and business owners are liable for sending these tax payments to the IRS.

5. Property tax

If your business involves a brick-and-mortar location, don't forget to factor in your property tax! This tax depends on regulations enacted by your city or county, so remember to brush up on your local laws to sufficiently budget for your small business property taxes.

Step 3: Keep good business tax records.

When does a small business have to pay taxes? And how much tax does a small business pay?

This is perhaps the most crucial step when it comes to making sure your business remains successful. Depending on your business structure and how you pay yourself from your business, you need to make sure you adequately budget for taxes.

If you own a sole proprietorship, partnership, or S corporation and you had tax liability for the prior year, you are responsible for making quarterly estimated tax payments to the IRS. To figure out how much estimated tax you will owe, you can use Form 1040-ES.

What kind of records do I need to keep for my small business tax return?

Keep small business receipts, invoices, bank statements, payroll records, fees, and any other documents relating to your income or potential tax credits and deductions.

The method you use for keeping good tax records is up to you. Just make sure you're diligent! Keeping organized tax records is essential when it comes to preparing your tax returns and avoiding any underpayment penalties. Records will help you obtain a clearer understanding of how your business is performing and keep better track of your deductible expenses — ultimately saving you more money.

Step 4: Take advantage of small business tax deductions.

It's time for everyone's favorite section … let's look at your small business tax deductions checklist.

Tax deductions for new businesses

Just starting out and not sure what kind of tax breaks your small business may qualify for? Here are some things to keep in mind.

- **Business startup deduction:** The IRS allows new business owners to deduct up to $5,000 of business startup costs and $5,000 of organizational costs. To qualify for this deduction, your startup costs need to total $50,000 or less. If you do not qualify for the deduction, your startup costs can be amortized over 15 years, meaning you deduct a fixed amount of the expenses each year.
- **Common startup expenses you may deduct:** Business insurance, real estate purchased for your business, any necessary business supplies, small business loan fees and professional fees, any business assets, and home office deductions.

Now you're starting to see why good record keeping is an essential part of owning a small business. Keep track of those receipts!

Tax deductions for existing businesses

If your business has been around for a while, you aren't out of luck when it comes to available tax breaks.

- **Qualified business income (QBI):** If you are self-employed, make sure you take full advantage of your QBI deduction. The IRS allows you to deduct up to 20% of your qualified business income, and you can take this deduction in addition to your standard or itemized deductions. To claim this deduction, use Form 1040.
- **Common business expenses you may deduct:** Property rent (as well as utilities and repairs), supplies or equipment purchased for your business, any business travel or vehicle expenses, business insurance costs, contract labor costs associated with independent contractors or freelancers, and wages paid to your employees.

Start your small business tax preparation

Now that you're well-versed in how to pay your small business taxes, it's time to put that newfound knowledge into practice. The best part? TaxAct® can help you file your small business taxes with ease.

Remember, your business structure is the key to determining how you will pay business taxes. Once you've determined your business structure, read up on your local tax laws and regulations to help you prepare an estimated tax budget. Don't forget to stay organized. Keeping detailed records will help you minimize your business taxes and maximize your tax savings.

With the proper planning and preparation, you'll be a small business tax pro in no time.

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