

U.S. Small Business Administration
Interview with Thomas Ochsenchlager

Ron Johnson: Owning a small business is a big responsibility. While many small business owners seek to improve their bottom line, few may realize how the current and new tax structure can help them do so.

Hi, I'm Ron Johnson with SBA's Your Small Business Resource. With me today is Thomas Ochsenchlager, vice president of Taxation for the American Institute of Certified Public Accountants. It is good to have you with us, Tom.

Thomas Ochsenchlager: Real good, thanks for letting me come on.

Ron Johnson: Tom, what are some of the things a small business owner can do to get their small businesses ready for tax season?

Thomas Ochsenchlager: Well, I guess the no-brainer is to get your books and records in order. You certainly do not want to be paying a professional to be sifting through a whole bunch of books and records you have in a shoebox or something. And you should be doing that all year round, not just when tax time comes around. The problem here, of course, is that small business people are in the business of whatever business they are in and a lot of times getting their own books and records in order is something they put in kind of the backburner because

they are more interested in making money in their day-to-day activities. So it is something they need to have in the front of their mind as they go through the year.

Ron Johnson: How about home-based businesses? What are some of the unique deductions or taxes pertaining to home-based businesses?

Thomas Ochenschlager: This gets a little tricky, Ron, but if you perform the essential functions of your business in your home, so let's say you bill all your clients out of your house, and in the end this is really important here, you have a place in the house that is dedicated to the business. The IRS takes a dim view if you do this in your family room and also have a TV there where you watch the Super Bowl or something.

So you should have an area that is dedicated to the business. And if you do, then you can take a proportional amount of expenses for the house based on the square footage of this dedicated space to the total square footage of the house. You can take that proportion of the expenditures of running a house. For instance, the maintenance on the house, roof repairs, but the utilities are probably the largest one, and that should pass IRS' muster as long as you fulfill those two requirements: it is an essential function and it is in a dedicated spot of the house.

Ron Johnson: If a husband and wife are joint owners of a business, how does this affect their taxes?

Thomas Ochsenschlager: Well, it affects it many different ways, Ron, depending on what type of entity you choose. As you know you can be a corporation, and even though there are two different types of corporation, a regular corporation and an S corporation. Or you can be a partnership and that takes the form sometimes of a partnership or what we call a limited liability company, which is generally taxed as a partnership. So depending on how you structure that, you get different results. But the bottom line is if both you and your spouse are active in the business, then you are either going to be withholding taxes if you are a corporation on the earned income from the business, or you are going to be preparing a self-employment tax form.

So for instance, if you are a partnership and the income of the business flows directly to you, it is not taxed at the entity level, then you will have the responsibility not only reporting the income for income tax purposes but also that same income for purposes of the self-employment tax. And if both you and your spouse are active, you will be paying two sets of each. Now, it can all appear on one 1040 return. You do not have to file separate returns.

But a conceivable advantage of being an S corporation as opposed to an S corporation is also a flow-through so all the income flows through to the owners of the corporation. In your example, it would be the husband and the wife. One slight advantage to that, and this is one of those situations you do not want to go too far, is that as an S corporation, not all the income that you receive from the S corporation is subject to self-employment tax. It is if you are a partnership, but not if you are an S corporation.

In an S corporation if you have a significant capital investment in the company, you can treat some of the income as coming as return of capital. So like if you are a manufacturing company, a small business but you are manufacturing and have a lot of investment in machinery, then part of the income can be considered to be exempt from self-employment tax because it is a return on your investment, if you will. It is kind of a tough decision when you lap over to that, and that is one of the reasons you probably want to pay a professional to work with you on that, at least on the initial tax returns.

Ron Johnson: What if you started a business in 2008 but have yet to earn income? Now, Tom, how does this impact the way you file your taxes for the new business?

Thomas Ochsenschlager: Well, again, it depends on the type of business, Ron, but generally speaking, the key thing to

remember here is that if you do not have any earned income from the business in the particular year, you may not get the deductions from the business. Let me flesh that out just a little bit.

The IRS has special rules, Congress passed statutes that forces the IRS to enforce these rules that deal with startup cost. And if at the end of the year you have maybe incurred some expenses to start the business, you know, legal cost and licensing and things of that nature, but you have not actually opened the doors to let customers in yet, then those deductions cannot be taken until such time as you actually are in a position to offer your services or your products to individuals, to your customers. So you do not get those deductions; you carry them over until the first year that you do open the doors, so to speak.

And then you can only take of those expenses that you incurred in that earlier year, the so-called startup expenses, you can only take \$5,000 in the first year. With the remainder, it is amortized or depreciated pro rata over the next 15 years. So if there is one thing to remember here, Ron, is that the key thing is get those doors open as quickly as possible so you put a cap on those expenditures and you get to start deducting them currently as you incur them.

Ron Johnson: Now, Tom, as we close, what are three of the most important points you find for small businesses?

Thomas Ochsenchlager: Well, for one thing, be sure and keep proper books and records. That is absolutely important especially if you come under examination by the IRS. But even if you are not, you want to make sure you have accurate books and records because, quite frankly, well, you know, just for your own personal interest, it will tell you how you are doing as a business. And if you do not have accurate records you really do not know if you are making money or not or if you have a reasonable profit margin.

Also, and I think it is super important particularly in the -- I think it is probably important in every year, but particularly the year in which you start a business, when you are getting started, to have a professional, ideally a CPA because I represent CPAs, but a CPA attorney or an enrolled agent that works with you in setting up the business and the books and records so that it is easier for you to maintain them. But also, that person is going to be a business advisor. In all likelihood, they do a lot of businesses like yours and they can give you a lot of good business tips as to what works and what does not. And make sure you are not paying any more tax than you have to.

And the other thing I would emphasize and we have not talked about in the interview is make sure you deposit your payroll taxes. So if you have got employees, or even if as I mentioned earlier if you and your spouse are the only employees, make sure you pay those payroll taxes currently because there is joint and several liability on payroll taxes. And if the company does not pay them, then the owners of the company are directly responsible. They have joint and several liability for it and the IRS does not mess around with that. They will slap a lien on your house and your family pets if you do not have those things paid.

Ron Johnson: Well, Thomas, it has been great having you on the program [cross-talking] --

Thomas Ochsenchlager: Well, Ron, thank you very much and thanks very much for including us in this. This is a good PR for us. I hope it is a win-win on both sides.

Ron Johnson: Our thanks to Thomas Ochsenchlager, vice president for Taxation for the American Institute of Certified Public Accountants for sharing tips to help small business owners prepare to file their 2008 taxes. You can learn more about all of our resources at www.sba.gov. Until next time, this is Ron Johnson with SBA's Small Business Resource.

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