ClientLine®

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PAYING YOURSELF AS A BUSINESS OWNER

Owning a business is challenging and hard work, so you'll want to compensate yourself appropriately. How you do that depends on the structure of your business.

SOLE PROPRIETORS (SOLE PROP)

As self-employed taxpayers, sole props aren't employees and aren't paid a salary. Therefore, when sole props need to take money from the business to pay themselves, they take draws.

Draws aren't taxed when they are taken. Instead, because a sole prop is a pass-through entity, all of the business's income is taxed on the owner's tax return using Schedule C. And self-employment tax will be calculated on Schedule SE.

PARTNERSHIPS

Like sole-props, partners in a partnership aren't employees. Profits from the business are distributed per the partnership agreement. These are called distributions or guaranteed payments.

Partnerships are another type of pass-through entity. Partners receive a Schedule K-1 that reports their share of the partnership's income. And partners pay income and self-employment tax on their individual tax returns similarly to sole props.

LIMITED LIABILITY COMPANIES (LLC)

If an LLC has only one owner, called a member, it's treated the same as a sole prop for tax purposes. If there are two or more members, it's treated as a partnership for tax purposes by default. Regardless of the number of members, any LLC can elect to be taxed as an S-corporation by filing Form 8832.

S-CORPORATIONS

As an S-corp owner, you are also an employee and will need to be paid a reasonable salary. What's considered reasonable depends on many factors including your industry, responsibilities and experience. This means the owner and the S-corp must submit payroll taxes. The owner reports these W-2 wages on their tax return, and the remaining business profit flows through to the owner's tax return via a Schedule K-1. However, since the IRS doesn't consider the owner of an S-corp to be self-employed, these earnings aren't subject to self-employment tax.

STATE TAXES

State income taxes vary so consult with your tax professional about how your company's profits will be taxed locally.

Tax Diversification in Retirement Planning

In the same way that you diversify your investments, you'll want tax diversification too. Tax diversification involves making decisions today based upon what you think tax rates will be in the future. This will help to minimize the total amount of tax you'll pay in retirement.

Choose the right tax vehicle for the correct tax purpose. For example, keeping dividend-paying stocks in a traditional IRA allows your account to grow quickly when you reinvest the dividends while you defer paying income tax.

Keeping growth stocks in your Roth IRA allows you to enjoy the appreciation tax-free when you make withdrawals after age 59 ½ and have held the Roth IRA for five years. All retirement planning should include cash invested in brokerage accounts to avoid paying early withdrawal penalties when you need money before retirement. Since you'll pay tax on earnings from your brokerage account each year, keep the funds invested in municipal bonds for generally tax-free interest.

MANAGING INFLATION RISK DURING YOUR RETIREMENT

Longer retirements mean inflation can put a serious dent in the best-laid plans. Most people factor in inflation when planning how much they will need when they reach retirement. But inflation does not stop the day you retire. In fact, your budget on the day you retire could look very different five, 10, or 20 years into retirement.

BE REALISTIC

It's important to set realistic expectations for both how long you may be in retirement and how much income you'll need. Designing a realistic budget that considers essential, discretionary and unexpected costs is a smart first step.

With that as a start, you can review the ways high inflation and low interest rates may affect total rates of return on your investments and your annual income.

WITHDRAWAL PLANNING

Maybe you'll try to address inflation risk on your own by withdrawing no more than 4% of an asset and then increasing the withdrawal by the rate of inflation each year. But as those withdrawals grow, they could represent a large piece of your retirement account over time. This can seriously erode funds.

Some fixed index annuities and index variable annuities offer potential income increases every year to help address the effects of inflation. These annual increases are available by purchasing optional riders for an additional charge.

CHOOSE TO DELAY

If you can delay applying for Social Security benefits until you're 70, consider doing so. Each year you put off collecting Social Security increases your annual payments 8%. This a cost-effective way to maximize your inflation-protected income.

As you think through your future expenses and how inflation may impact them, it's essential to manage expectations, be realistic and focus on what you can control. Working with your financial professional can help address longevity, inflation risk and rising health care costs in retirement.

Client PROFILE...

My business is located in Michigan, but I'm considering hiring remote employees who live in other states. How will this impact my payroll taxes?

You'll need to withhold federal payroll taxes just as you would for your in-state employees. But you'll also need to withhold state and possibly local payroll taxes in the state where your remote worker lives.

This will require you to register your business with that state's revenue department so you can follow their filing schedule and pay the tax on time. You'll also need to register your company with that state's unemployment department to pay unemployment tax.

It can get even more complicated. Now your company may also be subject to that state's sales tax laws. Each state has different rules for when you meet the minimum requirements of doing business there. And having an employee can be the trigger.

Similarly, having an employee in another state can trigger corporate income tax for your company.

Client Profile is based on a hypothetical situation.
The solutions we discuss may or may not be appropriate for you.

CONTROL CASH FLOW AND COSTS WITH JUST-IN-TIME INVENTORY MANAGEMENT

Holding small amounts of inventory with a Just-In-Time (JIT) inventory system can improve cash flow and create operating efficiencies.

FREE CASH

JIT involves ordering inventory for production and customer sales only when it's needed to produce goods, not before. When you no longer have to hold huge stockpiles of inventory, you free cash for other uses. And you'll reduce storage costs.

REDUCE WASTE

Because you're not making products in advance, there's no risk that you'll have a supply of finished goods that outweighs demand or have raw materials left unused.

SHORTER RUNS

When you're making products only when needed, it's easier to halt one product's production and switch to a different one to fill orders. With shorter production times, mistakes can be spotted quickly and corrected, resulting in fewer defects and waste.

STRONG SUPPLIERS

JIT systems are sensitive to disruptions in the supply chain. A single supplier with a machine breakdown or inability to secure raw materials can stall or shut down your manufacturing process.

LOSSES AND YOUR RENTAL PROPERTY

The general rule is that rental activity is passive, whichs limits the amount of losses you can claim on your tax return.

PASSIVE-LOSS LIMITS

Except for real estate professionals, most taxpayers will be limited on the amount of rental loss they can deduct from their tax return. The amount of passive loss you can deduct on your tax return is typically limited to the lesser amount of your investment that is at risk or your total passive income. You aren't allowed to offset passive losses against other income types (e.g., wages or capital gains). If you have excess losses, they can be carried forward to offset future passive income.

$25,000 EXCEPTION

The IRS allows an exception. If you participate in your rental activity and have an adjusted gross income (AGI) of less than $100,000, you may be able to deduct up to $25,000 of your loss from non-passive income sources. The deduction amount begins phasing out until it's completely eliminated when your AGI reaches $150,000.

Active participation involves significant and bona fide involvement like approving tenants and deciding on rental terms.

... Q&A

Q **Are cash or point rewards I earn from my credit card taxable?**

A The general rule is no, because the IRS reviews these as discounts on purchases you make. This is true whether you receive cashback, statement credits or airline miles.

There are exceptions. For example, if you receive a cash or points bonus simply by opening an account, it's taxable if there are no spending requirements attached.

Keep in mind that these rules also apply to bank accounts. If your bank gives you $500 for opening a savings account but doesn't attach any spending requirements, generally this will be considered taxable income.

Q **My business needs to buy some new machinery. Which is better for taxes – leasing or purchasing?**

A When you lease equipment for your business, generally you can deduct the lease payments as rent. But you'll need to make sure the lease isn't a disguised installment or conditional sale agreement, which would mean accounting for it as a purchase.

Purchasing equipment generally means you'll recover the cost through annual depreciation. This spreads the cost across the equipment's useful life. But now, through December 31, 2022, purchasing certain equipment will allow you to write off the entire cost in the year you start using the equipment.

ClientLine® SHORT BITS...

> INCREASED DONATIONS FROM DONOR-ADVISED FUNDS

According to the National Philanthropic Trust, charitable giving through donor-advised funds increased in 2020. The first half of 2020 saw a 78% increase in giving to human services organizations compared to 2019. And international charities, environmental and animal welfare groups, and educational institutions saw increases of 42 percent, 31 percent and 11 percent, respectively.

> CLOSING TIME

The IRS is closing ten lockbox addresses in San Francisco, CA and Hartford, CT that taxpayers use to make payments. The ten boxes are all associated with Bank of America and will cease operations on January 1, 2022. The post office will forward mail to new addresses in Louisville, KY and Cincinnati, OH through 2021. Starting January 1, 2022, payments sent to the closed addresses will be returned to the sender.

> WHO'S ONLINE?

In a Pew Research Center study, 7% of US adults say they don't use the internet. Nearly 25% of all adults ages 65 and older say they never go online and 14% of adults with a high school education or less never use the internet. There was no statistical difference between gender, race or community type.

> PANDEMIC RELOCATIONS

According to data from the U.S. Postal Service, relocations accelerated during 2020, with affordability being a driving factor. With the median home price in California reaching $700,000 in August 2020, moves from San Francisco to various cities in Texas increased 32.1%, and Miami saw a 49.4% increase in San Francisco transplants. About 135,000 more people left California in 2020 than moved in, with just 21,200 people moving to California between July 2019 and July 2020.