INSIGHT

A Complete Guide to Setting Up Your Business for Financial Success

Brought to you by

Lookahead Advisory & Grey Snow

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What to Expect from this Guide

Clarity

Understand entity types, tax deductions, financial concepts and more.

Confidence

Be confident that your tax deductions and accounting is accurate.

Resources

Templates and content you can continually refer back to again and again.

A Plan

You know where you want to get to financially, now you can create a plan on how to achieve it.

The Timeline

01

Read All Materials

Read through the eBook, review the templates and cheat sheets, and make notes on antyhing you need further clarificaiton on.

02

Write Business Plan

Write out your business plan specifics.

03

1st Consulting Meeting

We will review your business plan, discuss margins and financial literacy, and establish a weekly and monthly business cadence for your accounting tasks.

04

Financial Pro Forma

Fill out in detail your financial forecasting, budgeting, and cash flow spreadsheets

05

Month One of Bookkeeping

Complete your first month of bookkeeping in your chosen accounting system

06

2nd Consulting Meeting

Review spreadsheets and month-one of bookkeeping, plan for growth and discuss what that looks like and how your business & roles within business change, discuss business organization design.

01 Business Plan

What are we doing and why?

An important concept that many business owners (new and established) don't stop to clearly articulate is - what am I doing and why am I doing it? Those two questions should be driving every decision in your business, but so often people get so caught-up in the "doing of the things", they lose site of the bigger picture.

A good business plan is your bigger picture, and should be a consistent reference guide as you move forward and grow you business. Below are the components of a good business plan, and included in the PDF templates is an outline of one for you to fill out as well.

- **Mission Statement -** Statement of WHY an organization exists.
- **Vision -** What the company desires to achieve in the long-run.
- **Core Values -** Beliefs, principals, and philosophies that drive your company. Usually companies have at least 3-10.
- **Business Overview** - What service or product are you offering? Who's your target market? What "problem" is your service offering solving? How will your product or service be delivered?
- **Pricing Strategy -** How will your service or product be profitable? What are expenses associated with delivering the product or service, both direct and indirect. Is your pricing strategy similar or different from your competitors?
- **Advertising & Promotion -** What is your marketing strategy? What channels will you use? What will be "start-up" marketing costs verse "on-going" marketing costs?
- **Objectives -** What are some objectives you'd like to achieve and how will you measure them? What are obstacles you could encounter when pursuing your objectives?
- **Competitor Analysis -** Who's your competition? How are you similar? Different? How does your value-propisition set you apart?

02

Choosing your Business Entity

Advising on business entity types is one of the most-common areas of consultation we do. That's because selecting the correct entity type is critical to your financial success. In this section, we dive into each business entity type to help guide you on which is best for your specific situation.

02

Sole Proprietor

A sole proprietor is the most-simple type of business entity. It's because you literally don't have to do anything to become one, as soon as you start doing business and making money, congrats, you will file as a sole proprietor. As a sole proprietor, you can file under your social security number, or you can go to IRS.gov and get an EIN (free and instant!).

The tax form you will report income and associated expenses for with this type of business will be Schedule C (which is incorporated into your personal tax return filings annually) and WILL be subject to an additional level of tax known as self-employment tax. Unlike an LLC, as a sole proprietorship you have no LEGAL protections separating you from your business. So if you were sued in your course of business, they could come after your personal assets as well.

While this is fastest path to getting up and running, we rarely advise this form of operating structure (more on that below). Although there is nothing else you must do on the federal side, most state and local jurisdictions will have their own business registration and filing requirements.

02

LLC

Of all the legal entity types, the LLC is most misunderstood (short for Limited Liability *Company*). This is because an LLC is not a federal tax designation - it's a legal designation as a matter of state law. LLC owners are commonly referred to as "members" and shares of ownership referred to as "units" or "interests."

For tax purposes, an LLC elects a tax status and has the potential to be taxed as a Sole Proprietorship, C-Corporation, S-Corporation, or a Partnership. Depending on the ownership structure of your business, the IRS will deem a default tax status to your company if not specifically elected otherwise.

If you're the only member ("Single-Member LLC") and you form an LLC, your tax status will default to a Sole Proprietor. You can elect to for this entity to become a C-Corporation or S-Corporation and that will have it's own separate business entity filing requirement (Form 1120 or 1120S) apart from your personal return. Because a Sole Proprietor as defined in the previous section isn't a registered entity, it by itself can't make this same election.

02

LLC-cont.

If you form an LLC with a friend (or twenty!), you have formed by default for tax purposes a Partnership (Form 1065). This structure may also make the same election to change its tax status to a C-Corporation or S-Corporation. The flexibility of tax status "choice" generally leaves flexibility for future tax planning opportunities and is one of the many reasons the LLC is our preferred entity vehicle.

An LLC creates a legal veil between you and your business, so if your business gets sued, your personal assets are protected. You need to make sure not to “pierce the corporate veil,” meaning you need to keep a separate book of records for your business and not commingle the financial transactions of your business and personal activities. Failing to take these important measures runs the risk of opening you up to personal to liability (despite the LLC registration).

To become an LLC, you must go to your state’s Secretary of State website and fill out the proper filing paperwork there. You will also have to annually renew the business registration and pay the pertinent licensing fees to keep it active.

02

S-Corp

An S-Corporation is a TAX ELECTION, and to become one, you must make the election (Form 2553) with the IRS. You must be either incorporated (a state registered Corporation) or an LLC in order to make this election.

The S-Corporation can either be owned by one shareholder or up to 100 (must be domestic, non-foreign shareholders and, with a few exceptions, must be individuals, not other entities).

The tax form the S-Corp is filed on is called an 1120S. An S-Corp is a pass-through entity, meaning all the income/losses that happen within operations are not taxed at the entity level. The earnings of the Company are "passed-through" to the individual shareholders. Shareholders receive Form K-1 from the S-Corporation annually which shows their taxable share of income to be reported on their individual return. Some state and local jurisdictions assess tax at the entity level (For instance, in Oregon, a state-level "Corporate Activities Tax" is imposed on any business with over $1M in gross revenue).

02

S-Corp-cont.

You may have heard the reason to become an S-Corp is so you can save on self-employment taxes. Unlike a Sole Proprietor, 100% of your business earnings are not subject to self employment taxes.

The catch though, is that you have to pay yourself a reasonable wage for services performed to the S-Corp. This creates deductible wages and payroll taxes against Company profits, and the remaining net profit AFTER these deductions will only be taxed at ordinary income tax rates and not subject to self-employment taxes.

So yes, the S-Corp has some attractive tax saving opportunities, BUT there is an extra administrative burden that comes with it. You have to file a business entity return, you have to keep a separate record of books, and you have to run payroll.   Due to these added administrative burdens, a CONSISTENT annual net income around $75k/year is when I suggest you speak with a tax professional about whether it makes sense for you to consider becoming an S-Corp.

If you're well over that amount and know it's time to make that election, HERE is a video walking you through how to fill out the 2553 to make the S-Corp election.

02

Partnership

A partnership is a multi-member LLC, meaning that it is owned by multiple partners. If you form an LLC with more than one partner, you will automatically default to this designation for tax filing purposes.

Similar to an S-Corp, a partnership is considered a pass-through entity (Form 1065) for tax purposes, meaning that all the income and expenses are passed-down on the K-1 tax form to the partners depending on their ownership % and agreed-upon profit-loss allocation and reported on their personal returns.

Unlike an S-Corp, owners of a partnership do not run wages for themselves. Instead, they can receive what's called Guaranteed Payments for services provided to the Partnership.

These payments lower the partnership's net income and are reported on the receiving Partner's K-1 in a separate box, and are subject to self-employment taxes.

02

Partnership-cont.

Additionally, there are called General Partners who are actively involved with managing and running the Partnership. Their distributive share of income is also subject to self-employment tax as well as income tax (whether the income is actually distributed or not). If you're a Limited Partner (mean not actively involved in the running of the partnership), your distributive share of profit is not subject to self-employment taxes, only income taxes.

A good question to ask is why you would choose to have a partnership over an S-Corp. Simplicity can be one reason - a partnership is not technically a formal business structure. Just a handshake can get you going (although we HIGHLY advise having an attorney draft you a partnership agreement and register your Partnership as an LLC).

Because of the flexibly nature of partnerships - it can also be easier to add or remove partners. Essentially whatever you write up in your partnership agreement become the specific "rules" you are governed by.

02

Partnership-cont.

There are some downsides to having a partnership over an S-Corp too. One big one being personal asset protection. That means as a member of a partnership, should the partnership be sued, you as a member can be personally liable if money is owed.

One thing to keep in mind as well - you actually can have S-Corps be owners in a partnership. That means sometimes we have situations where a partnership is owned by two single-member S-Corps. The reason we do this is so we can have the flexibility of dividing income at the partnership-level, and then focus on the tax-savings at the individual S-Corp level.

Ultimately - there is no one-size-fits-all solution out there, which is why it's important to discuss entity-considerations with a CPA , so we can tailor our advice to your specific situation.

02

C-Corp

If you've ever heard the phrase "double taxation" in terms of business taxes, what they are talking about is the taxation that happens with a C-Corporation.

With a C-Corp, you can have an unlimited number of shareholders. That's important if you're trying to raise money. As a result, almost all publicly traded companies are C-Corps.

Unlike S-Corps and Partnerships, C-Corps are actually taxed at the entity level on net profits (this tax rate used to be 35% but was cut down to 21% federally). Then, when the shareholders are issued dividends (they are getting a cut of the company's profits), those dividends are taxed at capital gains rates (either 0%, 15% or 20% depending on your overall income level). So the earnings are being taxed twice, once at 21% and then again at the capital gains rate when the profits are removed from the company.

Generally speaking, forming a C-Corp for small and closely held businesses is not a suggestion we commonly make.

02

S-Corp v. Sole Properietor

This is a very common question - what are the legal and tax differences between an S-Corp and a Sole Properietor? The reason why you would choose to be a S-Corp over being a Sole Proprietor s because IF your income is high enough, you will save in self-employment taxes. The reason for this being, as an S-Corp, your full profit is not subject to self-employment tax, only the portion you pay yourself in wage (see more on that below).

But let's take one step back - an S-Corp is considered a separate filing entity, meaning it gets filed on a completely different tax form (called the 1120S) with a different due date (3/15) than you individual return (where you would file your sole-proprietor income/expense amounts on).

It's what's considered a "pass-through" entity, meaning outside of local taxes (and sometimes state excise taxes), all the income or loss is not taxed at the entity level, but flows to the owners and is taxed on the owner's person return (the form that reports these that's given to the owner by the business is called a "K-1" and is reported on the owner's Schedule E).

02

S-Corp v. Sole Properietor-cont.

It's important to note - it doesn't make financial-sense to elect to become an S-Corp until you reach a certain income threshold because there are added administrative costs. This means, you want your savings in self-employment taxes to be GREATER than the added administrative costs of creating a separate filing entity.

Here is ball-park of what those costs per annum (on the low end) of having an S-Corp:

Business Entity Return Prep: $2,000
Payroll Costs (you have to run a W-2 wage as an S-Corp owner): $600
Client Accounting Services for Books/Records: $3,000
Total yearly S-Corp administrative costs: $5,600
PLUS - you will be paying employer taxes on the W-2 wages you run for yourself.

This means, your self-employment tax savings needs to be GREATER than $9,600 before it makes sense to elect to become an S-Corp. From a yearly net-profit standpoint, this is why we advise you're making AT LEAST $75k in net profit on a multi-year basis FIRST.

02

S-Corp v. Sole Properietor -cont.

The next question that arises is - exactly HOW does the savings work?

As a Sole Proprietor, 100% of your net profits will be subject to both self-employment tax AND your regular income tax rate.

With an S-Corp, your net profits are only subject to your regular income tax rate.

Remember, you're also running a W-2 wage for yourself, so you're paying self-employment tax on that portion, not the net profit portion.

We've included two different PDF resources to help you understand when that difference happens. The first is a simple flow-chart to see if you're reaching the point where an S-Corp makes sense.

The second is an excel-sheet (with a video tutorial linked in the spreadsheet) where you can actually plug-in different net income levels and see how the tax savings flows down.

03

Setting up your Entity

Once you've decided what entity type is right for you, now it's time to make sure it's set up right! Depending on which entity type you select, all these steps may or may not be applicable to your situation.

Getting an EIN

An EIN is short for “Employer Identification Number”, and is a way for the IRS to identify you as a business for tax reporting purposes. As an LLC, S-Corp, Partnership or C-Corp you HAVE to have one. BUT GUESS WHAT, even as a sole proprietor you can get one! I highly recommend it since some companies or individuals you do business with will ask you to provide a W-9 that shows them what type of business you are, and an EIN allows you to provide that as your identification instead of your SSN if you are a sole proprietor. And the best news! It’s FAST (you will receive it immediately), ONLINE, and FREE. Go the IRS website HERE to get started!

03

LLC Filing

Now that you're fully apprised of what an LLC is and have decided it's the best business-structure for you, here's how to become one!

First, you need to go to your state's Secretary of State website and search to see if the name you want is available. If it is, go through the online steps of getting it setup.

If your state also requires a copy of the Operating Agreement, you'll need to create one of those as well. The really cool thing is that there are TONS of websites out there that will do this for you. You basically just enter in your information (state of incorporation, name and ownership of members, business address, LLC name, purpose of LLC, etc) and they will format and create the Operating Agreement for you.

Some states might have a different organization you need to file your Articles of Organization with, or they might have a different state agency where the documents need to be uploaded. SO CHECK WITH YOUR STATE, THIS DOCUMENT IS NOT GOSPEL.

And don't forget - you will have to renew your LLC filing yearly (your yearly filing fees will depend on your state). It's easiest to set it up on "auto-renew" if your state has that option. And if all this is overwhelming? Find a good business attorney to help :)

04

Taxes 101

Taxes cause a lot of uncertaity for most small-business owners, and with good reason. The tax code is vast, complex, and is one of the largest business-expenses you'll incur. This section is to provide clarity around self-employment taxes and help you understand the deductions and benefits you're entitled to as a small business owner.

Self-Employment Taxes

As a self-employed individual, you will be subject to self-employment taxes. As a reminder - these are folks who file a Schedule C (Profit & Loss from Business) on their tax return - NOT folks who are filing a Schedule E.

Self-employment taxes are taxes which fund the Social Security (12.4%) and Medicare (2.9%) programs. When you are a W-2 employee, these taxes are paid 50% by you and 50% by your employer, and are withheld from each paycheck. As a self-employed individual, these are taxes on your profit in addition to the taxes you will be on this income at your regular tax rate.

Let's do a very simplified example which doesn't take into account the 20% pass-through deduction (will discuss that below). You profit $1,000. Your self-employment tax would be $153. Assuming a 20% regular income tax rate, your federal tax would be $200. And then assuming a 9% state income tax rate, your state tax would be $90. That's a total tax liability of $443

But wait! You actually get to deduct the "employer" portion of the self-employment tax as a business expense. (Remember, this was the portion your employer would pay if you were a W-2, since you are technically your own employer, you get this deduction).

Self-Employment Taxes-cont.

The deductible part of the self-employment tax is 7.65% (half of the 15.3% total self-employment tax) which would be $76.50 of the $1,000 profit. So you new tax liability is now $443-$76.50 = $366.50, or an effective tax rate of 36.65%.

When you're planning for making your estimated payments, plan on setting aside at least 35% of your quarterly profit to make estimated payments.

On a side note - if you remember from the Tax Cuts and Jobs Act that was passed in 2018, there is a 20% extra business deduction off of net profit for determining your federal income taxes.

So in this example, when calculating our regular income tax rate, we would actually only use $800 as the net profit amount for determining what our regular federal income tax rate is. This is the important part though - this 20% extra business deduction DOES NOT reduce the profit from which your self-employment taxes are calculated. Your self-employment taxes are still calculated from the full $1,000.

04

Estimated Tax Payments

If you are self-employed, estimated tax payments are something you need to be aware of.

Essentially, the IRS wants you to pay your tax liability throughout the year instead of all-at-once when you file your taxes. The reason for this being, they need the money to keep the government running. When you're a W-2 employee, these payments are withheld from each paycheck you receive. When you're self-employed, the government wants you to voluntarily make these payments quarterly.

The due dates for quarterly estimated tax payments are as follows:
Q1: April 15 Q2: June 15 Q3: September 15 Q4: January 15 of the next yr

You might be wondering what happens if you don't make these - well, depending on your total tax liability, you could be charged an underpayment penalty of 3.398% of your underpayment amount.

So how do they determine if you're subject to the underpayment penalty? 1)If you owe more than $1,000 on your return 2) If you've paid less than 90% of the tax liability owed for the year 2) If you paid less than 100% of the prior year tax liability. To help you easily remember - please feel free to download and use the tax due-date resource guide as reference!

Deductions

What exactly qualifies as business a deductions? I will give you the famous accountant's answer - "It depends".

And the reason it depends, is because the IRS defines an acceptable business expense as something that is "ordinary and necessary" FOR YOUR BUSINESS AND INDUSTRY.

That means a hair stylist will have very different deductions than a plumber who will have very different deductions than a lawyer.

We can categorize expenses into two general categories - Cost of Goods Sold (Direct Costs) and Overhead Costs (Indirect Costs).

Cost of Goods Sold

Cost of Goods Sold are the DIRECT COSTS associated with you making income. Meaning if you don't spend money on these items, you can't provide the services or goods you sell.

For a hair stylist, this would be items like hair products, hair tools, hair chemicals, towels, etc. For someone selling sewed goods, this would be fabric, sewing tools, etc.

This also includes any direct labor you pay who helps you deliver your products or services.

Deductions-cont.

Overhead Costs

Overhead costs are expenses tied to running your business, but not direct expenses needed to deliver the goods or services.

Examples of overhead expenses are: Advertising, Bank Charges, Dues and Subscriptions, Auto Expenses, Office Supplies & Expenses, other Salaries & Wages, Rent, Travel Expense, Local Taxes, etc. If you take a look at the GL Spreadsheet, the first tab is set up to mirror what's reported on a Schedule C. That's a good example of common Overhead Costs.

Frequently Asked Questions

Q: Are the taxes I pay deductible?
A: Local income taxes are! State and federal taxes are not deductible expenses for your business. However, State income taxes are deductible on your Schedule A up to $10,000. Federal taxes are not deductible.

Q: Can I donate money to charities through my business and get a deduction?
A: While your business can certainly make the donation, the deduction is still taken as a personal deduction on your Schedule A, which is where you put your normal charitable giving totals. So any charitable contributions made will NOT lower your self-employment income on your Schedule C.

Deductions-cont.

Q Can I deduct clothes for my work?

A: Maybe. The IRS Publication that discusses this is 529. You must meet all three of the following requirements:

- The clothing is required or essential
- The clothing is distinctive or protective
- The clothes are not suitable for everyday wear outside of your job

For most of you reading this - you can easily see if you fall within these guidelines or not. Where the unchartered territory begins is with "Fashion Influencers" who's business and income is built around the clothes they wear. We have yet to have a tax-court case come down explicitly allowing or disallowing such deductions.

We are of the belief that you should deduct as many things as you can to the extent the law allows, but because of the gray-area, it's something that the IRS could come back and reject, or they could accept. In these cases we weigh the pros & cons of claiming the deduction.

Deductions-cont.

Q: Do I need to keep my receipts?

A: Yes and no. As an accountant, OF COURSE I'm going to advise you to keep records of all your business expense transactions. And since it's the 21st century, there are a lot of digital apps that allow you to take a picture from your phone, and they will all be stored for you electronically in the cloud so you don't need to worry about shoeboxes of receipts. Some apps that can do that are Quickbooks Online, Receipt Bank, Bill.com and Greenback to name a few...

The IRS says in Publication 463 IF the expense is under $75, you DON'T have to keep receipts or documents for meal, gift, travel (not including hotel costs), or entertainment expenses.

But there's a BIG caveat to this - you have to be able to show/prove the five following items in relation to the expense:

The Date the expense was incurred
The Amount of the expense
The Place where the expense occurred
The Business Purpose of the expense
The Business Relationship of who you were with

So, in my opinion, you should always keep records of receipts less than $75 because it will help you remember and document the five facts above.

Deductions-cont.

The IRS has resigned itself to the fact that most people won't keep paper-receipts, so if you forget to save them digitally, you also have some other record-keeping options for "proving" your business expense:

- Cancelled checks
- Bills
- Bank statements

Again, I stress you still need to be able to defend the expenses as business-related, regardless if they show up on a cancelled check, reciept, bank statement, etc.

The next natural question is - how long should I keep these records?

Three years is the minimum. In some circumstances there can be up to a six year requirement. What if you don't file a return, or file a fraudulent return? Keep those records indefinitely because the IRS audit-period for you will never close.

Health Insurance

Did you know as a self-employed individual, you may be able to write-off all your health insurance premiums?

There are a couple stipulations, but if you qualify, this is a GREAT deduction for you. This is because it's what's considered an "Above The Line" Deduction, meaning it's part of the calculation that determines what your AGI is (Adjusted Gross Income). The AGI is how they determine where phase-out hits for certain deductions or tax credits, so anything that lowers AGI is GOOD. Here are the rules:

- Eligibility is determined on a monthly basis, so you could be eligible for part of the year and not eligible for the other part.
- You and your spouse must not be eligible to participate in any employer sponsored plans.
- This deduction cannot exceed how much your net profit is in your business. So if you make $10,000 net profit in your business and your health premiums were $12,000, you'd only be able to take a $10,000 deduction.
- If you have employees and pay their premiums, those costs are 100% deductible regardless of the profit in your business.

Not too bad right? You can also deduct long-term care premiums, but these amounts have phase-outs and change yearly. And remember, anything you can't deduct for self-employment health insurance, you can always carry down and deduct on Schedule A under "medical expenses".

Retirement

If you're self-employed, it's a good idea to start exploring options for contributing to an Individual Retirement Account (IRA). Let's break down all the options so you can decide what's the best option for you.

SEP IRA

This is a VERY common one for self-employed individuals. It's for self-employed individuals who have no or just a few employees. You can contribute each year up to 25% of your compensation or NET self-employment earnings up to $57k (for 2020).

All these deductions are PRETAX - meaning they will lower your taxable income and AGI. These plans also cost less to maintain and there's no reporting rules to the IRS for them. You also don't have to contribute every year if you choose not to.

An important component of this retirement plan is contributions for employees - you have to contribute an equal % to their plan as you do to those. So if you contribute 20% to your fund, you also have to contribute 20% to their fund. For these plans, employees can't make contributions themselves, contributions are dependent solely on you as employer.

Retirement-cont.

SIMPLE IRA

This plan is more common with businesses with more employees (up to 100) and allows employees to contribute as well through salary deferral (up to $13,500 for 2020 and an additional contribution of $3k each year if you are 50 or older).

There's a catch though - employers must match up to 3% of employee compensation contributions OR do contributions that are fixed of 2% based on compensation for each employee (up to $285k in wage).

SIMPLE IRA distributions are taxed as income and will be taxed and additional 10% for early withdrawal (or a penalty of 25% if the withdrawal is made within the first two years of owning the SIMPLE IRA, so no rolling over into another account during this period).This plan will have more administrative costs and require more paperwork than the SEP IRA.

Traditional or Roth IRA

A Traditional IRA is a pre-taxed individual retirement account. If you have one of these, you are not required to set them up for your employees. You can also roll money from other IRA accounts from prior jobs into these as well.The 2020 limit if you are under 50 for 2020 is $6k

Retirement-cont.

The ROTH IRA is post-tax, meaning you don't get a deduction on your contributions, but you also don't have to pay tax on the account's earnings. If you are younger, IMO this option is preferable to the Traditional IRA IF you think your tax rate will be lower now than it will be when you retire. The only downside to a Roth is that there are income limits - so if you earn more than $139k in 2020, you will have to choose the Traditional IRA option instead.

SOLO 401k

For this plan - you can't have any employees (unless it's a spouse). This is similar to a SEP in terms of contribution limits of up to $57k (you can do an additional $6k contribution if you are over 50). If you choose this - these contributions are PRE-TAX so they lower your taxable income and AGI for that year, and distributions that are made (after you've hit the magical age of 59 ½) are taxed.

There is also an option to do a solo Roth 401(k). Again, these contributions are made post-tax, so you don't get any current tax deduction on them, but any earnings/distributions are tax-free.

Retirement-cont.

Unlike the Roth IRA, there are more rules around distributions. Even if you are 59 ½, the account must be in existence for 5 years before withdrawals are allowed. AND you are required to start taking distributions at 72 whether you want to or not. If these restrictions are too burdensome, you can roll your Roth 401k account over into a Roth IRA.

What Now?

You've chosen what plan is right for you - how do you set it up? I've found Fidelity.com makes it very easy for you to set up these plans when you decide which is right for you. I also recommend consulting a tax advisor that can walk you through the structures of these types of arrangements and make a recommendation of best fit for your situation.

Employees & Contractors

One HUGE mistake I see small business owners making is NOT understanding the difference between an employee and a contractor.

Naturally, people will gravitate towards classifying everyone as a contractor because it’s both less legal responsibility and cheaper since you don’t have to pay employer payroll taxes or take on the administrative burden.

Unfortunately, the IRS doesn’t let you just arbitrarily decide who’s an employee and who’s a contractor, there are rules. If they meet the following criteria - they most likely should be classified as an employee.

Behavior Control

- You control and direct the work the contractor performs
- You control when and where the work occurs
- There is a high degree of instruction and oversight
- There is some type of evaluation system in place to measure the employee’s work
- There is job training that is needed and/or provided.

Employees & Contractors

Financial Control

- You own the equipment that that contractor uses
- There aren't many reimbursed expenses (high usually indicates independent contractor)
- The services provided by your hired person are not available on-market to other businesses
- There is a guaranteed wage, not a flat fee for services provided

Relationship

- Employee-type benefits are provided (sick-leave, retirement, health insurance, PTO)
- There's a permanency to the relationship - it's not a one-off project but an on-going engagement
- The Services provided are a key-activity of the business.

Oh no - you have an employee that you need to start running payroll for - how do you do that? My FAVORITE platform for this is Gusto - it's very cost-effective, has a great and fluid onboarding process, can grow with you as your business grows, and has the ability to help with human resource issues and benefits. Additionally, if your use Quickbooks Online, they have a nice, inexpensive Payroll module that's embedded in QBO. So if you use QBO and want one-less place to navigate, that can be a great option for you.

Employees & Contractors

Now - what do you do if you determine that the person you're hiring is NOT an employee?

First - if you will be paying them over $600 in the calendar year, have them fill out a W-9. The W-9 gives you the information you need to issue them a 1099-NEC at the end of the year. GUSTO CAN ALSO DO THIS FOR YOU.

If you've never heard of the 1099-NEC, it's because it's a new form, it used to be part of the 1099-MISC but for 2020 they created a separate form for it.

One more note - you DO need to issue 1099-MISC on both RENTS and ATTORNEY COSTS over $600 you paid - so don't forget to give your landlords and attorney's W-9's as well!

Setting Up a Home Office

For whatever reason, the Home Office Deduction seems to have a lot of mystery and myths around it.

Fortunately, the IRS is very clear on the guidelines.

Your home office space must:

Be your principal place of business (you cannot work primarily from another office outside your home. Also, if you are a W-2 employee working for another company, this deduction is **not** allowed for you) AND...

The space within your home you must use REGULARLY and EXCLUSIVELY for work. What does that mean? You can't use a spare bedroom as both a guest room AND your "home office". You can't use the dining room table where you also have dinner as your "home office". What about one cushion of the living room couch? Also out of the question. The space can be as little or as big as you'd like it, but it must meet those two requirements.

There are also two different ways you can choose to take the deduction, the Regular Method, or the much easier Simplified Option.

Setting Up a Home Office-cont.

- The Simplified Option - A flat $5/square foot deduction per year. So if your home office space is 100 square feet, your home office deduction for the year would be $500.

- The Regular Method - With this method - you determine the actual expenses of your home office. Usually how this is calculated is taking total home expenses (rent/mortgage interest, property taxes, home insurance, utilities, depreciation) and allocate a proportional percentage of those costs to the home office. So you figure out what percent, based on square footage your home office is (say 10%), and multiply your total home costs by 10% to figure our your home office expense. (Tax softwares will do this calculation for you and only ask for totals).

The Simplified Option is easy-peasey, just take total office square footage and times by $5, and that's your deduction, while the Regular Method takes a little more work. What makes the Regular Method trickier is if you OWN the home where your home office is, because you have to figure out what the basis of your home is for depreciation. AND when you go to sell your home, you have to "recapture" the depreciation expense you took for the years you claimed the home office and pay a 25% tax rate on it.

Setting Up a Home Office-cont.

Let me show you how to do all this though.

To figure out your home basis, you need to know how much you purchased your home for, and have the latest property tax statement that was issued before you put your home office into “use”. On that statement, it will allocate value to property, and value to the building.

For simplicity sake, let’s say it’s allocating $100k to land and $150k to building. (side note - this total will usually not equal what you bought the house for, it’s just how your county is valuing your house and deciding how much to tax you). 40% of the total value of the property is to land, and 60% to the building.

Then, you take your purchase price of the house, and times it by the 40% to figure out your land value, and 60% to figure out your building value. Land does not get depreciated, but your total building value does. Since a home office is considered “commercial” use, the total value of the building will be depreciated over 39 years.

Let’s say after 5 years of having a home office, you decide to sell your home. You’ve taken over those 5 years $10,000 in depreciation expenses related to your home office. That $10,000 in depreciation expense you took will be taxed at 25%, so you’ll owe $2,500 in taxes when you sell your home.

Setting Up a Home Office-cont.

“What if I just don’t take depreciation expense even though I do the Regular Method?” you ask? Doesn’t matter. Even if you don’t actually take the depreciation expense, you STILL have to pay the recapture tax on it as if you HAD taken the depreciation. Lame right?

Another item to note . You can’t take a home office deduction in excess of income. So if you only made $1,000 after all your other income and expenses, your home office deduction can’t exceed $1,000.

BUT a cool feature of the Regular Method, any amount of deduction you can’t take this year, carries over to the next year and can be taken as a deduction then. So if you could only use $500 of your home office deduction out of $1,000, the excess $500 can be used in the following tax year if you have enough income to offset it.

One last side-note on establishing a home-office. You can unlock more mileage-deductions since technically anytime you leave your house for something work-related, those are work-related miles and are deductible. Let's say you also have an "outside office" where you work 1 or 2 days of the week, that mileage from your home office to your outside office is now deductible. Without your home office, you would not get that mileage deduction.

Meals & Entertainment

Meals & Entertainment are a deduction that are highly misunderstood.

First off - because of the Tax Cuts and Jobs Act that was passed in 2018, entertainment expenses are no longer deductible. Sorry about that. If you buy food at the entertainment venue (golf, concert, etc) that is still deductible.

Meals are still entitled to a 50% deduction, BUT, it must occur with a "person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective."

There are some other recent changes to the meal deduction as well as of 2018. Keeping food on-site for employees is "fringe" benefit, and is only 50% deductible. So if you're stocking up the company fridge or snack cupboard, those costs are only 50% deductible.

Meals & Entertainment -cont

Some meal costs that are still fully deductible - these include:

- Expenses treated as compensation(meaning you pay payroll taxes and it's included as part of employee's wage)
- If the items are also available to the public (something visitors and clients could also have)
- Items purchased that are resold to the public or employees
- Food & beverage expenses related to employee activities (ie employee BBQ,holiday party, etc that is open to all employees)

And remember - as always, it's a good idea to keep documentation and record who you ate with, and what the business purpose of the meal was.

Travel Expenses: Mixing Business & Pleasure

If you have to travel for business and would also like to enjoy some personal activities or bring your family with you - these are the guidelines to follow to make sure your travel expenses are legitimate tax deductions.

- Make sure before you travel, the business purpose of the trip is already set. That means the conference is books, or if you're running appointments, those appointments are set and you have documented evidence of that. You need to leave your tax home. Your "tax home" is the main place/city/area you normally do business in.
- The PRIMARY purpose of the trip must be for business reasons. If your family is traveling with you - don't try and deduct their expenses. (if you share a hotel room, make sure you are expensing ONLY the cost you would have incurred had you not been traveling with them)
- Days where you aren't working - expenses incurred for those days are not deductible except...
- Days that are travel days (meaning traveling to and from destination) count as FULLY DEDUCTIBLE business days
- Don't try and expense anything lavish and extravagant in nature (ie don't spend $500 on dinner every night of your trip).
- Food is deductible - but only at 50% UNLESS you get food from a restuarant, for 2021 and 2022 it's 100% deductible.

Travel Expenses: Mixing Business & Pleasure

- If you're traveling outside of the US, 75% of the trip MUST be for business purposes - otherwise you have to allocate business expenses on a percentage basis of business versus personal.
- You can elect to use Per Diem rates instead of actual expenses if you can get more of a deduction. Per Diem rates are a fixed-allocated expense for lodging and food per diem depending on the city you're in. For Domestic per diem rates - GO HERE. For International per diem rates - GO HERE. KEEP ADEQUATE DOCUMENTATION.
- Remember - if you're audited, you need to be able to explain the BUSINESS PURPOSE of what you're doing.

Auto Deductions

Auto mileage and expenses can be another favorite deductions of auditors so you want to make sure you get it right.

First - you have two options for deducting your vehicle expenses - you can do actual expenses or mileage. There is one VERY important thing to remember though - EITHER WAY, YOU HAVE TO TRACK MILEAGE.

Let's start with the easy one - tracking mileage. Basically, you track all your business mileage for the year, and times it by the current-year mileage rate to figure out your deduction (it changes yearly, but for example in 2021 it was $0.575 per mile). So if you had 1,000 business miles driven x $0.575 mileage rate = $575 deduction. The IRS does require you keep a mileage log - the simplest way to do this is with an app like Quickbooks Online or Mile IQ.

The other way to get the auto deduction is by deducting actual vehicle expenses. Actual vehicle expenses you can deduct are:

- Vehicle cost
- Gas
- Repairs & maintenance
- Permits
- Auto insurance
- Lease payments

Auto Deductions-cont.

As mentioned above, you still have to track mileage because it most instances, you will not use your car 100% of the time for business, so you have to allocate your auto expenses on a percentage-basis of business use.

This isn't as hard as it sounds.

Let's say total business mileage was 5,000 out of 10,000 miles driven. Your car was used 50% of the time for business. Total car expenses for the year was $6,000. $6,000 of total car expenses x 50% business use = $3,000 in deductible auto expenses.

The one tricky part is the vehicle cost because it needs to be depreciated. Luckily, we currently have two favorable-depreciation rules in place that allow you to accelerate the depreciation of your vehicle and take bigger deductions sooner..

Bonus Depreciation

Bonus depreciation allows you to deduct a percent of your vehicle's cost (new or used!) the year you place it into service in your business. There are some rules though (aren't there always?).

Auto Deductions-cont.

If it's a heavy van, pick-up or SUV, these are considered transportation vehicles and must be used at least 50% of the time for business. They also must be over 6,000 pounds before any modifications are made. The vehicle can be used as well, it just has to be new to you and not acquired in a like-kind exchange or from a related party. What if your car/truck/van/suv isn't over 6,000lbs?

These are yearly bonus depreciation limits for vehicles that vary each year with inflation. The best way to determine what that is to check bonus depreciation limits for the current tax year via the IRS.

Additionally, if these vehicles aren't used 100% for business, depreciation must be reduced by % of personal use. One final note on bonus depreciation - if your bonus depreciation can create a net loss for your business, unlike with Section 179 which requires you to carry the excess depreciation to be used against income in future years.

Section 179

Unlike with Bonus Depreciation, to qualify for this deduction the business vehicle MUST be used for business purposes at least 50% of the time. Vehicles that qualify for a 100% deduction include: heavy transportation vehicles (over 14,000lbs), 9+ passenger vans, vehicles modified for business use (ie seats removed).

Auto Deductions-cont.

Heavy vehicles (between 6,000lbs and 14,000lbs) can qualify for a deduction up to $25,000.

Passenger vehicles & non-heavy vehicles are limited to $11,160 for cars and $11,560 for trucks and vans.

As mentioned above, if your Sec 179 deduction takes your business income to a loss, any excess depreciation has to be carried over to a future year and is unlocked when you have sufficient income to offset the deduction.

Can you take both Bonus and Section 179 in the same year? Yes. First you take the Section 179 expense, and then with the remaining value of the vehicle you use Bonus Depreciation to reduce the remaining cost of the next 5 years.

One last item to consider - IF you sell your car that you used in your business at any point that you took depreciation on, and you sell it for more that’s basis (purchase price minus depreciation), you must count the difference in price as a gain and pay taxes on it at ordinary income rates.

04

Depreciation

I remember learning about the concept of depreciation in my Accounting 101 class, and I was like... what the fu- is this nonsense.

Simply put, depreciation is a way to expense the cost of an item over a period of years instead of expensing it all in the first year of purchase. The reasoning behind this is, the item is considered an “asset” and has value to your business over a period of years instead of just over one year. Depending on what the item is will determine over how many years you depreciate it. But there’s a little twist.

The asset must be over a certain amount of $$ for it to be depreciated and not immediately expensed in the year of purchase. The IRS refers to this as the “Safe Harbor” amount and is currently set at $2,500. So your asset must cost OVER $2,500 for you to depreciate it. Otherwise, you can expense the total cost of the asset in the current year.

BUT, you need to ELECT THIS ON YOUR RETURN. It's called the Section 1.263(a)-1(f) de minimis safe harbor election - make sure you select it in Turbo Tax or instruct your tax preparer to elect it for you.

What if your asset is over $2,500? Well depending on the type of asset, you can choose “Bonus Depreciation” or “Sec. 179” depreciation to depreciate the entire cost of the asset in the current year.

Depreciation-cont.

But let’s take a step back - why or why wouldn’t you choose to do this?

If you have a high income year and you’re looking to offset some tax liability, using either Bonus or Sec 179 can be a great tax-savings strategy.

REMEMBER THOUGH, you are essentially spending a dollar to save a quarter. Meaning don’t just buy assets you don’t need to offset your tax liability, because from a cash-flow perspective, you’ll be out MORE money than if you just paid the tax.

Here’s a quick very simple example to illustrate: You have a profit of $5,000 and owe $1,250 in taxes. You decide to spend $3,000 on a new computer for work before year-end to lower your profit and reduce your tax liability. Your new profit is now $2,000 and you owe $500 in taxes. You now owe $750 LESS in taxes than you did before, but you spent an additional $3,000 for the computer.

From a cash-flow perspective, you are $2,250 worse off than if you had not bought the computer. So buying assets with the sole purpose of avoiding taxes is not always a good strategy if you’re also looking to conserve cash.

On the flip side - why would you choose to forgo the Bonus or Sec 179 election and depreciate the asset over its regular tax-life?

Depreciation-cont.

Some years you WANT to show income, like if you're using your income to try and get financing.

So, you'd want your expenses to be as few as possible. Or, you know that you won't have much income this year, but will in future years. You can choose to reserve that depreciation and use it when you actually have income to offset it against.

So the last question is then - over what life should your asset be depreciated? The IRS has an incredibly dense publication called P946 that talks all about depreciation - but if you skip ahead to page 29 you can see the lives over which assets are depreciated.

04

Sales Tax

If you're like me and live in Oregon, you're not very familiar with sales tax because we don't have it. BUT, if you are in a state that collects sales tax - here is what you need to be aware of.

First - is the product/service you're selling subject to sales tax, or is it exempt? Usually if you're selling a product (it can be picked up and moved), it will be subject to sales tax.

Also be aware - based on WHO you're selling too, some of your buyers might be exempt from paying sales tax. Entities like non-profits and government agencies can be an example of this - so again, DOUBLE CHECK your state's rules.

What if you only sell services? A lot of time, services are exempt from sales tax. But double check in your state. Avalara has a great resource breaking down what types of services different states tax.

Where it can get complicated is with ecommerce products. Can you really afford to track 50 different state's sales tax laws? Probably not.

f you're a smaller business with ecommerce operations - I suggest using TaxJar for your ecommerce Sales Tax tracking.

Sales Tax-cont.

IIf you're doing millions of dollars in sales, that's when it might make sense to switch to Avalara.

Both of TaxJar and Avalara are tech companies that automate the tracking and remittance of your sales tax liabilities.

Also be aware that some states (like Washington for example) have a Business and Occupation tax. This is a tax on gross receipts of the business you're doing. I would be especially aware of this in states where there is no income tax (because they have to make up the revenue somehow).

Bottom line - you're going to have to do some due diligence and look up what your specific state and local sales tax and business tax laws are. Or, hire a CPA to do that for you. They can change year-to-year as well so don't assume since you are in compliance one year, that automatically makes you in compliance the next.

12 Ways to Avoid An Audit

The IRS PR department has done a great job of striking the FEAR OF GOD in people and making them think if they get audited their life savings will be stripped from them and they will spend the remainder of their days in jail. I promise you, the chance of that happening is INCREDIBLY small unless you're just a really bad person.

Also, the chances of you even getting audited are about 1%. Even so, here is a list of 13 tips to avoid an audit.

- Don't make a ton of money. Only partly kidding on this one. Also, don't make too little money that you're claiming in Earned Income Credit. Basically, the IRS isn't going to spend time going after people with a low amount of income or expenses because they are trying to maximize the claw-back in their audits. It's going to be a complete waste of time for them to audit an Office Supplies account with only $1k in expenses to find $50 that was actually personal expenses. Cool IRS, you just got $15 back in tax.
- Report all your income. The IRS receives over 20+ types of required income disclosures annually from third parties of potential income from all your key sources (W-2s, 1099s, K-1s, etc...). If you report numbers that are lower than what you've received, they will sometimes send you love letters asking for substantiation or adjust your account presumptively and force you to prove the adjustment wrong with explanation.

12 Ways to Avoid An Audit-cont.

- E-file your return. If you use a tax-preparer or an online tax prep software (like Turbo Tax), you will be able to submit your return electronically, and electronically-submitted returns have a lower chance of being audited.
- Make sure your Federal, State and & Local returns match. So this cool thing happens where our taxing authorities sometimes talk to each other, so if you're reporting different income on your Federal return than you're reporting on your State or Local return, don't be surprised if you receive a letter from one of the taxing authorities.
- Beware of commonly "audited" expenses. The big ones are Meals, Home Office, Travel, and Auto. Make sure these expenses are "ordinary and necessary" for your business, and that you keep GOOD records of them.
- Match Tax ID #'s. Make sure you've recorded onto your tax return correct ID numbers you're pulling off your tax forms. If there is a mismatch to what the IRS has on their end - this increases the chances that, at minimum, a letter will be sent to you to try and reconcile the difference.
- Review your prior year return. This is something we do in our accounting firm as part of the tax-prep process - we look at the prior year return to see if there was information reported that we didn't receive documentation for this year. We then follow up with the client to verify if this document should have been submitted to us. This is one of the best ways to catch missing information.

12 Ways to Avoid An Audit-cont.

- File your return. This sounds obvious, but file your return and file it on-time.
- Have clear descriptions in expense categories. On the Schedule C and Schedule E, there are spots where you can add-in expense categories. Make sure these categories are clear. Don't dump $10k into "Miscellaneous" and not expect an audit.
- Form an LLC or Corporation. When you perform these extra steps of legitimizing your business, it gives the appearance that you're actually invested in what you're doing. One the flip side, if you're just a sole proprietor, that will increase your chances slightly of an audit verse if you were an LLC or a Corporation.
- Make sure it's a business and not a HOBBY. Basically what people have tried to do is write-off their hobbies as businesses, and show a loss year-after-year that they would deduct against their other income. You need to show a profit at least 3 out of 5 years or the IRS will start to get suspicious that it's actually a hobby and not a business.

For it not to be a hobby - the IRS will look at the following things:

- The purpose behind the activity must be to make a PROFIT

- Operate the business LIKE A BUSINESS (ie get a business license, keep accurate records and books)

- They look at the amount of time spent on the activity and if you depend on the income for your livelihood If you have a loss - is it for reasons outside of your control? Or are you having losses year after year?

12 Ways to Avoid An Audit-cont.

-What if you have a hobby that makes you some money? You can deduct hobby expenses up to the amount of hobby income you have, effectively netting out any tax liability that would be due. These expenses though need to be deducted on Schedule A, so you have to have enough itemized deductions above the standard deduction to even qualify for this.

- Make sure your math is correct. And the last way to avoid and audit - double and triple check your work - make sure you've included ALL your income, and ALL your expenses, and make sure you haven't transposed any numbers (ie typing $46,000 instead of $64,000)

And what happens if you are subject to an audit? Don't panic. Take some deep breaths. Gather your killer documentation you've collected so you can back-up your expenses. And worst-case scenario, spend a little extra money to hire a CPA or tax attorney to aid you during the audit.

05

Financial Literacy

Along with tax knowledge, financial literacy is an important component of running a profitable business. Budgeting, cash-flow planning and financial forecasts are all important concepts and will be covered in this section.

05

Financial Keywords

An integral part in the success of your business is financial literacy. I've worked with many business owners who see money in their bank account and think that means they're making money.

Or even worse, they see no money in their bank account and think that means they aren't profitable, when in reality they are. That's an UGLY shock come tax time when they end up owing thousands but have no money in the bank.

So how can we avoid this?

With some basic, financial education that will arm you with the tools and knowledge to track and understand your business's financial situation. We will discuss common financial terms as well as do a deep-dive into budgeting, forecasting, and cashflow spreadsheets. And the best part? It's simple enough that a non-accountant can understand it.

05

Financial Keywords- cont.

- **Gross Revenue:** Total money earned on delivery of goods or services.
- **Cost of Goods Sold (COGS):** Direct costs of producing a good or service.
- **Gross Profit:** Gross Revenue minus COGS
- **Gross Margin %:** (Gross Revenue-COGS)/Gross Revenue
- **Overhead Costs:** Indirect costs of running a business (advertising, bank charges, depreciation, office supplies, etc)
- **Net Profit:** Gross profit minus Overhead Costs
- **Profit & Loss Statement:** Revenue, costs and expenses during a certain period (month, quarter, year, etc)
- **Budgeting:** Estimate of revenue and expenses over a certain period of time
- **Financial Forecasting:** Using historical data to predict future trends in your business's profitability
- **Cash Flow:** Amount of cash being transferred in and out of a business

05

Budgeting

Now that we are speaking the same language, the FIRST thing I always do is build a budget to help me determine profitability and make sure I'm pricing my products or services correctly.

In this shared drive you will see a Budget Spreadsheet - go ahead and open it up. There will be a blank template for you to fill out as well as a sample template. The first thing I want you to do, is write down on a PER service or PER product what your Revenue is in the budget spreadsheet.

You'll want to eventually figure this out for each service or product you offered, but just start with one for now. For some of you who are performing services, you can charge on different models - hourly, fixed fee, or value-based. What's cool is you can use this budgeting spreadsheet to see how your profitability changes with each of those revenue methods to see which is right for you.

Next, I want you to write down the Cost of Goods for each product.

05

Budgeting-cont.

In the sample template, you can see the direct costs I associated with the product. Depending on your industry, your cost of goods sold will be different.

If you're unsure what they could be, a simple Google search will tell you what common ones are for your line of work.

After I figure out all of those, I find out the gross profit and gross margin %. The higher the gross margin %, the more profitable your product or service is. You'll also want to compare this number with your industry average to make sure you're pricing your product correctly.

What if you figure out your gross margin % and it's below the industry average? You can either 1) raise your price per product/service, 2) figure out ways to decrease your cost of goods sold, 3) do a combination of both.

Sometimes you'll have to tinker with the numbers until you arrive at a gross margin % that feels good to you.

05

Budgeting-cont.

Now that you've determined what your gross profit and margins are, it's time to calculate out on a per month basis what sales would be, and add in overhead costs as well.

My FAVORITE way to do this, is to actually start with what I want my take-home to be, then work backwards to figure out how much I need to be selling to hit that net profit number. I consider this my "starting point" even though it's my end-goal.

Without the end-goal in site, it's going to be impossible to chart and measure the appropriate path forward. The big piece to figure out in this will be your overhead costs. If this is a brand-new business, you're not going to have historical data to know exactly what these will be, so the best thing to just do estimates for now.

For this example, I've decided I want to net $15k per month. I went ahead and filled out my estimated averages for overhead costs. Obviously, these costs may vary depending on the month, but again, we're just going for an average right now and building our financial model.

05

Budgeting-cont.

In the revenue section, I created a formula, so depending on how many bottles I put in the orange square, it will automatically calculate the revenue and cost of goods associated with it. Since my overhead costs are fixed and don't change depending on revenue, those numbers will stay the same regardless of how many bottles I sell.

For this model, I'm going to be depending heavily on social media advertising in order to drive revenue. For this product, I'm going to do solely Facebook ads to drive business, so I did a search on what the average return on investment is for Facebook ads. This was a 4 to 1 ration.

I did another formula in the advertising cell (blue) which assumes I need to spend $1 in advertising costs for every $4 in revenue. In other words, to sell one bottle of supplements ($60), I need to spend $15 in advertising costs ($60/4). So in my advertising cell, I created a formula to reflect that. Now everytime my revenue changes, my advertising costs will automatically change as well.

05 Budgeting-cont.

Then, once the formulas are all flowing, I just adjust the number of bottles I need until my Net Profit is showing $!5,000. Now I have an end goal and data points to work towards as I create and strategize for my business.

On an ongoing basis, then you can easily tract where you end up each month verse where your budgeted goal is. Are your estimates accurate? Are you spending more on overhead? Less on overhead? Are your direct costs more than you thought? Less?

By analyzing these figures in real-time, you're going to be able to make actionable and informed decisions quickly. If I've learned anything from being a business owner, it's that you have to be adaptable and be willing to pivot when the actual numbers aren't the same as your estimates.

And never view variances from your estimates and an indicator that you've failed, or that your business idea won't work. Instead, view it as you now have better data to use to keep steering your business toward success and have clear path to follow.

05

Financial Forecasting

The financial forecast is the second step to budgeting, and is quite complementary to the process. Now that you have your monthly budget in place, you will run out what your budget is for the whole year to estimate how you will perform for the year.

You will want to use the Financial Forecasting template and basically run out a budget for the next 12 months. Then as each month closes, you'll want to update your budgeted numbers with actual numbers, and adjust the rest of the forecast accordingly.

This is also very useful for planning for taxes since you can estimate what year-end revenue will be, and make more-accurate estimated tax payments.

This is a great way to chart-out what your business will look like as it scales. Usually what happens is that you will get to a tipping point where you'll need to expand operations.

The forecast is going to help you determine exactly what revenue volume that will happen at. It'll also help you calculate how the added expenses of expansion will affect net profit.

05

Financial Forecasting-cont.

What you don't want to happen is for Gross Revenues to grow while net profit shrinks, which essentially means you're working harder and making less than you were at a lower volume.

In the Forecasting Sample, I've ran out what my supplement business will look like in 12 months, as well as at what points it makes sense to think about expansion and how that affects my expenses.

I've included a video walk-through as well so you understand how I'm utilize the spreadsheet and how changes will affect your overall financial-position.

Just like with budgeting - this is not an exact science and it's not meant to be. Sometimes your estimations will be way-off from what actually occurs. That's okay. All this is doing is creating a blueprint to help you strategize and track with a focused-financial end-goal in mind.

05 Cash Flow

Did you know that 60% of businesses that fail are actually profitable? How can that be? It's because they have no control over their CASH. CASH IS KING.

Remember earlier when I talked about how most business owners determine profitability by cash in the bank? And assume if there is no cash they aren't profitable? And vice versa?

Cash is definitely related to profitability, but it's related from a TIMING standpoint. Meaning there isn't always a match-up of when money comes into your business and when those correlating expenses go out. That's why cash flow management is SO IMPORTANT.

It helps you see the timing difference between when cash is coming in and leaving your bank account to make sure you have money in there to cover all your on-going expenses.

It can also be an indicator that revenue is taking too long to collect on finished projects, suggesting there might need to be a change for how you bill and collect on your invoices.

05

Cash Flow-cont.

What can happen if you don't track cash flow is you can start quickly accruing debt to cover on-going expenses. Then you're having to pay interest on that debt and becoming less profitable. The cycle usually keeps repeating itself until you're drowning in debt and interest and struggling to pay your monthly bills. Cash flow tracking will help you monitor this.

It will also help you decide if you can even afford to take out business debt. Running out the numbers of debt and the payback period will help you see clearly what the best path forward is.

Go ahead and open up the Cash Flow template and watch the accompanying video showing you how to fill it out.

You'll see that the template is laid out by week and not by month, unlike our other templates. Cash is something that's useful to track weekly versus monthly because sometimes you can have big expenses hitting on certain weeks of the month (ie rent, payroll) so it's important to make sure you have cash in the bank to cover these.

06

Accounting Systems

Even though it's being covered last, a strong accounting system is the foundation for good financials. Luckily, accounting technology has progressed to the point that many functions can be automated, and the UX of these programs are simple enough for non-accountant users to operate with a little bit of guidance.

06

Excel

As an accountant - I have a love/hate relationship with excel. Love because I can customize and build to my heart's desire, hate because people try and use that as their only accounting system to monitor their Profit & Loss.

It pains me to say this, but I think if your transaction volume is small enough and you're a schedule C filer, you can use excel. My personal cut-off for that would be in the realm of 30-40 transactions a month. After that, I think it makes sense from a time-perspective to transition to Quickbooks Online.

They key with using Excel is structuring the formulas correctly so that you aren't doing duplicate-date entry and are getting the information in an understandable format.

So I've created a spreadsheet for you to use. This spreadsheet will allow you to download the transaction data from your bank, assign to a category, and auto-populate a Schedule C template for you. There is a linked video in the spreadsheet to walk you through where to put your downloaded data, how to select categories, and how it populates the spreadsheet.

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Quickbooks Online

Quickbooks Online (QBO) is the accounting system you'll want to use if 1) your transaction volume surpasses that 40/month mark OR 2) if you are an S-Corp, Partnership or Corp. The reason for #2 is that you also have to maintain a Balance Sheet for tax reporting purposes, and it's a financial statement commonly requested by lenders and needed to file tax returns.

QBO is product we use internally with 99% of the business we provide on-going accounting services for. Let's be sure to not confuse QBO with Quickbooks Desktop either. QBO is hosted in the cloud, and thus can be accessed from any device with internet. Quickbooks Desktop is hosted locally on your desktop. QBO also has integrations with banks and credit cards, so it will automatically pull in all you business transactions for you to categorize. QBO can also connect with a host of other apps to digitize and automate your business (invoicing, inventory, bills, etc).

HERE is a more-thorough video really walking you through all the features in detail of QBO. If you decide QBO is the right system for your business, we offer a QBO set-up service to help you get started off on the right foot.

I know QBO likes to bill themselves as a product even non-accountants can use, but you need SOME basic accounting knowledge or you'll mess up your books REALLY fast. HERE is a great video that summarizes some bookkeeping basics you need to understand to use QBO correctly.

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