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Accounting Concerns of the Small Practitioner

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Choice of Business Entity

- a. Single Member LLC (SMLLC)
- b. LLC or Partnership
- c. S-Corporation
- d. Sole proprietor – no corporate shield – **not recommended**
- e. C-Corporation – double taxation – **not recommended**
- f. **Recommendation: all entities should have separate bank accounts, records and EIN**

Single Member LLC

(aka “Disregarded Entity”)

- a. Sole ownership
- b. Separate legal entity, but does not have its own income tax return filing.
 - i. Instead, the income and expenses are reported on your federal personal income return (Form 1040) via Schedule C

Limited Liability Company or Partnership

- a. Multiple owners, as documented in the Operating Agreement
- b. Offers flexibility with ownership changes and income allocations
- c. Separate income tax filing (Form 1065)
 - i. Income or loss is passed through to the owners via Form K-1
- d. The pass-through income is subject to self-employment tax (~15%)
- e. Carefully review and sign operating agreements. Note that partnerships have unlimited personal liability.

S-Corporation

- a. Single or multiple owners, as documented in the Articles of Incorporation
- b. Separate income tax filing (Form 1120-S)
 - i. Income or loss is passed through to the owners via Form K-1
- c. The pass-through income is NOT subject to self-employment tax
 - i. However the owners must receive a reasonable salary (via W-2) which is subject to standard payroll tax
- d. Distributions – must be reasonable and equal to ownership %'s
- e. Owner's health insurance and personal usage of automobiles must be reported as W-2 income, if applicable

Business Structure Pros and Cons

ENTITIES	PROs	CONs
Sole Proprietor	<ul style="list-style-type: none"> • Inexpensive and simple • One level of tax • No separate tax return 	<ul style="list-style-type: none"> • Unlimited personal liability • Ownership limited to one person
Partnership	<ul style="list-style-type: none"> • Ownership not limited to one person • One level of tax on net income • Income and expenses allocation can be unrelated to percentage of ownership 	<ul style="list-style-type: none"> • Unlimited personal liability • Responsible for business actions of other partners • Requires separate tax returns
S Corporation	<ul style="list-style-type: none"> • Limited personal liability for shareholders • Business net income taxed as personal income of shareholders 	<ul style="list-style-type: none"> • Requires separate tax returns • Restrictions on adding investors • Net income allocated according to percentage of ownership
C Corporation	<ul style="list-style-type: none"> • Limited personal liability for shareholders • Easy to transfer ownership/add investors • Perpetual continuity presumed 	<ul style="list-style-type: none"> • Requires separate tax returns • Net income may be double taxed • More costly to set up and maintain
Limited Liability Company (LLC)	<ul style="list-style-type: none"> • Limited personal liability for members • Income and expenses can be allocated in a manner unrelated to percentage of ownership 	<ul style="list-style-type: none"> • Not automatically perpetual like S or C corps • Cost to set up and maintain

DC Business Registration

- a. <https://otr.cfo.dc.gov/page/new-business-registration>
- b. You will need your federal ID number and/or SSN, legal form of business, and business address
- c. All domestic and foreign filing entities are required to appoint and maintain a registered agent (includes LLCs, partnerships and corporations)
 - i. Entities may act as its own RA if it has an office in DC
 - ii. <https://dcra.dc.gov/book/corporate-registration-faqs/corporate-registration-faqs-process>

Property Tax Returns

- a. Due by July 31, 20XX
- b. Reporting the remaining cost as of July 1, 20XX
- c. Maintain detailed records of fixed assets, reviewed annually for additions and disposals
- d. Filing is required for all DC businesses, but you are exempt from taxes if your remaining cost is \$225,000 or less

Income Tax Filings

- a. In general:
 - i. Form D-30 – LLCs, partnerships and sole proprietors – \$250 / \$1,000 minimum payment based on gross income (\$1MM threshold)
 - ii. Form D-20 – Corporations (including S-corps) – same minimum payment as D-30
- b. Form D-65 is allowed for partnerships with gross income less than \$12,000, investment partnerships, and any business deriving more than 80% of its gross income from personal services rendered by its owners
 - i. No payments required
- c. DC S-Corp / Virginia resident owner
 - i. VA does not offer a credit for taxes paid to DC
 - ii. Tax planning: pay the owner a payroll bonus to reduce the business' net income

Accrual vs Cash Accounting

- a. Cash – revenue and expense are recognized when the cash is received/paid
- b. Accrual – revenue is recognized when it's earned and expenses are recognized when they're incurred (accounts receivable, accounts payable, accrued expenses, etc.)
- c. Typically, books are kept on the accrual method to provide a more accurate snapshot of the business, while the tax return is usually on cash method.
 - i. If books and tax are on separate methods, your tax accountant will need to record annual adjusting entries to prepare the return

Benefits of QuickBooks – Part 1

Keeping an accurate set of books is essential for managing your business and preparing income tax returns. QuickBooks is designed to be intuitive and easy to understand, even for business owners who lack an accounting or financial background.

- a. There are multiple versions of QuickBooks with different prices and options to select from.
<https://quickbooks.intuit.com/desktop/> and
<https://quickbooks.intuit.com/pricing/>
- b. There are several ready-to-use templates that can be used to create a chart of accounts, invoices, spreadsheets, charts and business plans. You may also customize these reports to meet your specific requirements.

Benefits of QuickBooks – Part 2

- c. Transactions can be downloaded from many banks and credit cards.
- d. Memorized transactions can be set up so that they automatically post on a basis set up by you. This is nice for repetitive transactions.
- e. QuickBooks has their own payroll service. However, many outside payroll services can template their reports so that they can be easily imported into QuickBooks.
- f. Form 1099s can be printed from QuickBooks.
- g. The ability to integrate with other programs.

Recommendation: If you are new to QuickBooks, we recommend that you have your accountant set up your QuickBooks and train you on how to use. This can usually be done within 3-4-hours.

Monthly Reconciliation of IOLTA Accounts

- a. Client or third-party funds in your possession must be placed in a trust account. If the trust funds are nominal in amount or expected to be held for a short period of time, the trust funds must be held in an IOLTA account in a compliant bank.
- b. Best practice: monthly reconciliations of your accounts to avoid any issues
- c. Interest earned on the pooled trust funds in a D.C. IOLTA account goes to the D.C. Bar Foundation to fund pro bono legal services. The account uses the Bar Foundation's tax identification number; the Foundation is the beneficial owner of the interest.

(<https://www.dcbbar.org/bar-resources/practice-management-advisory-service/iolta.cfm>)

Form W-9 and 1099

- a. Form 1099 is required to be filed for each entity (person, LLC, or partnership) in the course of your business to whom you've paid at least \$600 during the year for personal services and rent.
- b. Generally, 1099s are not required for payments to a corporation, however attorneys' fees paid to a corporation are reportable payments
- c. Form W-9 should be filled out by your 1099 recipients, to ensure you use the correct information.
 - i. **Recommendation: obtain a completed W-9 before issuing payment**

<https://www.irs.gov/pub/irs-pdf/fw9.pdf>

<https://www.irs.gov/pub/irs-pdf/f1099msc.pdf>

Employee vs. Independent Contractor

- a. Behavioral control
- b. Financial control
- c. Relationship (benefits, permanency, etc.)

<https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation>

Quarterly Income Tax Payments

- a. Personal (federal and state) and DC Franchise estimates may be required to avoid any interest and penalties
- b. Methods
 - i. Safe harbor – even payments based on 100%-110% of the prior year tax liability
 - ii. Annualized – estimated payments based on actual YTD income

SEP-IRA Plans

- a. Solo 401k – permits sole practitioner to have their own 401k.
 - i. Pros: Allowed to contribute dollar-for-dollar of net income up to regular 401k limits (\$18,500 or \$24,000)
 - ii. Cons: higher administrative costs and Form 5500 filing once assets exceed \$250,000.
- b. 401k (multiple participants)
- c. SEP
 - i. Pros: easy to set up, can be set up after year-end, very low cost, \$55,000 max contribution
 - ii. Cons: only allowed to contribute up to 25% of your SE net earnings
- d. Eligible employees must be covered under the plans

Other Considerations

- a. Home Office
- b. Sec. 199A SSTB
- c. Multi-state activity
- d. Basis issues of S Corporations and Partnerships
 - i. Loans
 - ii. Distributions

About E. Cohen & Company, CPAs:

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