



Hard Lesson from the Tax System

Here's a lesson for all owners of Small Business Owners concerning income taxes.

When you had a day job, meaning you were an employee working for someone else, you really didn't have to worry too much about calculating your income and Social Security/Medicare taxes.

Why? Because your income was fairly predictable, meaning that you and the boss had agreed how much you would be paid, and that the company was paying you on a payroll system that deducted your various taxes each time you were paid.

And while it's easy to forget, the company was matching your Social Security and Medicare taxes, meaning that you only had to pay for ½ of your total contribution into the Trust Fund.

But you really didn't like working for someone else, and so somewhere along the line you quit that job, so you could start your own business and Be Your Own Boss.

Probably when you were getting started, your company wasn't making a profit, or if it was, the profit wasn't very much, and so your tax problem was minimal.

You never thought about one very important thing, though. I know I never did.

That very important thing is that when you became your own boss, you accepted the responsibility for predicting your total income and hence your tax liability.

And you became responsible for making sure that you paid enough taxes to cover that liability.

It didn't seem like a very big deal at the time and so you concentrated all your efforts and energies on building the business.

And over time, you became successful, the business started to prosper, and the financial squeeze began to ease.

Enter the Hard Lesson From The Tax System. Turns out you were supposed to be paying your income tax and both the Employee's share of the Social Security/Medicare as well as the Employer's share.

And of course you couldn't do that unless you had been keeping up all along with the financial progress of the company.

A Real Life Example

Here's a real life example. Three years ago Sally started a two-person LLC taxed as a partnership. Her mother-in-law put in the money, and Sally put in her considerable skill, energy, and ability.

It took a few years to make it happen, but Sally persevered, and proudly

came in to have her financial reports prepared and have her taxes done.

She proudly reported that her sales had surpassed \$350,000, which if you think about it is quite an achievement for one person with some part-time help.

After adding up all the expenses, she had cleared a profit of \$50,000.

In prior years, she had been splitting the profits with her mother-in-law, and they had been sharing the fairly modest tax burden.

But this year—the year of success—brought with it a double whammy. First, there is that matter of \$50,000 to pay taxes on.

And on top of that, her mother-in-law has just said that she doesn't want to pay much tax this year. After all, she doesn't work in the business, and just provided some capital in the beginning to get started.

Fair enough. Partnership rules permit that sort of thing, but only by shifting some of the \$50,000 from one partner to the other.

So to keep Mom happy, Sally must take on more of the profits—and more of the tax bill.

It's probably going to be \$9,000 or more, and none of it has been paid.

What Can You Do?

The most important thing you can do is to recognize that as the owner of the business, you are now responsible for predicting your sales, expenses, taxable income, and ultimately, the taxes.

I'm not talking about tax avoidance or tax reduction strategies. I'm saying that being captain of your own ship requires that you be responsible for financial and tax planning, and that you take the time to learn the way the tax system works.

When do you do this? Just before you start making significant money.

Learning all this stuff after you've made the money and are going in to get the taxes done is too late, and it's going to cost you dearly.

Sally? She's going to be just fine. She had a sad Friday, and she cried a good bit. And then she said, "Well, I'll get the money. What I want to do is to learn how to keep this from happening again.

That's the attitude winners—and successful business owners—have. And in the long run, that's what counts.