

CMU Entrepreneurs

Do It Right the First Time!

Presented by:
Sisterson & Co. LLP
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Choice of Legal Entity Type

- What did you (or would you) choose and why?
 - LLC, C Corp., S Corp., SMLLC, Ltd. P-Ship
- Initial concerns - liability and taxes
- Income tax on exit
 - C Corp double tax cost vs. possible 1202 capital gain exclusion
- Will future investors care?
- Can we switch later? Does the timing matter?

Founders Preliminary Concerns

- Am I an employee or self-employed? Does this impact how I get paid for my services?
 - W-2 vs. Guaranteed Payment if using an LLC
- Are early stage losses deductible on my personal tax return if I formed as an LLC? Is this true even if the losses were “funded” by another member/party?
- Does an IRS 83(b) election need filed for any restricted shares/units (e.g. those with a vesting period) I/others receive?
 - Timing is critical – 30 day rule for IRS filing. Send certified
 - Keep a signed copy

Employee Benefits and Retirement Plan

- Owners need for health, disability and/or life insurance?
 - Term insurance is inexpensive at a young age
- Choice of a retirement plan (e.g. 401k) “down the road”
 - Roth IRA as a substitute until you have a plan?
- Retention of key employees - special incentives? (stock options/etc.)
 - Rules are complicated. You will need some advice here.

Payroll Taxes

- Payments for services – are they your employees (W-2) or independent contractors (1099-MISC)?
 - Think “control”
 - Classification of interns?
- Should we outsource payroll?
- Before first payment, obtain:
 - Form I-9 for each new employee hire
 - Form W-9 for each independent contractor
- Don't pay anyone before a “system” is in place!
- EE withholdings have to be timely paid – could have personal responsibility/liability

Sales and Use Tax

- Are you required to collect and remit on your revenue?
 - If so, a tracking system needs implemented
 - If you are selling something, you may depending on who you are selling to, where they are located and what they are doing with your product
- Are you required to pay on your purchases?
 - E.g. – items used in manufacturing have exemptions
- Watch for “use” tax on out of state purchases
- Before you bill your first customer - do your homework and/or get some advice on the rules
- Avoid surprises – sales tax audits are not uncommon

Accounting

- Who will keep records?
 - Trade-off of inside vs. outside cost
- Is Excel enough in year one?
 - Cash receipts and disbursements by “category” and reconciled to your checkbook/bank statement
 - Save receipts – write the check #, date, and business use
- Do we need accounting software? (e.g. QuickBooks)
 - Benefit of software – balance sheet, P&L, SOCF
 - If you have inventory, software is a must

Employee Expense Reimbursement Policies/Recordkeeping

- Accountable vs. non-accountable plan - tax differences
 - Actual expenses vs. allowances
 - Recordkeeping – expense reports
- Reimbursement for automobile business use
 - IRS standard mileage rate x business miles (need support)
- What can my business reimburse me for? – use common sense for what is business vs. personal
 - What about meals (e.g. lunches)?

Early Stage Issues

- State registration outside of legal formation
 - PA Form 100 – one-stop shopping
 - Do this ASAP. Legal counsel will not do this.
 - Keep your IRS/PA welcome letters/etc – account #s will be needed by income/payroll tax preparers
- When does business “begin” under the federal tax law and its impact on early stages expenses/losses
 - Tax concern only. Your books will show a loss
- Use of convertible debt
 - Interest needs properly accrued to determine stock on conversion
 - 1099-INT will need issued for accumulated interest on conversion

Keystone Innovation Zone

- A PA tax credit created for designated geographical zones to foster innovation and create entrepreneurial opportunities
 - Greater Oakland and Pittsburgh Central KIZ
- Calculated based off of an increase in revenue
 - Need base year
- Apply online:
<https://www.esa.dced.state.pa.us/Login.aspx>

Is Your Company Doing R&D?

- A source of eventual “found money”
 - Federal rule of thumb – 6.5% times the sum of gross wages, supplies and 65% of outsourced US R&D
 - You get a credit for actual costs incurred. If “you” are doing the R&D for equity only, that doesn’t count
- Documentation is important by employee and by project
 - Time records are the best
- Utilization of credits will be deferred until profit is made and tax is owed.
 - 20 year carry-forward, though
- Unused PA (but not federal) credits can be sold for cash – 10% or so discount

Thoughts from Years of Experience

- Rule of Thumb #1 – Economics First – Taxes Second
- Rule of Thumb #2 – Minimize Taxes – but Sleep Well
- Final thought – Doing it right the first time may cost more in the ST but much less in the LT!

Contact Information

Thank you for coming!

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