

CMU Entrepreneurs

Do It Right the First Time!

Presented by:
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Choice of Legal Entity Type

- What did you choose and why?
 - Impact of recent federal tax reform
- 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?
- 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?
- IRS 83(b) election needs filed for any restricted shares/units (e.g. those with a vesting period)
 - Timing is critical – 30 day rule for IRS filing. Send certified
 - Keep a signed copy for the company

Payroll Taxes

- Payments for services rendered
 - Owner of LLC
 - Employee vs. self-employed?
 - No W-2 but gets guaranteed payment
 - Employees (W-2) vs. independent Contractors (1099-MISC)
 - Think “control”
- 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
- 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
 - What does ownership/management need to see/know and when?
- Is Excel enough in year one?
 - Cash receipts and disbursements by “category” and reconciled to your checkbook/bank statement
 - Business vs. personal – avoid charge card with co-mingled use
 - Save receipts – write the check #, date, and business use
 - Keep good records of equity, loans, grants, etc.
- Do we need accounting software? (e.g. QuickBooks)
 - Benefit of software – balance sheet, P&L, SOCF
 - Once you have inventory, software is a must

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
- Use of convertible debt
 - Interest needs properly accrued to determine stock on conversion
 - 1099-OID may need issued annually for accrued interest
- Use of stock options
 - ISO's vs. Non-Qualified have different tax consequences to the employer and to the employee/consultant – be proactive here
- When does “business begin” for tax purposes?

Keystone Innovation Zone Tax Credit

- Created for designated geographical zones to foster innovation and create entrepreneurial opportunities
 - Greater Oakland KIZ
 - Pittsburgh Central KIZ
- Calculated based off of an increase in revenue
- Due on or before September 15 (Strict Deadline)
- Filed version of all state and federal tax returns must be submitted with application
- Apply online:
<https://www.esa.dced.state.pa.us/Login.aspx>
- Awarded no later than December 15th of each year

Research and Development Tax Credit

- 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 (carry-forward) until profit is made and tax is owed.
- Unused PA (but not federal) credits can be sold for cash – 10% or so discount
- Unused federal R&D tax credit can offset payroll taxes

Job Creation Tax Credit

- Business creates full-time jobs in PA within 3 years
- Eligibility criteria available online
- \$1,000 for each new job created up to a specified amount approved
- Credits utilized by business after jobs are actually created
- Unused PA credits cannot be sold for cash but utilization of credits will be deferred until profit is made and tax is owed.
- Apply online at:
www.newpa.com/programs/job-creation-tax-credits-jctc

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

Carissa Habsburg, Tax Manager

cmhabsburg@sisterson.com

(412) 594-7745

Bill Richardson, Tax Partner

wmrichardson@sisterson.com

(412) 594-7708

<http://www.sisterson.com/Emerging-Growth>