

# 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
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# 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”
    - 1099-MISC PA Nonresident Withholding
- Should we outsource payroll? **YES!**
- 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 15<sup>th</sup> 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](http://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

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