

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?
- 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

State Income Tax

- ✓ Service based companies (including SaaS) can be exposed to income tax and filings in states where your customers are located even if all employees providing such services are in your location state, e.g. PA
 - Companies selling a physical product have less tax and filing risk but still need analysis
- ✓ Registering and/or having employees in other states puts you at higher risk as you are “on the radar”
- ✓ Lack of compliance in this area could cause interest & penalties for non-filing and could create an issue with a prospective investor or buyer in “due diligence”
- ✓ Are your employees going to provide services (excluding sales solicitation) outside of their resident state? If yes, the possibility exists for his/her W-2 to need wages sourced to multiple states

Sales and Use Tax

- Are you required to collect and remit on your revenue?
 - Impact of Wayfair Supreme Court Case
 - A tracking system for revenue by customer location needs implemented
 - Even if you are selling a service/SaaS, you may have a sales tax collection requirement 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

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

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 before you anticipate having payroll.
 - 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 for “accrued” interest on convertible notes
 - Request a W-9 from all note holders
- 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

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
 - All work for qualifying expenses need to be done in the US
- 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
- Unused federal R&D tax credit can offset payroll taxes
- PA is checking entity and owner’s tax compliance

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
 - Prize money and Grants/contracts from SBIT/SBTT, NIH, DOD, etc. are considered revenue
 - Max credit = \$100,000
- 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
- PA is checking entity and owner's tax compliance

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
- Need to apply before the company does the hiring
- 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!

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