



New Business Tax Checklist

By TurboTax

Employer Identification Numbers (EIN)

An Employer Identification Number (EIN) is a federal tax number used to identify a business entity. If you are a sole proprietor and are hiring your first employee, you will need an EIN to file your payroll taxes. Even if you choose to use independent contractors instead of employees, you need to report your contractor's earnings yearly and you will need an EIN to identify your business to the IRS. Whether you have employees or not, if you are a corporation, partnership, or purchase or inherit a business, you need an [employer identification number \(EIN\)](#).

If you don't have an EIN, apply for one on-line by completing [Form SS-4](#). In some cases, you might also need an identification number for your state. Visit your state's Web site, or consult with your tax professional for more information.

Hiring Independent Contractors vs. Employees

It's important to distinguish between employees and independent contractors since the IRS differentiates between the two and requires that businesses properly classify workers.

One test you can use to distinguish between an independent contractor and an employee is to determine how much control and independence the worker has over determining their work schedule and completing their job. In general, employees are provided with more direction and equipment to do their job than independent contractors. You don't incur payroll taxes nor do you have to file payroll tax returns for independent contractors.

At the end of the year you file Forms 1099-MISC and 1096 with the IRS to report payments to independent contractors. Similarly, you file Forms W-2 and W-3 with the IRS to report payroll payments to employees. Other payroll tax returns are required to be filed, and payroll deposits made, at different intervals during the course of the year. For more information, review [IRS Publication 15-A, Employer's Supplemental Tax Guide](#).

Choosing a Tax Year for Your Business

Many small-business owners assume that January 1 to December 31 is their only choice of periods for income tax reporting. However, the IRS allows certain businesses to use different "tax years" when it comes to figuring their taxable income. A tax year is an annual accounting period for keeping records and reporting



income and expenses.

Calendar Year

A calendar year is a period of 12 consecutive months starting on January 1 and ending on December 31. The vast majority of individuals and businesses use this time period for their tax year. In fact, except in a few special circumstances, individuals are required to use the calendar year for their tax reporting.

One advantage of a calendar year to a small business owner is that payers of interest, dividends, and many other kinds of income send their reports to you on a calendar year basis. Suppliers, financial institutions, and others to whom you make tax deductible payments may also issue you a year-end statement. Therefore, it is usually easier to determine your taxable income on a calendar year basis.

Fiscal Year

A fiscal year is any period of 12 months that ends on the last day of any month other than December. Why would a business owner choose a fiscal year rather than a calendar year? Some businesses have “seasons” that don’t follow the traditional calendar. Choosing dates for a fiscal year that correspond to a business’s busy season may provide a better accounting of the business’s finances. For example, a business with a busy season from November through February may want to use a March to February fiscal year.

One side benefit of having a fiscal year is that it may reduce your accounting costs. Since most taxpayers have a calendar year end, tax preparers and financial auditors are often overloaded with client work when trying to meet traditional calendar-year deadlines. If your tax and financial reporting can be done during a non-peak period of time, your accountant may be willing to give you a break on his or her fees.

IRS Rules for Establishing an Accounting Period

Ordinarily, the tax accounting period you use on the first tax return you file for your business is the tax year you are required to use for the life of that business. After that, you must use the same period for all your books, records, and tax reporting.

Certain businesses are required from the beginning to either use a calendar year, or to use the tax year of a majority of the business’s owners. This rule applies to partnerships, S corporations, and personal service corporations; since the owners of such businesses are usually individuals using a calendar year, the businesses themselves are also usually required to use the calendar year. To use a tax year other than a calendar year, these businesses must have a legitimate business reason, such as a busy season which does not correspond to the traditional calendar year.

C corporations have more flexibility to choose a tax year other than a calendar year, but in certain situations must also apply for IRS approval.

[IRS Publication 538](#), Accounting Periods and Methods, discusses the requirements for electing a fiscal tax year.

Tax Planning

A new business may experience a loss in its first year. Such a loss reduces the business’ tax liability. Start-up costs and initial asset purchases often result in a loss in the business’ first year. Be aware that start-up costs



may be eligible for amortization.

Estimated Quarterly Tax Payments

In the first year of business, there is an alternative to paying quarterly estimated tax payments: Base your tax estimates on your income as you earn it. For example, if you have a loss in the first half of the year, delay your estimates until you start showing a profit. This method requires that you keep track of your monthly net income (or loss).

File Form 2220 (or Form 2210 for sole proprietors) with your tax return next year to report how your quarterly income (or loss) was earned during the tax year. This is called using the annualization method for computing your tax estimates.

Self-Employment Taxes

Remember to compute self-employment tax on your new business income, if your business is a sole proprietorship filing Form 1040-Schedule C. If you also have an employer, remember to count any withheld social security tax when you figure your self employment tax. For more information on self-employment tax, see [IRS Publication 533, Self-Employment Tax](#).

Accounting Methods for Your Business

There are two basic accounting methods used by most small businesses — cash and accrual. The business owner can choose which method to use, but may be required to use the accrual method for tax purposes depending on the particular circumstances of the business.

Cash Method

Under this method, you only recognize income or expense for your business when money actually changes hands. Most small businesses use this accounting method because it is easy to track and it gives a good picture of the company's cash flow. "Cash" receipts or payments for purposes of this method do not have to be actual cash money; payments by check, credit card, barter, etc. also apply.

While this method is simple to use, it can distort the true financial situation for some businesses. For example, if your business extends or uses credit, your cash receipts and cash outlays can become mismatched to such an extent that it is hard to determine if your company is profitable. This problem also arises when a business keeps an inventory because large cash outlays may be required to build up the inventory, and the eventual income from the sale of the inventory could come far in the future.

Accrual Method

With the accrual method, you recognize income from a sale when it actually occurs, regardless of when you are paid for the sale. Similarly, you record an expense when you receive the item you purchase, or when you otherwise incur the cost. For example, salary which has been earned but not yet paid to an employee would be recognized as an expense under the accrual method.



The accrual method is often more complicated to maintain, because you have to determine when a sale or an expense has occurred without necessarily using cash inflow or outflow. However, it can give a more accurate picture of the financial status of your business because income is recorded when it is actually earned, and expenses are recorded when they are actually incurred.

Cash vs. Accrual for Your Business

Whichever accounting system you decide to use for your business records, IRS rules may require you to use the accrual system on your tax returns. Therefore, it is possible that you could use one method for your records and another for your taxes, although this is not recommended for most small businesses due to the difficulty in maintaining two sets of books.

The IRS allows all businesses to use the accrual method of accounting. However, most small businesses use the cash method because it is simpler and it can allow for some flexibility in tax planning. For example, around year end it is often possible to time your cash receipts in order to defer income, or to move income into the year in which you are in the lowest income tax bracket

The following businesses are required by the IRS to use the accrual method:

- C corporations
- A business with inventory
- A business which has gross annual sales in excess of \$5 million

There are other instances which might require a company to file its tax returns using the accrual method, and there are a few exceptions to the above rules as well. For more information on IRS rules regarding accounting methods, see [IRS Publication 538, Accounting Periods and Methods](#).

Changing Your Accounting Method

The IRS carefully regulates changes in tax accounting methods, because it is concerned that taxpayers will change back and forth to gain unfair tax advantage. Therefore, before you can change the method you use for accounting on your tax return, the IRS requires that you seek permission using [Form 3115, Application for Change in Accounting Method](#).

Certain changes are allowed without seeking permission. If there is a “fundamental change” in your business, like moving from a service business to one that carries inventory, or going over the \$5 million sales mark, you can change your business’s accounting without the IRS’s permission.

For complex tax accounting method situations, or if you are contemplating a change in your business’s method, consult your tax advisor.

Deductions That Require Special Recordkeeping

Business Meals & Entertainment

A business purpose is required for these expenses to be deductible (and only 50% of the total expense is deductible). A deductible meal is usually with a business contact. An entertainment event usually follows a business meeting.

For record keeping purposes, write on the receipts whom you met with, as well as the business purpose of the meeting. Save these receipts with the rest of your tax records.



Auto Expenses

Keep a written record of all of the miles accumulated for business purposes, including:

- Starting and ending mileage
- Dates of travel
- The business purpose of each trip

Employees and sole-proprietors have the option to use the standard mileage method, where the automobile deduction is computed at a flat rate per business mile, instead of the actual auto expenses (gas, repairs, insurance, lease, etc.), selecting the most advantageous deduction.

Employees and sole-proprietors who want to use the standard mileage rate in the future, **MUST** use that method for the first year. Employees and sole-proprietors who lease may use the standard mileage method, but they must do so for the entire lease period.

Note: Employers, such as corporations and partnerships, may not use the standard mileage method.

Retirement Planning for Sole Proprietors

If you're self-employed, or if you have a few employees in a small business, you may want to consider setting up a SEP as a retirement plan.

A Simplified Employee Pension (SEP) lets you make contributions to an IRA (Individual Retirement Account) on behalf of yourself and your employees. In a SEP-IRA, contributions and the investment earnings can grow tax-deferred until withdrawal (assumed to be retirement), at which time they are taxed as ordinary income.

SEPs are popular with self-employed people because they are simple and don't involve a lot of paperwork. Unlike a Keogh plan, which has an annual reporting requirement, SEPs don't require annual reporting as long as each participant gets a copy of the plan agreement.

For more information, see [IRS Publication 560, Retirement Plans for Small Business](#).

Home Offices for Sole Proprietors

Benefits of a home office include additional tax savings. Some personal expenses may be considered deductible business expenses. Most home expenses become, at least in part, deductible. Home expenses are deducted based on the percentage of the total size of the home the office occupies. To qualify, a home office must be used exclusively for business and be the primary location for managing a business.

For more information, see [Calculating Home Office Expenses](#) at www.turbotax.com.



Year-end Documents

- Forms 1099
- Forms 1099 you receive
- For service businesses, customers who pay more than \$600 should mail you Forms 1099-MISC. If you don't receive one, the income should be reported anyway.
- Forms 1099 you issue
- Prepare Forms 1099-MISC for each of those to whom you pay more than \$600 for services (excluding corporations).

Remember to get social security numbers from your contract workers, along with their addresses; you'll need that information when you complete their Forms 1099-MISC.

For more information, see [IRS Publication 334 – Tax Guide for Small Businesses](#) at www.turbotax.com.

For the main URL address for IRS forms and publications, go to <http://www.irs.gov/formspubs/index.html>.



Tax laws change frequently, so be sure to check www.turbotax.com for the most up-to-date information and tips. TurboTax also has a range of solutions to help you do your taxes quickly, easily, and accurately. To learn more visit: www.turbotaxdirect.com/qbntw05



At QuickBooks, we've spent more than 10 years working with small businesses to develop tools that will help them succeed—tools so intuitive and useful, our customers can't imagine running their businesses without them. Today, our products and services support over 2.6 million small businesses.