SMALL BUSINESS ADDENDUM LETTER-2025

I apologize in advance for the length of this letter, but because of confusion surrounding how best to implement these strategies, I want to clarify a few things. Correct implementation is critical, to avoid costly mistakes- both in wasted deductions and higher taxes.

The last few years have seen some changes to the Tax Code, beginning with the Trump Changes followed by some Biden Changes and Adjustments.

Many of the Trump changes will “sunset” (expire) at the end of 2025. This means that President Elect Trump will need to either extend them or replace them. We are expecting some major changes but they most likely will impact next tax season and not so much, this tax season. For the time being, we are proceeding based on the existing laws and will adjust strategies when we see what the changes are going to be.

Tax Rates:

Under the Trump laws, the Federal corporate tax rate is a flat 21%. This means that no matter how much the net profit equals, you will pay 21%. However, the personal rates are still variable and in most cases are higher than the 21%. This is one area that changes are expected after Pres. Trump takes over, again.

There has been a lot of speculation about changes to the tax rates, so we have to “wait and see”.

When you pay yourself or take money from your corporation, you have to pay Self-Employment tax of 15.4% on the money that you draw from the company. This money you pay to yourself is considered your salary or what I refer to as "Officer's Draw" or “Management Fees”, and once it moves from your company to your personal account, it becomes subject to the personal tax rate and Self-Employment tax.

If you are paying yourself and issue yourself a W-2, this does not apply since your FICA and Medicare are deducted from your gross pay.

Corporation Locations:

If your business is a “brick and mortar” business (one with a physical location) then you must domicile your business in your state of residence. If you are more of a virtual business or with the bulk of your customers in other states, than the location of the corporation is less important.

Certain states, such as California, will extend their reach beyond the state borders and tax you globally, unless you can allocate the income and show that some is in-state and some out-of-state.

Additional corporations:

If you have excess capital that you will not need the following year and want to invest it for long-term usage, such as your retirement, you may want to set up secondary, investment corporations in tax-free locations.

I have been helping many of my clients set up new corporate entities, in order to take advantage of states with lower tax rates.

The State of Florida has no corporate tax on the first $50,000.00 of profit. Other states, such as Texas, Wyoming and Nevada have no state tax, so for clients who need to shelter more than $50,000.00, these other states offer opportunities.

Since I am domiciled in Florida and Colorado, I use those states as the primary location for most of my clients' corporate locations, unless the client is already located in a zero-tax state.

I can form a corporation in any state and can serve as the Registered Agent either directly or through the use of a "proxy".

You can serve as your own Registered Agent but you will need to file all of the required forms. If you don't want to be responsible for the filing, you will need a Registered Agent to do so for you.

While the primary business may need to be in taxed states, the secondary corporations can be anywhere, so the choice of domicile is based on the state tax rates.

Utilizing additional companies:

Retirement –

Many small business owners postpone investing in their own retirements and play "catch-up" as they near retirement. Creating these additional companies gives you a place to accumulate money for retirement without the restrictions of a bona-fide retirement account. These corporations can also be used to accumulate funds for college tuition and expenses as well as to build reserves for large scale investments.

The more conventional approach would be to create an IRA or an SEP in your primary business that is based on your stated draw (salary). However, since you should be reducing your draw by shifting expenses to the business, your retirement contributions would also be lower. Utilizing additional corporations to accumulate funds is an excellent opportunity to offset the reduced retirement contributions.

At the same time, many small business owners have family needs that require additional money from their businesses. They need to know how to take the money out without causing an escalation in their taxes.

What expenses should my business pay?

Every business owner is expected to draw at least a base salary from the business, to cover the "core" expenses of the household, unless there is household income from other sources to covers the basic cost of mortgage/rent, utilities, homeowner's insurance, water, sewage, trash, HOA fees, food, clothing, etc.

However, other non-essential expenses should be paid directly by your business, lowering the amount of cash coming into your personal account, which would therefore be taxable at the higher personal rate.

Your business should also pay expenses that are related to the running of the business, even if part of the cost is for personal use. Examples of these, are your primary vehicle being used for the business, cellphones, internet fees, etc.

While 100% can be paid by the business, the business can only deduct the portion that is business related. The non-deductible portion will become part of the taxable profit and taxed at the corporate rate. However, this is usually a lower tax rate than if you pay yourself and then pay the bills personally.

Medical expenses:

If you or your spouse/partner work for a company that has medical benefits, use them to the fullest. ALL medical expenses that are not paid through a W-2 job, should be paid by your primary business.

Large Purchases:

The same applies to large, unexpected or extraneous costs, such as vacations, home renovations, etc. While these are not deductible, it makes more sense to use company money which is taxed at the 21% corporate tax rate, as compared to paying yourself which requires paying the personal tax rate, plus paying Self-Employment tax (SE Tax).

Any time you write yourself a check or transfer money to your personal accounts, you have "paid" yourself and that money is deducted by the corporation at 21% and taxed at your personal rate plus the SE tax. That is what you want to avoid. If you pay a bill from the company and the expense is not deductible, it will be treated as a non-deductible expense and taxed at 21%.

If your company has a profit and has excess capital that it will not need, you should consider opening a secondary investment corporation for children's college education, investments, future projects, etc. The plan is to form the second company, set up a bank account for the minimal transactions and then to decide how you want to accumulate the funds for the future. Bank accounts pay minimal interest so you should look into opening brokerage or investment accounts (Business Investment Accounts-BIAs) so that you have some growth.

The concept is that the investments will grow until you need to use the funds and then instead of moving the money back to your personal accounts to spend, you pay the expense directly from these accounts.

Paying for college:

A good example is paying for college education. If you pay the college, directly from the company, you will not try to deduct the expense. You will spend the money that the corporation has already paid taxes on.

If you transfer the money to yourself and pay the college, you will have to pay taxes on the money just for transferring it.

Why double tax your money if you don't need to?

Another example is using the funds for retirement.

In summary, if you pay bills from the company, directly, you are not taking a draw. If you pay yourself, you are. Again, why pay double taxes to transfer money from one account to another?

Short term funds accrual:

These corporations can also be used for short term projects, too. One of my clients is accumulating cash for real estate investments and when he has enough, he will create an LLC to buy a property and his corporation will loan the money to the LLC and he can then pay back the loan and increase the reserves for the next project or investment.

If you are interested in using any of these strategies, let me know and I will set up an entity for you and discuss how to use it, based on your personal situation.

You do not have to fund these corporations all at one time, and you can put in whatever is affordable.

You can move money monthly, quarterly or annually but when you make the transfer, you should pay the IRS their 21% immediately.

All tax payments to the IRS must be made using the EFTPS automated system and if you pay the tax when you make a transfer, you will eliminate penalties for underestimation of the taxes.

Lastly, most states have now implemented penalties for non-prepayment of taxes. If your primary company has a profit, you must send a payment with the extension or the extension may become invalid and you will be subject to late filing penalties.

I know that this is a lot to understand but if you want to beat the Federal and State governments at the tax game, you have to have a plan and a strategy. This is a winning plan that works and should continue to work until the laws are changed.

As always, if you have any questions or concerns, please let me know ASAP. Procrastination creates an expensive loss of money and we are all in business to make money, not throw it away.

Have a happy, healthy and profitable 2025!