GIANT BOOK

of Business Owner FAQs

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Wouldn't it be great if there was an operating manual for running a business? Hey, we've got you! In this handy resource, we've compiled the most common questions we hear from owners of small and midsized businesses.

Do I have an employee or an independent contractor?

The US Department of Labor (DOL) recently updated its guidelines for distinguishing an employee from an independent contractor. Beginning March 11, 2024, the DOL began to take a totality-of-the-circumstances approach. This approach considers many different factors, including:

- The permanence of the working relationship
- Your investment in the worker (e.g., trainings, equipment provided)
- How integral the work is to your business
- The worker's skills and initiative
- The worker's opportunity for profit and loss
- The nature and degree of control you have over the work

Because the DOL's goal is to provide protections like minimum wage and overtime pay to workers, the new rules tend to make it easier for them to argue for employee classification. Noncompliance could be costly for your business, so be sure you understand the rules.

What entity should I choose for my business?

Entity selection is arguably the most important business decision you'll have to make. It affects ownership rules, tax exposure, filing requirements, employment options, and so much more. As a small business owner, you'll likely be organized as one of the following tax entities:

- **Sole proprietorship**
  A sole proprietorship is a business owned by a single owner. The business is disregarded for tax purposes, which means that business income is reported on the owner's personal income tax return.

- **Partnership**
  A partnership is a tax structure for two or more owners who share in the business's profits and losses as if they were their own. Business income is reported on a separate partnership tax form, typically a Form 1065 with a Schedule K-1 to report how income and loss flows through to partners.

- **C corporation**
  C corporations are entities that stand separate from their owners. Business income and losses are taxed at the entity level, on a corporate return, typically Form 1120.

- **S corporation**
  S corporations are actually C corporations or LLCs that elect to be treated as a small business corporation for tax purposes. Instead of business income and losses being taxed at the entity level, they flow through to the shareholders and are taxed on their individual income tax returns. Business income and losses are typically reported on Form 1120-S, with a K-1 to shareholders.

There is a lot of nuance that goes into entity selection, from both a legal standpoint and a tax standpoint. For more information, download our Business Entity Comparison.

I’m self-employed. What taxes do I owe?

Self-employed individuals are subject to many different types of taxes. Whether you’re a sole proprietor or you own a large business with multiple employees, you should be factoring the following tax types into your financial projections:

- Federal income tax
- State income, excise, franchise, or gross receipts tax
- Payroll tax
- Self-employment tax (FICA and Medicare)
- Sales/use tax (state, local, city)
- Property tax
- Net investment income tax
- Other local taxes

I file my small business income tax and payroll tax returns. What compliance tasks am I forgetting?

Small business compliance goes beyond just taxes. Additional compliance concerns are:

- **Employment compliance**

  If you have employees, you’ll need to comply with federal and state labor laws. The Department of Labor has expectations regarding:

  - Workplace safety (see: OSHA)
  - Employee pay and working hours (see: FLSA)
  - Workers’ compensation
  - Benefit plan administration (see: ERISA and COBRA)
  - Whistleblower protections
  - Racial and sexual discrimination (see: EEOC)
  - Family and medical leave (see: FMLA)

- **Corporate compliance**

  Your state’s department of revenue will provide information about corporate compliance, but these expectations might include:

  - Keeping meeting minutes
  - Filing annual reports
  - Maintaining proper board oversight
  - Maintaining a code of conduct and harassment/discrimination policies
  - Documenting your company’s operational policies (e.g., vendor payment schedules, information security procedures)
  - Conducting risk assessments

- **Legal compliance**

  A few legal guidelines you may need to follow are:

  - Keeping active business licenses

- Protecting intellectual property with patents, trademarks, and copyrights
- Writing employment contracts
- Drafting business formation documents like partnership agreements, LLC operating agreements, or articles of incorporation
- Purchasing appropriate business insurance

How can I avoid estate taxes?

Estate tax planning is essential for business owners to consider, and they should do so sooner rather than later. There are countless techniques for reducing or eliminating estate taxes. Just a few are:

- **Establish trusts.**
  Trusts can be excellent tax planning tools established to benefit yourself, your heirs, or charity.

- **Make gifts during your lifetime.**
  Lifetime giving is one of the easiest ways to reduce or eliminate your estate tax liability. If you plan ahead, you can reduce the amount of money left in your estate at your death by gifting smaller amounts that are eligible for the annual gift tax exclusion.

- **Relocate to a tax-favorable state.**
  Some states have more favorable estate or inheritance laws.

- **Watch estate tax laws closely.**
  Estate taxes are always a contested part of the Tax Code, and as a result, estate tax rates and exemption amounts change frequently.

- **Give to charity.**
  Charitable giving is almost always tax deductible.

- **Purchase life insurance policies.**
  By purchasing a life insurance policy, you may be able to remove a portion of your wealth from your estate.

As always, talk to your accountant and legal advisor before implementing any new tax strategy. Each person's estate plan will look a bit different, and your advisor can find an approach that's perfect for you and your family's needs.

What are some year-end tax planning strategies for small businesses?

Small businesses have a lot on their plate at year end, and taxes are often the last thing on their minds. But taking a few small steps to consider your taxes before year end can make filing season that much smoother.

- Reconcile all cash and credit card accounts.
- Review your outstanding accounts receivable balance and shore up your bad debts account.
- Review inventory levels and determine if making a purchase before year end would be beneficial.
- Talk with your advisor about the depreciation options — accelerated depreciation options may look different than in years past.

- Make sure meals and entertainment are properly classified. Consider creating multiple M&E accounts for different types of expenses so your CPA can give you the best deduction possible.
- Consider making year-end charitable contributions.
- Finalize and initiate year-end bonuses.
- Make a list of expenditures that may qualify for a tax credit, like:
  - Installing energy-efficient property
  - Establishing a new pension plan
  - Making matching contributions to a new retirement plan
  - Incurring research and development expenses
- Review your retirement plan and determine if matching contributions have been made according to the Plan Document. If matching contributions are optional, determine whether you want to make those contributions and in what amounts.

I want to give my children money while I'm still alive. How can I do that tax free?

With the annual gift tax exclusion, you can give a certain amount to each of your children every year without worrying about gift taxes. In 2025, this dollar threshold is $19,000. If you give more than this amount, you still won't owe gift taxes, but you would reduce your lifetime gift/estate tax exemption.

You may also be able to transfer money to your children (or use money to benefit your children) in some of the following ways:

- Fund a 529 plan.
- Pay your children's educational or medical institutions directly.
- Establish a trust.
- Hire your child to work for you.

Do I need an audit*?

Most privately held companies are not required to get a formal financial statement audit* from an independent accounting firm, but it may be wise to do so.

- **Financial statement audits can benefit you internally.**

  Because audits are an examination of your financial statements, auditors will dig into your accounting system, your internal controls, and your reporting policies. An audit may help you improve your internal reports, which can help you make better business decisions.

- **Third parties may request financial statement audits.**

  Your bank, for example, might want to see an audit report before approving financing.

If you don't think a full-blown audit is right for you, you can also consider getting a review or a compilation. They aren't as comprehensive as an audit, but they can help you identify areas for improvement and ultimately help you and your business partners make better strategic decisions.

What is a cost segregation study?

Cost segregation studies analyze and reclassify property costs into different (and more advantageous) depreciation recovery periods. This can help you accelerate depreciation deductions, freeing up tax dollars that you can apply in other areas of your business.

Most often, the goal of a cost segregation study will be to move a portion of costs from a 39- or 15-year asset into a 5- or 7-year depreciation bucket. Here's a quick example:

A manufacturing company purchased a factory that included specialized electrical and plumbing systems. After performing a cost segregation study, the company determined that these electrical and plumbing systems could be removed from the cost of the building and reclassified as 7-year assets, allowing them to accelerate those depreciation deductions.

Should I hire my children?

Hiring your child to work in your business can provide them with invaluable work experience, but it can also save you taxes. Just be sure that you:

- Give them an actual job.
- Pay a reasonable wage.
- Follow all employment laws.
- Keep good records.

Your child will only have to pay income taxes on wages that exceed the standard deduction ($15,000 in 2025), and wages over that threshold will be taxed at your child's (typically much lower) marginal tax rate. Additionally, if you and your spouse are the only shareholders of the business, the wages you pay your child may also be exempt from Social Security and Medicare taxes. Talk to your tax advisor for more information.

When are shared expenses deductible?

In general, personal expenses are not deductible, even for self-employed people. But if you have expenses that are shared between business use and personal use, you may be able to deduct a portion of those costs.

The IRS has distinct rules for how to deduct shared costs from the following:

- **Vehicles**

  If you use your personal vehicle in your business, you may be able to deduct the cost attributable to the car's business use. You can figure your deductible expense by either:
  - Calculating ongoing car expenses (like registration fees, licenses, tires, or repairs)
  - Using the standard mileage rate.

- **Home office**

  You may be able to take a deduction if you have a home office that you use exclusively for business, but you must prove that you use that office regularly.

- **Hobby costs**

  The IRS no longer permits deductions for hobby expenses. Be sure you know whether your side gig counts as a legitimate business or whether it's considered a hobby.

For most other shared expenses, the IRS allows you to claim a deduction for the portion of costs that are attributable to the business. For example, if you secure a loan and use 75% of those loan proceeds in your business, 75% of interest on that loan is likely deductible as a business expense.

Are client meals deductible?

Meals and entertainment expenses have always been a bit confusing. *Are client meals deductible? If I bring food into the office, does that change the answer? What about holiday parties for employees where clients will also be present?*

Although there are plenty of exceptions, the general rule of thumb is that business meals are 50% deductible and entertainment costs are nondeductible. For an in-depth look at how M&E expenses have changed over the last couple years (and how they will change in the near future), check out our meals and entertainment guide.

Why should I make an S-election for my LLC?

LLCs are great entity options for small businesses because of the liability protections they offer. But how are LLCs taxed?

By default, LLCs are taxed as disregarded entities (if a single-member LLC) or partnerships (if a multi-member LLC). If your business is taxed as a disregarded entity or a partnership, your share of business earnings is considered self-employment income and will be subject to the 15.3% self-employment tax. If your business makes an S-election, you may be able to opt into a more favorable tax treatment.

In most cases, S corporation earnings and profits that pass through to you as an owner are not subject to self-employment tax. The only self-employment tax you'd owe on S corporation earnings would be the wages you receive as an employee of the business. The IRS requires all shareholder-employees to take a reasonable salary, but doing so will also help you significantly reduce your self-employment tax liability.

Not all LLCs are able to make an S-election. The IRS has a list of requirements for what types of entities can make the election, who can be a shareholder, and how many shareholders you can have. Be sure you understand the eligibility requirements.

How do I make an S-election?

To make a valid S-election, you must file Form 2553 — Election by a Small Business Corporation with the IRS within 2 months and 15 days of the beginning of your business's tax year. For calendar-year taxpayers, your S-election must be made by March 15 of the year you wish the election to take effect.

This window of 2 months and 15 days, or about 75 days, can be tricky for new businesses. The clock starts ticking on the earliest of:

- The date you first had shareholders
- The date you made your first asset purchase
- The date you began doing business

Elections made before or after this time window will be invalid, so be sure to consult your tax advisor to discuss any elections.

How should I pay myself?

Should you pay yourself with a salary or with owner draws?

It all depends on your business structure. If you're an S corporation, the IRS requires you to take a reasonable salary so that you pay in your fair share of payroll taxes. But owner draws are acceptable for sole proprietorships and in certain partnerships. If you're actively involved in your business, the table below can help you determine if you're paying yourself in the right manner.

If your business is a …	You'll most likely pay yourself with …
Sole proprietor/single-member LLC	N/A — All business income is yours already
Multi-member LLC (taxed as a partnership)	Partner draws
Multi-member LLC (taxed as an S corporation)	Salary + shareholder distributions
Partnership	Partner draws
S corporation	Salary + shareholder distributions
Closely held C corporation	Salary + dividends

What is "reasonable compensation" and why does it matter?

The IRS often catches small businesses paying their employees either too much or too little. For example, in a closely held C corporation, the IRS will be on the lookout for entities that are *overpaying* shareholder-employees. Businesses may be tempted to inflate their salary deduction to reduce business taxable income. In contrast, in an S corporation, the IRS will be on the lookout for entities that are *underpaying* shareholder-employees. To reduce self-employment taxes, business owners may be tempted to take a smaller salary and simply take a larger shareholder distribution to make up the difference. In both scenarios, the IRS will try to determine if those owner-employees are getting paid "reasonable compensation."

There is no distinct definition of reasonable compensation, but a few things the IRS will look at during a reasonable compensation audit are:

- The shareholder-employee's salary compared to non-shareholders at the company
- The difficulty of work the employee is performing
- The scope of the employee's duties
- The amount of time they spend performing those duties
- What they could charge to perform those duties at another company
- Whether their level of pay appears commensurate with their level of experience

When should I start taking retirement distributions?

The year you turn 73, the IRS requires you to begin taking distributions from the following retirement plans:

- Employer-sponsored qualified retirement plans (e.g., 401(k), 403(b), and 457(b) plans)
- Traditional IRAs
- IRA-based plans like simplified employee pensions (SEPs), salary reduction SEPs, and savings incentive match plan for employees (SIMPLE) IRAs
- Roth IRAs from a deceased spouse (RMD rules do not apply to Roth IRAs while the plan owner is alive)

If you fail to take your required minimum distributions (RMDs), the IRS could assess a 25% penalty of the amount you should have withdrawn.

Before you reach age 73, talk to your tax advisor. There may be some tax strategies you can employ to either shrink your RMDs or change how those withdrawals are taxed. Some strategies to consider are:

- **Convert to a Roth IRA.**

  Although doing so would require you to pay taxes up front, all future withdrawals would be tax free if you meet certain rules.

- **Reinvest the money.**

  If you don't need the funds from your RMDs, you can reinvest those funds into a non-retirement account and begin earning additional income.

- **Take smaller withdrawals before you're required to.**

  You can begin taking smaller withdrawals when you're 59½ to decrease the value of your retirement account. By the time you reach age 73, your retirement account will be smaller, and therefore your RMDs will be smaller. This could potentially place you in a lower tax bracket than you would have been otherwise.

- **Donate your RMD to charity.**

  You can contribute funds from your retirement account directly to a charity. Qualified charitable distributions (QCDs) aren't taxed.

I'm looking to sell my business. What can I expect?

If you're thinking of selling your business in the next few years, get familiar with the process. There are many things you can do now to help make a future sale go much more smoothly.

Before you begin any sort of sale proceedings, your financials must be spotless. It could take a year or two for you to clean up your books, so start early. You may even benefit from commissioning a third-party review to ensure your financials are accurate and follow generally accepted accounting principles.

Ask yourself why you're selling your business and how you want to sell it. For example, if you want to take a step back from operations but still have control over the entity, your "sale" could look much different than if you wanted to fully withdraw from all involvement in the business.
Once you determine what type of sale (or merger, or acquisition, etc.) you want, talk to a tax advisor and a lawyer to get transaction planning underway. How you structure your sale can have a significant impact on your tax bill.

I'm looking to sell my business. How will my business be valued?

The three most common methods for valuing your business are:

1. **Asset approach — A business is valued based on the assets it owns.**

   You might be more likely to use the asset-based approach if your business has high-value assets that you can quickly sell, as is the case with many real estate and investment companies.

2. **Income approach — A business is valued based on its earning potential.**

   Since recurring cash flows are so important to the income approach, this tends to work best for operating entities.

3. **Market approach — A business is valued by looking at sales of comparable businesses.**
   The market approach is best used for businesses that closely resemble others on the market in terms of business operations, risks, growth potential, etc.

If I'm not selling my business, why would I need a business valuation?

There are many reasons why getting a business valuation is beneficial — or even required — for businesses not looking to sell.

- **Strategic planning**
  Understanding how your business and its assets are valued could help you make better decisions about expansion, new investment, or diversification.

- **Succession planning**
  Accurate valuations are necessary whether you're planning for a family member to purchase your shares, looking to sell to a management team, or transitioning your share to an employee stock ownership plan (ESOP).

- **Mergers and acquisitions**
  If your business is looking to merge with or acquire another company, you'll need a valuation during negotiations.

- **Internal transitions**
  In family-owned businesses, it's not uncommon for businesses to be passed down from generation to generation. Whether those shares are purchased, earned through employment agreements, inherited, or gifted, the business itself will need to be valued.

- **Litigation**
  Business valuations may be necessary during a legal dispute or in bankruptcy proceedings.

A professional valuation is almost always worth the costs for the benefits it provides.

What should I do before closing my business?

If you decide to liquidate your business, there are a few major steps you should take to close your business properly.

1. **Collect all outstanding receivables.**
   You may even want to consider using a collections agency.

2. **Settle all outstanding debts.**
   This includes items like loans to banks and bills from suppliers.

3. **Cancel unnecessary contracts and leases.**
   You may need to keep contracts with certain customers until you deliver the services agreed upon, but cancel as many as you reasonably can. If your contract has an early termination penalty, weigh the costs of paying those penalties versus the costs you will incur while you fulfill that contract.

4. **Dispose of business assets.**
   Selling off your assets can help you pay outstanding debts, including remaining tax liabilities.

5. **Address all outstanding tax obligations.**

   The IRS has a six-step list you should follow to address all your remaining federal tax obligations. A few of these steps are to file a final tax return, make your final payroll and withholding tax deposits, and close your account. For the full list, check out the IRS's Closing a Business page.

Should I finance my business with debt or equity?

If you need to raise money to open your business, to fund a business expansion, or for any other reason, you can do so by taking out a loan (issuing debt) or selling ownership rights in the business (issuing equity). For most businesses, using a combination of debt and equity financing is best.

Here are a few things you should think about when determining whether to issue debt or equity.

- **Debt financing is faster and simpler.**

  Taking out a loan is much simpler than building an investment package, valuing the business, and negotiating ownership dilution with current partners.

- **There's no cash flow demand following equity financing.**

  In most cases, the capital that you acquire through equity financing does not need to be repaid to investors until the business dissolves. With debt, you'll likely begin repaying principal and interest the very next month.

- **Debt financing is a bit cheaper.**

  Interest on debt payments is tax deductible, whereas dividend payments (or return of capital) to equity investors are not.

- **Equity financing requires you to give up some control of your business.**

  Taking out a loan from your bank won't dilute your ownership in the business.

Determining the optimal split between debt and equity will require an in-depth discussion with your tax advisor.

Should I claim bonus depreciation or Section 179? Or neither?

Expensive purchases like equipment and building improvements are not always deductible right away. Instead of deducting a capital asset in the year of purchase, you're typically required to spread those deductions out over the life of the asset. There are two options for accelerating your depreciation deductions:

- Bonus depreciation changes frequently with new legislation. For assets placed into service in 2025, bonus depreciation allows for a deduction of 40% of the purchase price.
- Section 179 allows for a deduction of up to 100%.

In addition to the healthier first-year deduction, Section 179 is a bit more flexible than bonus depreciation. You must apply bonus depreciation to all assets in a chosen asset class, while Section 179 can be applied on an asset-by-asset basis.

However, it may not be the best choice for you. For example, if you're in a loss position, you cannot take a Section 179 expense deduction, but you would be eligible for bonus depreciation. Section 179 also is not available if you place in service more than $3,130,000 of assets in 2025.

Keep in mind that the best option may be choosing to delay depreciation deductions. Talk to your advisor about your depreciation options.

Can I loan money to family members?

Yes, you can loan money to family members. A few things you should do to prove that your loan is legitimate are:

- Document everything.
- Collect payments.
- Charge interest.
- Take legal steps toward collection if the loan isn't repaid.

If you fail to follow these steps, the IRS might reclassify that loan as a gift, and you could be subject to gift taxes. The IRS also might classify the loan as equity, which can cause major issues for S corporations.

What is an ESOP?

An employee stock ownership plan (ESOP) is a retirement plan that sets aside shares of ownership in the business for employees to claim when they retire. ESOPs can be used in lieu of or in conjunction with more traditional retirement plans that hold cash and investments for the employee's benefit.

Typically, ESOPs are used in closely held corporations when shares of company stock are not easy to sell. By creating a marketplace for those shares, the ESOP makes it easier for owners to transfer shares to their successors when they're ready to leave the business.

How does an ESOP work?

To establish an ESOP, a company will create an ESOP trust fund and do one (or more) of the following three things:

1. Contribute new shares of company stock to the ESOP trust.
2. Purchase existing shares from current owners and contribute those shares to the ESOP trust.
3. Direct the ESOP to borrow money to buy new or existing shares, and then contribute cash to the plan to enable the ESOP to repay their loan.

As the business grows, so will the value of the shares held within the ESOP. When it's time for employees to retire, they can either (1) claim those shares of stock, or (2) sell those shares back to the company and take the market value of those shares in cash.

What are the tax benefits of an ESOP?

ESOPs have a number of noteworthy tax benefits, including:

- The contributions the business makes to the ESOP are tax deductible.
- If the ESOP borrows money to fund its own trust, contributions the company makes to repay that loan are tax deductible.
- In an S corporation, profits that are allocated to the shares held within the ESOP will not be taxable.

- In a C corporation, existing shareholders who sell at least 30% of their company stock to an ESOP can defer federal taxes on that transaction if they reinvest their proceeds into other securities.

But saving taxes isn't the only way that ESOPs can benefit companies. There are plenty of non-tax reasons to establish an ESOP as well, like incentivizing employee engagement and performance, as well as building a clearly defined exit strategy.

What should be in your business continuity plan?

A business continuity plan (BCP) helps a business prevent and recover from a crisis. It protects against threats that are physical (like natural disasters) or intangible (like cyberattacks and service outages). When creating a BCP, keep the following priorities in mind:

- Protecting employees
- Safeguarding records, documents, and inventory
- Communicating with clients and customers
- Staying flexible
- Maintaining cash reserves

Do I need to have an ESG policy?

As a business owner, you've likely heard buzz around the term "ESG." Employees, investors, and other stakeholders are increasingly concerned about environmental, social, and governance (ESG) risks. Even if you aren't required to formalize an ESG policy, it may be wise for you to create one because:

- **ESG policies matter to current and potential employees.**

  Current and potential employees, especially those in younger generations, care about a business's stance on environmental and social protections and will want to work for a company that addresses those concerns.

- **ESG policies matter to lenders and investors.**

  Some banks and individual investors want to see that businesses have addressed certain ESG risks before they will approve a capital infusion.

- **ESG policies often lead to greater revenues.**

  ESG policies can boost revenues by qualifying businesses for grants and awards, reducing costs of raw materials, and making current processes more efficient.

Ready to get started on your ESG policy?

First, assess your current ESG risks. Then establish your goals, measurable objectives, and policies and procedures that will make those commitments a reality. Most importantly, monitor your company's compliance with your ESG policy, and update it when new threats emerge.

More questions? CRI's got your back!

Whether you're choosing an entity type or getting ready for a sale, we're here to help. Reach out to your CRI advisor with any questions about running, growing, or transitioning your business.