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A BUSINESS OWNER'S PLANNING GUIDE

BUILDING TOWARDS WEALTH

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Building Towards Wealth

Let me start this with a little heart to heart, one crazy person to another. All of us business owners are crazy, right? According to data from the Bureau of Labor Statistics, approximately 20 percent of small businesses fail within the first year. By the end of the fifth year, about half will have failed. And by the end of the decade, only 30 percent of businesses will remain. Yet we persevere and overcome.

I personally have been through a couple of business failures myself, but as the proverb says "Fall down seven times, stand up eight."

Why do we do it? To be the final word on decisions. We do it for the unlimited income potential, the ability to choose our coworkers, the ability to set our own schedules, creative control, and to build something that becomes a part of us.

We also get to learn every nook and cranny of our business. Customer service, shipping, marketing, sales… we do it all. You learn to be a jack of all trades if you want to be successful.

No matter where you are in your journey, whether you are a 50-employee corporation or a solopreneur, this guide is for you. Whether we are talking about the golden rule of business ownership, risk management, investing or reducing taxes, there is something in this guide for you. Helping other business owners is a calling for me and I hope the steps outlined in this guide will help you achieve your goals. I want to provide you with simple steps and tips to help you realize the success every courageous entrepreneur deserves.

Business Structure

In determining this, you will likely want to sit down with your success team. Sometimes called your inner circle, your success team should be made of people you can trust that are big thinkers and not yes people. Napoleon Hill says in *Think and Grow Rich* "Surround yourself with like-minded, success focused people who want to reach their goals, and they will help you reach yours."

Some people you might want to consider for your success team are your financial planner, tax professional and/or lawyer as well as other business owners who have been on the same journey.

This is a very brief overview of the structures.

Sole Proprietorship is the default and simplest structure for a single owner. Business assets and liabilities are not separate from personal. Should you end up getting sued or going bankrupt, your personal assets can be at risk.

Partnership is a pass-through entity and is the default and simplest structure for two or more owners. General partners have unlimited personal liability, but in an LP or LLP, limited partners can limit their liability.

C-corporation is a separate legal entity and is the most formal structure offering the strongest protection to owners. As a separate taxpayer, business profits are subject to double taxation (corporate and shareholder level).

S-corporation is a corporation that elects to be treated as a pass-through entity, (no double taxation). Eligibility restrictions apply, including limits regarding stock classes (one) and the identity and number of shareholders (100 or fewer, with family aggregation).

If you elect S corporation taxation, you are considered an employee of the business. As an employee, you must pay yourself a salary. Your salary is earned income subject to FICA tax. The remaining earnings are distributed to you and not subject to self-employment or FICA payroll tax.

This sounds great, but what is the catch? First, you must pay yourself a "reasonable salary". Salary is subject to FICA payroll tax, which is a 15.3% tax. If you remember, this is the same rate as the self-employment tax.

Limited Liability Company (LLC) is a separate legal entity that shares corporate characteristics (e.g., limited liability), but is unincorporated. An LLC can elect to be taxed as a corporation (S or C), partnership, or disregarded entity (This means they don't distinguish between the business and the owner)

The Golden Rule: Pay Yourself First

As a business owner, I am sure you have heard of the concept of paying yourself. Unfortunately, based on my experience of working with dozens of business owners, it is a concept that many just do not practice. There are a couple of reasons for this but, the chief among those are business owners feel compelled to put everything back into their business, and they do not track how much money they take out of the business.

We have all heard the saying that you should not have all your eggs in one basket. This is true for business. There are numerous factors -- many of which are outside your control -- that can have a serious impact on your business. These factors can even put you out of business. If you have re-invested everything you had back into your business, and it does not work out, you may be left with nothing.

When looking at paying yourself first, it will often depend on what stage your business is at. The reality is that you are going to need some money to live off of. This money may be coming out of savings, however at some stage, you are going to need to be able to take some money out of the business.

You want to know that your basic living costs are going to be met. You need to do a personal budget, and make sure that you are going to have enough money to cover your basic living expenses. There is nothing wrong with having two or three budgets.

Budget 1.0 might be when you are starting your business and can afford to take very little out of the company. Budget 2.0 would be when your business is sustainable, and you are able to afford to take a little more out of the business. 3.0 is when you are enjoying the lifestyle that every courageous entrepreneur deserves. But take this warning -- I have seen many businesses suffer and fail because the owners have “killed the golden goose” by taking too much money out of the business.

It costs you to live. You want to determine that figure and track the amount of money you take out of your business to survive personally. As you build your business, it will go through various stages -- startup, expansion, maturity and sometimes, maybe even a decline. Depending on the stage of your business, you can determine how much you can and should pay yourself.

By having both a personal and business budget, you will be able to make better informed decisions, diversify your risk, and have a backup plan.

Planning for Unpredictable Income
A common challenge is planning for up and down income. You will want to project your income out for the year. Use your prior year's income as a guide, if applicable. Determine the highest and lowest expectations of what you think you will make each month. If the low end of this range covers your expenses and savings, use this number for business budgeting and cash flow planning.

If the low end of the range does not cover all expenses, or you make more money in certain seasons, use an average income number for the year. For most people, using an average number for the year will work best. When there are months you earn more than expected, stash away the additional income to supplement the lower-income months.

If additional savings pile up at the end of the year, use it to invest back in the business, save more, or put it towards goals you have not funded yet.

Business and Personal Expenses
If pay yourself is the golden rule then keeping your personal and business expenses separate is the silver rule. It will save you a ton of problems and can actually make it easier to properly take deductions to reduce your taxes.
You should have a bank account and a credit card specifically for your business expenses, even if you are a sole proprietorship.

Your business account is where you will want to place money for taxes and business operations.

Cash Reserves
While concepts such as profit margins, assets and financial risk are important to any business owner, developing an understanding of the term cash reserves is equally as important. Without cash reserves, a business owner may be ill-

equipped to handle unexpected or emergency expenses. How much money to have set aside for cash reserves is a crucial question both new and veteran business owners must answer to help ensure the success of the company.

If you never run out of cash, you're never out of business. With that in mind, a key part of planning your cash flow is setting up a cash reserve.

Personal Cash: Depending on your family situation, needs and incomes, an adequate emergency fund for your personal expenses is 3-12 months. You will likely keep more cash on hand than a salaried employee. This reserve will allow you to not take money from your business, if you do not have to, during a slow period and your personal reserve will keep you from taking too much money from the business to cover a personal emergency.

Business Cash: Cash flow is rarely as regular as we would like it in business. Whether its seasonality, slow payment from a client or any of a hundred other reasons having cash on hand will allow your business to weather any storm and reduce the need to take on debt.

Understanding business cash flow is like understanding how much oxygen you have in order to breathe and thus survive.

3 months of expenses is good for many companies, but seasonal companies or less established organizations are usually better served by 6 months in cash.

Plan with the End in Mind

It may sound counterintuitive, but you should be planning how you will exit your business from day 1. Do you want to:

1. Run it for income while you can
2. Build it to be sold to an acquirer
3. Build a generational business to pass on
4. Sell to a partner/investor/ESOP/Liquidation
5. IPO

Each one of these end goals will influence best practices for your business.

Managing Risks

There is a whole world of new risks you will want to consider as a business owner. Some risks, like someone breaking in to your store and stealing inventory, may seem obvious and others like the risk of you distributing a defective product may be less apparent.

Then there are the geographic risks that vary from area of the country to area of the country, climate risk, political risks and socio-economic factors that can all play a part in the ultimate success and failure of your business.

You will need to identify the risks that are universal, as well as those that are unique to your type of business, industry you are involved in, and area of the country you operate in.

You will need to manage them all and insurance can be a very cost-effective way to manage many of these risks.

Business Insurance consider insuring against common risks such as business interruption, injuries at the business, professional liability, and data breach. Types of coverage to consider include.

> **General liability insurance:** Every business — including those that are home-based — needs general liability insurance, because it covers most of the common types of accidents that can occur when you are interacting with a customer or client.
>
> **Commercial property insurance:** If your business operations include property and other physical assets, you need commercial property insurance. It protects your business against loss and damage to your facilities, equipment, tools, and computers caused by events such as fire, weather, civil disobedience, and vandalism.
>
> **Home-based business insurance:** If you operate a business out of your home, you should add a rider to your homeowner’s policy that offers additional protection on business equipment and liability coverage for third-party injuries.
>
> **Workers' compensation insurance:** If you have employees, you need workers' compensation insurance. In fact, it is required by law. It covers the business and its employees in the event they are injured on the job.

Professional liability insurance: Also known as malpractice insurance or errors and omission insurance, professional liability coverage protects service businesses against financial loss when a service provider commits an error or is negligent, and as a result, causes a negative result for a customer.
Product liability insurance: Product liability coverage is necessary for businesses that manufacture, wholesale, distribute, or sell products. It protects against financial loss caused by defective products that cause injury or harm.

Data breach insurance: A new type of coverage is offered to businesses that store sensitive information about their customers and employees. A data breach policy helps cover the costs involved if a breach occurs that puts that data at risk of being stolen and misused.

Life Insurance
Personally, you may need to increase coverage to provide liquidity for your estate and/or enable your heirs to maintain the business.
If you have a Buy-Sell Agreement, life insurance can be used to fund purchase obligations.

If you have key employees, key person life insurance can help to ensure business continuity in the event of their death.

Term life insurance is the way to go for most people. It provides coverage for a set number of years.

There are scenarios where whole life or cash value insurance makes sense, but it is not nearly the number of scenarios that some companies would have you believe.

Disability Insurance
Long term disability covers you if you cannot perform the job you specialize in. You will want an own occupation disability policy that covers at least 60-65% of your estimated income.

If you have a Buy-Sell Agreement, a buy-sell disability insurance policy can be used to fund purchase obligations.

If your business would suffer to the point of failure without your presence, you may want to consider Business Overhead disability insurance. BOE covers your business expenses, like employee salary, benefits and rent if you are sick or hurt or unable to work.

Planning for Taxes

Types of Business Taxes

First and foremost, let’s explain the types of small business taxes that you, as a business owner, may be responsible for. Generally, business taxes can be broken down into three levels—federal taxes, state taxes, and local taxes. Your federal taxes, as you may already know, are those that you’ll need to pay to the IRS—making up the largest part of your tax burden.

As for state and local taxes, these will vary from state to state and municipality to municipality, and therefore, your responsibility will depend wholly on where your business is located and what the tax laws are in that location. Because these taxes will be unique to your business based on location, we’d recommend consulting your state and local tax agencies for more information on these business tax obligations.

This being said, when it comes to federal taxes (and sometimes state and local taxes as well), there are typically six types of business taxes that you may be responsible for. These include:

- **Income tax:** Tax you pay on the income your business earns.
- **Self-employment tax:** Tax you pay, as a self-employed business owner, to cover social security and Medicare taxes.
- **Employment tax:** Also known as payroll tax, this is a tax you deduct from employee paychecks (if you have employees) for federal income taxes, social security taxes, Medicare taxes, and federal unemployment taxes.
- **Excise tax:** Excise tax is a tax you pay if your business is involved in certain goods or services, such as air transportation, fuel, or heavy trucks and tractors.
- **Sales tax:** Although there is no federal sales tax, 45 states have a sales tax requirement. If you sell goods and services, you may be responsible for calculating, collecting, and reporting sales tax.
- **Property tax:** A tax you pay on any commercial property, land, or real estate that your business owns. Any business property tax will be regulated on the local level based on where your business is located.

Finding an Accountant for Your Business Taxes: With some time, effort, and patience, any small business owner can navigate the process of filing business taxes on their own. But as a small business owner, you are juggling a lot of things at once, and you might not want to sacrifice any of your time managing your business to also serve as your business's accountant.

Therefore, if you do not have the time to do your small business taxes right (or even if you just want some help), you should absolutely consider hiring an accountant to help you out.

Choosing the Right Small Business Accountant: In the best cases, a business accountant does more than just file your small business taxes. They will understand how your business operates and manages its money, so a great business accountant can give valuable advice and guidance for managing your business's financials. Therefore, when you have found a few good business accountants to consider, you'll want to take the time to figure out which one will be the best match for your business.

When you are interviewing a candidate, here are a few questions you can ask:

- What is your experience working in my industry?
- Have you worked with a similar business entity before?
- What are your services beyond small business taxes?
- How often will we communicate?
- What are your rates?

Although not a comprehensive list of questions, you can ask these first to get a sense of whether the accountant will be a good match for your business.
You can also look to friends or trusted advisors like your Attorney or Financial Advisor for referrals as they will likely have dealt with many people in similar situations.

Strategies to reduce taxes

Nobody loves taxes, but I believe business owners dislike them a little bit more because we must deal with so many different versions. Self-employment tax, sales tax, income tax, unemployment tax, you name it we have to plan for it.
Tax deductions are an excellent way to reduce your taxable income and possibly even reduce your tax rate.

You should pay your taxes for every penny that you owe the government, but not a cent more. Keep good records and make sure you are writing off only qualified deductions. That's where it is important to deal with a good tax professional because there are hundreds of possible deductions. Below are a few big ones to keep an eye out for.

Tax Deductions
Self-employment taxes. You get to deduct half of your self-employment tax. That's important because it's 15.3 % of what you make

Marketing. The cost of advertising and promoting your business is tax-deductible. This includes things like your website, printed materials and google ads.

Home office. If you have a dedicated workspace at home, you can deduct your home office expenses.

Business loan interest. If a loan is used for business purposes, it's generally deductible. This includes interest on credit cards used for business expenses.

Travel. Expenses used for business travel are deductible. Travel expenses must be overnight, and business must be conducted. This includes airfare, rideshare, lodging, and meals.

Insurance premiums. You can deduct health, dental, and qualified long-term care insurance premiums you pay for out of pocket.

Education. Expenses that improve or maintain skills related to your business are deductible.

Health Savings Account. This is a personal tax deduction, but I'm a big fan of these accounts, so I am adding it here. These accounts are TRIPLE tax-free. You receive a tax deduction on your contribution, the money can grow tax-free, and then used on qualified medical expenses without owing tax. As a hidden benefit, an HSA can turn into a retirement account at age 65, just like an IRA!

Any expense involved with operating your business is worth keeping a record of. Work with your tax planning professional at tax time to make sure you maximize every deduction.

Retirement savings. A big advantage to being self-employed is you get to select a retirement account that fits your business. You are rewarded for saving by getting a tax deduction. This deduction deserves a section of its own!

Qualified retirement plans

Many of the business owners I have come across started their business to fund their retirements. Even more are depending upon the sale of their business to fund their eventual retirement.

There's plenty that could go wrong in this scenario. A business will only sell if it can continue to operate as a going concern. Is there a succession plan in place that will ensure business continuity? And do not forget market conditions, which determine if a business can be sold at an attractive price. The last thing any entrepreneur wants is to be forced into divesting at a fire-sale price. If you don't have a retirement plan, you could easily find yourself forced to sell under less-than-optimal circumstances.

Even if you never want to retire but only want to make work optional these accounts can help with reducing your tax bill and growing your wealth.
What type of retirement plan is best for you and your business?

Solo 401(k) If you're self-employed or a business owner with no employee other than your spouse, you're eligible to establish a self-employed 401(k). Also known as the solo 401(k), this is the retirement plan of choice for business owners who want to maximize their contributions to their retirement plans.

As an employee, you can contribute up to 100% of compensation, up to the annual contribution limit of $19,500 in 2020 and 2021. If you're 50 or over, that goes up to $26,000. Plus, you can make the employer contribution of up to 25% of compensation for a total maximum contribution of $54,000. Note that the total employer/employee contributions cannot exceed $57,000 for 2020 and $58,000 for 2021. If you are over the age of 50, you can add in the catch-up contributions of $6,500 increasing your total up to $62,500 for 2021.

The only disadvantages of this plan are that it may be slightly less convenient, as a plan administrator is required. Once plan assets reach $250,000, you'll also have to file a Form 5500 with the IRS.

SEP IRA The Simplified Employee Pension (SEP) IRA is an excellent choice for the sole proprietor who wants to save for retirement with a minimum of administrative headache. Unlike the Solo 401(k), a SEP IRA can cover employees, thus allowing greater scope for business growth. The plan is easy to setup and maintain, and there are no setup fees or annual charges. These plans are completely employer funded, and employees make no contributions. For 2020 and 2021, the employer can contribute up to 25% of compensation to a maximum of $57,000 for 2020 and $58,000 for 2021. Note though, that a SEP can become expensive if you want to save aggressively. While you as an employer are not required to contribute every year, you must contribute the same percentage for employees that you contribute for yourself.

SIMPLE IRA- The Savings Incentive Match Plan (SIMPLE) IRA allows businesses with fewer than 100 employees to establish an IRA for each employee. Employees can make salary deferral contributions of up to 100% of compensation, or no more than $13,500 in 2020 and 2021. Employees over the age of 50 may also make a $3,000 catch-up contribution for a total of $16,500.

The employer also contributes to the account, either matching employee contributions dollar-for-dollar up to 3% of compensation or contributing 2% of each employee's compensation. Advantages to this option include easy setup and few administrative burdens. The contribution limits are also more generous than those allowed for the traditional or Roth IRA. However, contributions to this account are considered "elective deferrals" that count toward an individual's overall annual limit on elective deferrals.

Defined Benefit Plan-High earning self-employed persons may benefit from a defined benefit plan. A defined benefit plan is also known as a pension plan. These plans offer large tax-deductible contributions.

A cash balance benefit plan is a type of defined benefit plan that is pretty popular and comparatively simple compared to other defined benefit plans.
These plans are more complex to administer than your other programs but the tax-deductible contributions can be sizeable, especially when stacked with the 401(k)

Business ownership can be the best of times (when business is good) and the worst of times (when it’s slow and you feel all alone). One of the best things you can do is to surround yourself with a great success team of professionals around you. Whether it’s an accountant, financial advisor, attorney or all three, surrounding yourself with trusted, competent advisors will help provide you the resources to make really good decisions early on. The sooner you can make really good decisions the better you and your business will be.

I hope this guide provided you some good information to help you sort through some of these decisions that you have in front of you. I am a firm believer that as a business owner we must focus on what will make us money. Focus on the what no one else can do for us or what moves the needle and outsource the rest to employees and professionals in the area.